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PART A

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PART A

BUDGET 1988 SCORECARD AND OVERVIEW

DD's 25 years N Azig 17/8/95

PO -CH /NL/0120
PART A

14-1-87
21.1.88

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CO[illegible] ON:-
PART B

29

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Broadly content. We can discuss 3(c) at tomorrow's mtg — & I am wavering on strength of [illegible] 3(d)): I think there is [illegible] for consultation: better now. N.

Content with proposals in para 3?

FROM: MISS C EVANS
DATE: 14 JANUARY 1987

1. MR CULPIN
2. CHANCELLOR OF THE EXCHEQUER

The immediate question is 3(a).

RC 14/1

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Anson
Mr Scholar
Miss Sinclair
PS/IR

BUDGET: CONSULTATION WITH OTHER MINISTERS

... I attach a list of Budget measures about which we suggest you will need to consult colleagues. In some cases consultation has already started.

2. You will want to consider how and when to tell Lord Young about the proposals on Fringe Benefits Tax/Car Scales/CT rate cut. One opportunity would be the bilateral meeting you are having with him on 20 January. We are briefing you to discuss the Budget representations in a very general way. If you wish, we could give you a note on FBT/Car Scales/CT rate which you could either give Lord Young at that meeting, or use as a speaking note. It was also agreed at Chevening that Lord Young should be told at a later stage about the VAT base proposals. We assume that this could be in February.

3. I should be grateful to know whether you are content:

(a) to speak to Lord Young next Wednesday as proposed in paragraph 2 above;

(b) to speak to Mr Moore if you decide tomorrow to proceed with the enhanced OPB proposal;

(c) to speak to Mr Baker and Mr Rifkind about covenants after tomorrow's meeting;

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(d) to write to the Lord Chancellor, Lord Advocate and possibly Home Secretary about maintenance early next month;

(e) to speak to Mr Ridley by the end of January about the private rented sector and MIR for home improvement loans.

Carys Evans

MISS C EVANS

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FP2

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CONSULTATION ON BUDGET MEASURES

Proposal	**Consultations Required**
Excise Duties	Meeting on alcohol abuse with Mr Hurd, Mr Moore, Mr Wakeham arranged for 9 February.
VAT base	Chancellor to talk to Lord Young: meeting in February to be arranged.
Treasury Supplement abolition/ NHS allocation/NIF surplus NICs at lower end	Chancellor has spoken to Mr Moore. Further meeting with DHSS at official level on 15 January. ST submission next week on these outstanding NICs issues and lower end measures. Meeting with Mr Moore likely to be needed by end January.
APA/Maintenance/Covenants	1) Mr Moore already consulted on proposal to replace APA by OPB - decision awaited on joint DHSS/ Revenue/Treasury report. 2) Mr Moore not yet told about proposals on maintenance which strengthen case for OPB enhancement. 3) Further meeting with Mr Moore likely to be needed if you decide on 15 January to press for OPB enhancement (see Miss Sinclair's minute of 13 January). 4) Lord Chancellor/Lord Advocate /possibly Home Secretary to be informed about proposals on maintenance (implications for Courts) perhaps in early February. (Revenue submission in preparation). 5) Mr Baker and Mr Rifkind to be informed orally by end January about proposals on covenants - see Mr Burr's minute of 12 January.

Proposal	Consultations Required
CGT reform	Bank of England consulted.
Fringe Benefits Tax, Car Scales, CT rate cut	Lord Young to be consulted on effect on employers, including FBT compliance costs and effect on motor industry.
Section 482/Lloyd's/BES	Lord Young to be informed by letter shortly before Budget.
Forestry	DoE, MAFF, Welsh and Scottish Ministers all aware of tax proposals; consultations with Forestry Commission on grant scheme now authorised by the Prime Minister. Further Ministerial meeting unlikely to be needed.
North Sea Fiscal Regime	Mr Parkinson to write shortly on his proposals for responding to NSFR report - meeting with Energy Minister likely to be needed in January (possibly taken by Economic Secretary)
Private Rented Sector/Home Improvement Loans	Chancellor to meet Mr Ridley; meeting by end of January to be arranged.
VED/petrol duty	Mr Channon has written with his proposals: you will need to write to inform him of your decisions next month.

4481/6/PN

BUDGET SECRET: TASK FORCE LIST

COPY NO 1 OF 29
FROM: MISS C E C SINCLAIR
DATE: 15 January 1987

CHANCELLOR

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

Mr Battishill
Mr Isaac
Mr Painter
Mr Lewis — IR
Mr Prescott
Mr McGivern

Mr Unwin
Mr Knox — C&E

NB If tax relief for private medical insurance, how does this fit w FBT?

What would be car scales – < years – if no FBT?

FBT - OVERVIEW 18 JANUARY

Mr Lewis' note of 14 January covers four papers on this topic. We suggest that discussion at the overview meeting might concentrate

(a) on the rate of FBT in the light of the current Budget package;

(b) on the increase in car scales which would be made when FBT comes into effect;

(c) on the payment dates for FBT;

(d) on the size of the cut in Corporation Tax which should accompany the introduction of FBT ;

Set out below is an annotated agenda for such a discussion. If time permits, you will also want to consider <u>coverage</u> - Mr Prescott's note of 14 January gives an annotated agenda for this.

(a) Rate of FBT

2. The issue here is that a rate of FBT which would be neutral for higher rate employees in a CT paying company <u>cannot</u> also be neutral for basic rate employees: the latter would pay more tax than they do now. (If the tax is neutral for a CT paying company, it favours benefits for a non-CT paying company.) !?

(i) Do you want to achieve neutrality for higher rate employees - this points to a rate of 55 per cent given a higher rate of 40 per cent?

(ii) Do you want to achieve neutrality for basic rate employees paying NICs - this points to a rate of 44 per cent with a basic rate of 25 per cent cut; and 42 per cent with a basic rate of 24 per cent?

(iii) Do you want a figure between (i) and (ii) - so that benefits to higher rate employees would be taxed more lightly than now, but those to basic rate employees more heavily?

(b) Car scales

Assuming FBT is introduced in 1990-91, do you want to increase the car scales in that year:

Too high?

(i) Using a 100 per cent standing charges formula - this would involve an increase of nearly <u>300 per cent</u> in the car scales in 1990-91 (paragraph 9 of Miss Rhodes' minute of 14 January).

(ii) As (i), but with the change phased over 2-3 years, either equally, or with a large step in 1990-91 and smaller steps thereafter (paragraph 10 of Miss Rhodes' minute)?

— here - ?

(iii) Using only a 50 per cent standing charges formula - this would involve an increase of over 100 per cent in 1990-91, (item B in Table 1 attached to Miss Rhodes' minute).

(iv) As (iii), but with phasing (item C, Table 1)?

(v) Do you prefer a completely different approach, taking the actual cost to the employer of providing cars (option C in paragraph 3 of Miss Rhodes' note)?

(vi) Would you announce your plans for car scales in 1990-91 in full in this Budget; or simply warn that you will be putting them on a realistic basis in that year?

Must give fig.

?

(c) Payment dates for FBT

(i) Do you want FBT to be paid annually (with annual returns) - this would be welcome to employers on cash flow grounds, but would mean that in 1990-91 there would be no FBT receipts to offset loss of £700 million of income tax on benefits (see paragraphs 6 and 7 of Mr Lewis' note of 14 January).

(ii) Do you want FBT to be paid quarterly - this would bring in three quarters of the annual yield in 1990-91 (paragraph 8-10 of Mr Lewis' note)?

Preferable

(iii) If the answer to (ii) is yes, what should be the basis for in-year payments (paragraph 23 of Mr Lewis' note)?

(iv) Do you want FBT to be paid monthly (paragraphs 11 and 12 of Mr Lewis' note)?

PN

(d) Cut in CT rate

The net yield of FBT will depend on behavioural effects, the decision on car scales and coverage. It might lie in the region of £350-700 million (paragraph 19 of Mr Lewis' note). A 1 per cent reduction in the main CT rate for FY 1989 would cost about £400 million in 1990-91, and £600 million in a full year.

(i) Is it agreed that the aim of a CT cut in parallel with the introduction of FBT is largely to ease acceptance of the latter; and that it is not necessary to strive for arithmetic "compensation" for employers?

(ii) Would you want to announce a specific cut in this Budget, or merely herald an unspecified cut in the future?

(iii) If you propose to announce a specific cut, will 1 per cent be enough?

better (iv) Would a 2 per cent be more effective?

(v) Do you agree that the CT cut should be effective for the year in which employers first feel the impact of FBT? This points to 1990 for the CT change if you go for FBT payment on an annual basis; and 1989 if you go for quarterly payments.

(vi) If you choose annual payments and 2 per cent CT cut, would you want to phase in the latter to balance the reduced tax yield in 1990-91?

CAROLYN SINCLAIR

on the other. Any general increase in the OPB will benefit people who do not receive the APA, as well as those who do. Increasing the OPB (from £4.90 to £12.30) to compensate for the withdrawal of the APA could add about £200 million to public expenditure; though the net cost, taking into account the additional tax revenue resulting from abolition of the APA, would be nearer £20-£30 million. At the same time certain groups who currently benefit from the APA - husbands with incapacitated wives, cohabiting couples with only one child, single parents with children over 19 in full-time education - do not qualify for OPB and would thus get no compensation via this route if the APA were abolished.

3. You will want to consider these aspects of replacing the APA by enhanced OPB. But we recommend that you do not take a decision now. It is necessary to look at this issue in relation to your other Budget proposal to abolish tax relief on payments to the children of unmarried mothers. Enhanced OPB would be a way of compensating this group as well: a single measure on the benefit front would thus solve two tax problems. An increase in OPB to compensate for abolition of the APA should be enough to deal with the problem of unmarried mothers - it should not be necessary to have a further increase in OPB on that account. The question is whether this makes the conversion option sufficiently attractive to outweigh its disadvantages.

4. Before reaching a conclusion, you will want to see the Revenue's fallback options for the taxation of payments to children. A submission will be coming forward in due course. At that stage we in FP will coordinate advice which will reflect the views of the expenditure side of the Treasury as well as those of the Revenue.

Carolyn Sinclair

CAROLYN SINCLAIR

CONFIDENTIAL

ADDITIONAL PERSONAL ALLOWANCE - ABOLISHING THE TAX PENALTY ON MARRIAGE: SUMMARY

NOTE BY OFFICIALS

The problem

1. The Additional Personal Allowance (APA) is a tax allowance intended for single parents, designed to put them in the same position as a married couple receiving the married man's tax allowance (MMTA). However, under current rules it is possible for two single people to live together and each to continue to receive the APA (if they have more than one child). This gives them a tax advantage over married couples (who can only receive one MMTA); and may act as a fiscal disincentive to marriage.

2. Relatively few single parents are in this position: perhaps around 5-20,000 (roughly 5% of all APA recipients). But the loophole attracts much publicity and has no justification.

Options

3. Four options to close the loophole are identified. A table with key numbers is attached.

4. Option 1 - abolish the APA without compensation - would solve the problem, and simplify the tax system, but at the cost of a straight loss to all single parent taxpayers (around 480,000 currently receive the APA). 60,000 would be brought into tax, there would be additional revenue of £175m, and extra benefit expenditure of around £15m (Housing Benefit and Family Credit).

5. Option 2 would treat cohabiting couples either:

   (a) as if they were married (i.e. allowing only one APA between them); or

   (b) as if they were two single people (i.e. by allowing an APA to neither).

Either would close the specific loophole but 2(b) would mean that up to 150,000 cohabiting couples currently benefiting from only a single APA between them would lose, as well as those couples benefiting from two. No additional expenditure, and increased revenue of around £6m (option 2(a)) or £35-£50m (option 2(b)). The general drawback to this whole option would be that Inland Revenue would need to operate a new eligibility test: two possible methods are identified.

6. Option 3 - link APA entitlement to benefits received by single parents - would withdraw the APA from a single parent living with anyone, irrespective of whether the cohabitee was him/herself also a single parent. Cohabiting single parents would thus be worse off, in tax terms, than single parents living alone or married couples. Up to 150,000 single parents would lose. Any changes in entitlement to a qualifying benefits (e.g. if OPB itself changed as part of the wider consideration of Child Benefit) would knock back onto the APA. There would be new procedures and administrative costs for IR and DHSS.

7. Option 4 - abolish APA and give compensation through benefits - would represent a major shift from tax-free income to income from benefits for single parents. As with options 2(b) and 3, up to 150,000 cohabiting single parents would lose eligibility, not just couples where both were single parents. To compensate non-cohabiting single parents, several benefits would have to be increased, since there is no exact overlap between receipt of APA and receipt of any single benefit: this in turn would create windfall gainers. Public expenditure would increase by around £180-£210m (depending on precise method and whether further losers, on top of the cohabiting single parents, could be accepted) and tax revenue by £175m. More generally, much more generous, visible cash benefits for single parents might appear to represent a new incentive to single parenthood.

Conclusion

8. Options 1 and 4 would involve very far-reaching changes compared with the scale of the problem and carry substantial political disadvantages (480,000 losers, major extension of benefit dependency, respectively). Options 2(b), 3 and 4 would go beyond ending the tax penalty on marriage, and leave any cohabiting single parent worse off, and with no specific help through either the tax or social security systems. Option 2(a) would be more closely targetted on the ending of the present loophole: but options 2(a) and (b) would both involve a new condition of entitlement to the APA, not currently used in the income tax context.

9. Option 1 could be implemented by April 1989, options 2 and 3 by April 1990 and possibly a year earlier. To implement option 4 primary legislation might be needed: if so, the earliest implementation date would be April 1990 (unless Ministers wished to introduce a special Bill, probably in the current Session).

10. Ministers are invited to indicate which option they prefer. In the light of their decision officials will then work up the relevant option(s) in greater detail.

December 1987

OPTIONS FOR ENDING APA TAX PENALTY ON MARRIAGE

	OPTION 1	OPTION 2a	OPTION 2b	OPTION 3	OPTION 4
Public expenditure	£15m	-	-	-	£180m-£210m
Extra revenue	£175m	£6m	£35m-£50m	£35m-£50m	£175m
IR admin costs	staff savings: £1.75m	£0.6m year 1 £0.35m annually thereafter		£0.6m year 1 £0.14m annually thereafter	staff savings: £1.75m
DHSS admin costs	small	-	-	* £0.75m	* £2.6m year 1 * £1m annually thereafter
Losers	480,000	5-20,000	100-150,000	100-150,000	100-240,000 (depending on method of conversion)
Gainers	-	-	-	-	up to 150,000
New taxpayers	60,000	small		small	60,000

Notes

The figures for IR and DHSS admin costs are based on staff costs and are rough estimates only.

* These figures include an element of £0.5m for the costs of policing the OPB.

CONFIDENTIAL

THE ADDITIONAL PERSONAL ALLOWANCE - ABOLISHING THE TAX PENALTY ON MARRIAGE

NOTE BY OFFICIALS

Objective

1. This paper identifies ways of meeting Ministers' objective of ending a tax penalty on marriage which can arise from the current tax treatment of single parents. This arises because two single parents may live together and both continue to benefit from the Additional Personal Allowance (APA) (if they have at least two children between them). If they married they would be worse off, since they would then be entitled to only one Married Man's Tax Allowance (MMTA).

The Additional Personal Allowance (APA)

2. The APA is a tax allowance which brings the single person's allowance up to the same level as the MMTA. Its assumed 1988/89 value is £1,430. It can be claimed by single people who are responsible for the support of a child or children and by married men whose wives are totally incapacitated by ill health or disability and who have a child or children to support. The allowance is provided in recognition of the costs to taxpayers of bringing up children single handed. It is paid at a single rate, not related to the size of families.

Numbers receiving the APA

3. It is estimated that in 1988/89 there will be 480,000 recipients of the APA. The revenue forgone as a result of this allowance is estimated at £175m. The total number of 480,000 recipients is composed of:

10,000	-	married men whose wives are incapacitated by disability or illness
175,000	-	single (divorced, separated or unmarried) men and widowers
225,000	-	single (divorced, separated or unmarried) women
70,000	-	widows

The tax penalty

4. Although the APA is intended for lone parents there is no requirement that anybody claiming it should be living alone. This gives rise to a loophole, unuer which two single parents living together may each claim the APA. This gives the equivalent of two MMTAs and clearly puts them in an advantageous position vis a vis married couples with children, who may at most receive a single MMTA and wife's earned income allowance (equal to the single person's allowance). The penalty on marriage therefore arises where two single people, both of whom are eligible for and receive the APA, live together - since if such couples were to marry they would stand to lose the equivalent of the APA. A couple consisting of a single person and someone who was not themselves receiving the APA (e.g. a non-parent; or another single parent with insufficient income to benefit from the APA) would be in the same position as a married couple and face no penalty on marriage.

Size of the problem

5. There are no firm data on the exact number of couples where both members are single parents and both have incomes sufficient to benefit from the APA. It is possible to make an estimate on fairly speculative assumptions which suggests that there could be as few as 5,000 or as many as 20,000 such couples. This would be in the region of 5% of all APA recipients. However, although relatively small in numbers, the loophole is widely publicized in press articles on family taxation and therefore looms large in public perception as a tax penalty on marriage which ought to be removed. Most couples who actually claim the double allowance are probably at middle to upper income levels.

Provision for single parents within the social security system

6. Before examining the options for removing the tax penalty it is useful to consider the treatment of single parents within the social security system as there is considerable overlap between it and the taxation system.

7. There are around 1m lone parent families, as defined for social security purposes, containing approx 1.5m children. In addition there are probably around another 300,000 families where a single parent is cohabiting. Lone parents may receive one or more of a range of benefits:

a) in common with all families, child benefit (currently £7.25 per week) is payable for each child in the family. In addition single parents may be eligible for one parent benefit (OPB), which is payable for the first or only child in a lone parent family. The current rate is £4.70 per week rising to £4.90 in 1988/89 and there are around 640,000 recipients. OPB is an addition to child benefit, and is tax free, non-contributory, and not income related. It is not payable to single parents who cohabit;

b) lone parent families in the lower income groups may receive income related benefits (e.g. supplementary benefit). At least half of all lone parent families receive income related benefits;

c) apart from OPB there are certain benefits that, by definition, go only to single parents. These are the Widowed Mother's Allowance (WMA), Widow's Allowance (with increase for a child) and Industrial Death Benefit (with an increase for a child). OPB is not payable to widows who are receiving these child dependency additions (CDAs);

d) small numbers of lone parents receive a range of other benefits, such as Guardian's Allowance, Retirement Pension and Invalidity Benefit. OPB overlaps with the CDAs paid to single parent recipients of these benefits (i.e. they have an underlying entitlement to OPB, but as its value is lower than the CDA they simply receive a payment at the higher CDA rate).

8. Almost all single parents receiving the APA will therefore be receiving social security benefits of some kind. In most cases this will be child benefit and OPB. But there is no single benefit or group of benefits where beneficiaries match exactly the group of people receiving the APA. There are some APA recipients who do not receive any social security benefits: the main group being single parents with children aged over 19 but still in full-time education or training. Such parents still qualify for the APA but do not receive child benefit, OPB or child dependency additions of any sort for children over 19.

Options for removing the tax penalty on marriage

9. This paper identifies four options for ending the present anomaly, spanning the taxation and benefit systems. It sets out the costs and wider effects where possible. The options need to be evaluated as far as possible, against the following criteria:

a) cost of options in programme and administrative terms;

b) numbers of losers and "windfall" gainers;

c) broader political considerations, including those of the Government's general strategy.

Under options 1, 3 and 4 separate consideration would need to be given within the tax system to the position of single parents with children over 19 in full time education, non-residents and married men who qualify for the APA because their wives are totally incapacitated.

Option 1 - abolish the APA - no compensation

10. Straightforward abolition of the APA would remove the problem of the tax penalty on marriage. Abolition could take place in one step, or on a phased basis (e.g. by freezing the value of the APA in cash terms; or by keeping it for existing recipients only).

Advantages

- administratively simple;
- would reduce IR operational costs - it should enable 125 staff savings once the APA had completely disappeared from the system. (There would be few savings while the APA remained for existing claimants.)
- £175m additional revenue (estimate for 1988/89).

Disadvantages

- not a well targetted solution, as all APA recipients would lose their tax allowance, not just those who currently enjoy a double allowance;
- all those receiving the full benefit of the APA (around 420,000 in total, possibly including the 10,000 married men with incapacitated wives), would face increased tax burdens of around £7.40 per week each;
- approximately 60,000 people would be brought into the tax net. They would face increased burdens of around £3.50 a week each on average;
- some public expenditure cost as a result of people being floated on to benefits - estimated to be of the order of £15m.

Option 2 - apply a cohabitation test to the APA

11. Under this approach a rule would be introduced to close the specific loophole by which a cohabiting couple may receive two APAs if they each have a child. Where two single parents were living together the options would be:

(a) to provide a single APA to divide as they chose; or

(b) to deny the APA to them both.

The first option would remove the penalty on marriage and leave any cohabiting couple with children in broadly the same tax position as a married couple. The second would go further and mean that a cohabiting couple with children would get lower tax allowances than a married couple or two single parents living separately.

12. The cohabitation rule might follow the formulation already used in social security legislation and in the planned Community Charge and deny the APA (or restrict entitlement to one allowance) to an unmarried couple who are "living together as husband and wife". This concept is not defined in legislation but DHSS have published guidelines which they issue for their adjudication officers to help decide whether a couple are living together as husband and wife. There is also a body of case law on the question which would be relevant.

13. It might be possible to avoid a straight cohabitation test by introducing an alternative test based on residence (although it might then be difficult to avoid disadvantaging people such as two female single parents living together, who would also be limited to one APA under 2(a) or to none in 2(b)). Single parents living together in, say, hostel accommodation might be excepted from this provision, if necessary. If Ministers were attracted by this general approach, its feasibility would need to be investigated further.

<u>Advantages</u>

- this option would end the present tax penalty on marriage in a way that did not require more wholesale change in the tax and benefit systems;

- if option 2(a) were chosen it would minimise the increase in the burden of taxation to the specific group of main concern (i.e. those cohabiting couples receiving two APAs);

- under option 2(a) there would be a £6m increase in the revenue yield, as cohabiting couples could no longer benefit from two APAs. Under 2(b) the increase in tax yield would be higher (up to £50m) as all cohabiting couples, including those with only one APA between them, would lose it;

- it would not involve increased public expenditure.

<u>Disadvantages</u>

- the concept of "living together as husband and wife" is not at present used in income tax legislation and Inland Revenue staff and the local tax appeal Commissioners have no experience of applying such a rule;

- under 2(b) up to 150,000 couples would lose up to £7.40 a week. Only a small proportion of these (i.e. 5-20,000) would be the couples currently benefiting from two APAs. (Under 2(a) only the double-APA couples would lose);

- there would be several practical issues for Inland Revenue. Taxpayers are expected to report changes of circumstances, and while that presents no major difficulty in relation to the birth of a child or a change in marital status, they might be less able, or less willing, to report a change involving "living together". Penalties and policing mechanisms would be needed (although this problem arises with almost every option apart from abolition of the APA) and this would incur some administrative cost: investigations could involve bringing together information on partners whose tax affairs might be dealt with in separate tax offices, possibly several hundred miles apart and each away from the couple's home address, although new arrangements could be made for those investigations to be carried out;

- a test of "living together as husband and wife" is inherently more difficult to apply in the context of entitlement to an allowance which applies for a 12 month period, not to each week taken by itself.

Option 3 - make entitlement to the APA dependent on receipt of OPB, WMA and other appropriate benefits

14. Tying APA to these benefits would enable most lone parents to continue to receive APA; but as the benefits themselves are not payable to a person who is living with someone as husband and wife, unmarried couples would be prevented from claiming APA. This option was put forward in the Green Paper on Reform of Personal Taxation as an alternative to converting the APA into OPB and other benefits. (The relevant extract is attached at Annex A.) The rules of entitlement for the qualifying benefits, particularly OPB which is technically an addition to child benefit, are themselves under review. Any changes decided upon would affect this option.

Advantages

- this option would achieve the aim of removing the tax penalty without the large increase in tax for single parents resulting from the abolition of the APA;

- there would be some additional revenue yield (perhaps up to £50m);

- it would avoid the need for the IR to operate a "living together" rule;

- DHSS would be able to assist IR in checking those claiming to be in receipt of the relevant benefits;

- it would avoid the increase in public expenditure that would arise from the conversion of the APA into a benefit.

Disadvantages

- this option would affect a wider group than those single parents who exploit the current loophole and receive two APAs. Cohabiting couples who were claiming only one APA (e.g. because only one was a parent, or only one was working) would also lose it, as they would not be entitled to benefits for single parents. In all up to 150,000 couples would lose the APA under this option. Only a small proportion of them would have been receiving two APAs. This would mean that these couples would be treated as if they were a married couple by the DHSS (and would therefore lose benefit) but as single persons by the Inland Revenue (and so would receive neither MMTA nor APA). Apart from leaving such couples worse off, in tax terms, than if they were either living apart or married, there might be some disincentive to family formation as a result;

- there is not an exact match between beneficiaries of APA and recipients of a certain group of benefit. The majority of APA recipients receive only OPB, some receive one of the other benefits that define them as single parents i.e. Widowed Mother's Allowance, Widow's Allowance and Industrial Death Benefit with an addition for a child (which precludes them from receiving OPB) and a very small number may be receiving other benefits such as Retirement Pension or Invalidity Benefit (with child dependency additions that overlap with OPB). So the rules and procedures might prove complex to arrange and to explain;

- there would be some recurring administrative costs to the DHSS and IR arising from the change in the system. These would depend on the precise details of the scheme. This change could be made by April 1990 but it is not certain that it could be made earlier than this;

- it would be necessary to issue questionnaires to all single parents claiming APA on the changeover to the new rules to give those entitled to one of the passporting benefits an opportunity to establish their continuing entitlement to APA. The administrative costs to IR would amount to 40-50 man-years in the first year and there would be some continuing costs thereafter - perhaps around 10 man years;

- as with option 2, difficulties could arise in relating a 12 month tax allowance to benefits based on circumstances which could in principle change from week to week.

<u>Option 4 - convert the APA into improved single parent benefits</u>

15. This possibility was also discussed in the Green Paper on the Reform of Personal Taxation (see Annex A). The APA would be abolished but an equivalent amount would be added to the OPB and other benefits for single parents to compensate for the loss. As such benefits are not awarded to single parents who cohabit, the penalty on marriage would be removed. The use of social security benefits (particularly OPB and widows' allowances) raises the same problem as with option 3, in that changes to these benefits (particularly if entitlement to OPB was restricted as part of the wider consideration of child benefit) would in turn affect the compensation for lost APA.

16. There are several possible methods of conversion, discussed in Annex B. But the option has a number of general advantages and disadvantages which would apply to any of them.

<u>Advantages</u>

- rationalisation: single parents would receive child support solely from the social security system (rather than from both tax and social security, as now);

- simplification of the tax system: since child tax allowances were converted into child benefit, the APA has been the only allowance for children in the tax system. Conversion would thus simplify the tax system and yield around 125 staff savings for IR;

- £175m additional tax revenue.

Disadvantages

- as under options 2(b) and 3, 100-150,000 cohabiting single parents (the great majority of whom only receive one APA at present) would lose, as they would not be entitled to OPB etc. Under one (the least expensive) of the methods discussed in Annex B, there would be up to 90,000 further losers (mostly widows);

- there would be around 150,000 windfall gainers;

- conversion to benefit would increase the tax burden on working single parents. (A widowed mother paying tax at the standard rate would pay £7.40 extra a week in tax; under some methods equivalent compensation would be added back through benefits);

- 60,000 people would be brought into tax;

- public expenditure on social security would increase by an estimated £180-210m (depending on precise method);

- improved, visible cash benefits for single parents might appear to send the wrong family signals, and to encourage single parenthood, especially when most ordinary families are having their child benefit frozen (and perhaps changed more radically in future);

- increasing single parents' reliance on cash benefits as opposed to tax allowances would extend, not reduce, the culture of dependency;

- the tax simplification from abolition of the APA would be achieved at the cost of extra social security complication. There could be an increase in the OPB caseload of up to 350,000. This is the estimated number of one parent families receiving supplementary benefit who do not currently claim OPB; if it were increased to £12.30 it would be advisable for all single parents to claim it. If they did there would be additional administrative costs for DHSS estimated at £1.75m in the first year and £0.5m a year thereafter;

- a much higher rate of OPB would require a higher level of policing of the benefit than exists at present. This would involve additional administrative costs for DHSS; these would depend on the level of policing adopted but e.g. reviewing each case once every three years would cost around £0.5m.

Wider legislative and policy considerations

17. It might be possible to achieve conversion of the APA into higher rates of benefits by means of regulations. However, straight conversion into the OPB would, at 1988-89 prices, result in its level being raised to an estimated £12.30. This would mean that OPB (which is not in law a benefit in its own right but only an increase to child benefit) would be almost twice as high as child benefit itself. If Ministers contemplated going down this path it might be prudent to seek Counsel's opinion as to whether doing this by regulations could be seen as an unusual use of powers which might lay them open to challenge from the Joint Committee on Statutory Instruments and perhaps to judicial review. If OPB were to be raised to such a high level, one possibility might be to detach OPB from child benefit and make it a benefit in

its own right. On current plans, any such primary legislation would be unlikely to receive Royal Assent before July 1989. If primary legislation was necessary, a separate Bill in the current Session might be needed in order to meet an April 1989 start.

18. More generally, such a major increase in OPB would mean that the Government was, in effect, creating for the first time a separate and specific benefit, of significant value, for one parent families. Such a benefit was, of course, proposed in the 1974 Finer Report and has hitherto been rejected. Once established, there would almost certainly be sustained pressure for further improvement to the new, higher-profile, benefit.

ANNEX A

1986 GREEN PAPER ON THE REFORM OF PERSONAL TAXATION : ALLOWANCES FOR SINGLE PARENTS

Single parents

4.9 Under the present system, single parents with dependent children receive the additional personal allowance (APA), of £1,320 in 1986-87, in addition to the single person's allowance. This means that single parents get allowances equal in total to the married man's allowance.

Support for single parents

4.10 Some 450,000 single parents, including nearly 100,000 widows, will claim APA in 1986-87. An estimated 615,000 single parents claim one parent benefit (OPB) through the social security system. This is a flat-rate benefit of £4.60* per week paid for the first child of a one parent family in addition to child benefit. Widows with children receive widowed mother's allowance of £38.70* per week, plus a child dependency addition of £8.05* per week for each child, rather than OPB.

4.11 The case for rationalising provision for single parents by converting the APA into increased rates of benefit, in particular OPB, was discussed in the Green Paper *The Taxation of Husband and Wife*** published in 1980. This approach would have a number of advantages. **First,** it would mean that financial support (from the State) for single parent families would be provided entirely through the social security system.

4.12 **Second,** the change would simplify the tax system by removing the one remaining tax allowance relating to children.

4.13 **Third,** like the conversion of child tax allowances into child benefit, the change would give more help to those single parents not on supplementary benefit who do not pay tax.

4.14 **Fourth,** the change would reduce the tax penalty on marriage. At present couples who are not legally married but who live together as man and wife can each claim APA (on top of their basic single allowances) if they have two or more children. Thus between them the couple get the equivalent of two married allowances. This is a widely resented element of the so-called tax penalty on marriage. Converting the allowance into a social security benefit would deal with this problem since the relevant benefits are, by law, not available to people living together as man and wife, and the DHSS ensure that only those with single-handed responsibility for children receive the benefits.

*From July 1986.
**Cmnd 8093.

4.15 The vast majority of organisations and individuals who responded to the 1980 Green Paper favoured the option of converting the APA into increased social security provision and a move to a system of transferable allowances could provide an opportunity to make this change. As the 1980 Green Paper pointed out, however, this approach would have some disadvantages. The conversion would lower the tax threshold for lone parents: they would pay more tax and begin to pay it at a lower level of income. For them the overlap between payment of tax and receipt of benefits would be increased - precisely the opposite effect to that which the other proposals in this paper are designed to achieve. There would also be considerable practical problems in adjusting benefit provision for those lone parents, in particular widows, who receive support for their children through child dependency additions to their national insurance benefits rather than through OPB itself.

4.16 An alternative approach, which would avoid some of these difficulties, but which would remove the present tax penalty on marriage created by the APA would be to change the qualifying conditions for the allowance so that entitlement was linked to the receipt of OPB and other appropriate benefits (in particular child dependency additions to national insurance benefits). By this means it would be possible to ensure that only people who had single-handed responsibility for children received the allowance without the need for the Revenue to make a separate check on eligibility. It would be for consideration how the necessary liaison between the DHSS and the Inland Revenue could be organised in order to ensure that the treatment of individuals was aligned. Once both departments are fully computerised in the early 1990s, one possibility might be that the DHSS could notify the Inland Revenue automatically of those benefit recipients who would be entitled to the revised APA. If this proved practicable, it would avoid the need for single parents to make a separate claim to the Inland Revenue for the allowance.

ANNEX B

Option 4 : methods of converting APA to social security benefits

1. There are various methods by which conversion could be achieved. However any proposal for conversion is complicated by the mismatch between the groups of APA and OPB recipients and the existence of various groups of single parents who receive benefits other than OPB yet are eligible or may be eligible for the APA. There are perhaps 80-90,000 people in this category, most of them (70,000) widows. They would gain no benefit from an increased OPB and so would lose if the APA was abolished. Thus, in considering methods of conversion there is a distinction to be made between straightforward conversion methods where there will inevitably be a number of losers and methods which build in some sort of compensation for those who would otherwise lose. This Annex identifies three possible methods of conversion.

2. OPB is not payable with (i.e. it is precluded from payment by) a Child Dependency Addition (CDA), payable with the following benefits, some of which are, by definition, payable only to single parents, while others are not restricted to single parents:

Benefits payable only to single parents	Numbers of recipients also receiving 1 or more CDAs
Widowed mother's allowance	58,270
Widows benefit (to be abolished in April 1988)	4,800
Industrial death benefit (to be abolished in April 1988 but retained for existing recipients)	1,935
Child special allowance (abolished in April 1987 but retained for existing recipients)	704

Benefits not restricted to single parents	Estimated number of single parent recipients
Retirement pension with CDA	2,500-3,000
Guardian's allowance	900
Invalid care allowance with CDA	600-1,000

3. There is also a small number of benefits where the OPB overlaps with the CDA for the first or only child when these benefits are received by single parents (i.e. the CDA amount of £8.40 is payable but it is considered to be made up of £4.90 OPB and the remainder CDA; a payment of OPB will be recorded in such cases). The main benefits involved (although the numbers are very small) are:

	Estimated number of single parent recipients
Invalidity pension with CDA	approx 10,000
Severe disablement allowance with CDA	approx 600

4. Single parents who receive any of the above could also be eligible for the APA as long as their other income was sufficiently large. The following paragraphs consider several methods of converting the APA into additional OPB and the likely effects on the groups mentioned above. Tables 1-4 give comparisons between the three methods discussed below as follows:

Table 1 - costs
Table 2 - numbers of gainers and losers

Method I - increase OPB by the value of the APA (£4.90 + £7.40 = £12.30) but treat it as an overlapping benefit for the first child

5. This would entail maintaining the current rules for paying OPB to those lone parents receiving other benefits. It would thus theoretically be straightforward in administrative and legislative terms. No additional computer programming at the Child Benefit Centre would be necessary and the increase in the level of payment could be achieved by a simple uprating with no requirement for regulations or primary legislation. This would probably also be the least costly, in public expenditure terms, method of achieving conversion. Estimated annual cost would be £180m. There would, as with all the conversion methods be administrative costs for DHSS arising from the increased level of claims from single parent families receiving supplementary benefit/income support (see para 14 of main paper).

6. However, the disadvantage of this method is that all those recipients of other benefits (see para 2 above) who are currently receiving the APA would lose their tax allowance but only be able to benefit from a portion of the new higher rate OPB (i.e. £12.30 - £8.40, the level of the CDA). This would leave them £3.50 a week worse off in most cases. As noted in para 1 the largest group of single parents who receive precluding benefits are widows. The Inland Revenue estimate that approximately 70,000 widows would be eligible for the APA in 1988-89. So under this method of conversion up to 70,000 single parent families headed by widows and a small number of other single parent families (up to 20,000) headed by those in receipt of other benefits, e.g. retirement pension or invalidity benefit would lose £3.50 a week.

7. The alternative is to devise a conversion method that compensates as many as possible of those who would otherwise lose out on the abolition of the APA. There are several possibilities but they have drawbacks. Two are described below.

Method II - a two-tier OPB with a standard rate of £12.30, and a lower rate of £7.40 for recipients of overlapping and precluding benefits

8. This would be a straightforward device for giving the lost £7.40 a week of tax allowance back as a benefit. The new lower tier of OPB would not overlap or preclude any CDAs or other benefits received by lone parents as listed in para 2. Thus the taxpayer lone parents would break even, while the

non-taxpayers (around 30,000) would gain £7.40 a week (although this might be offset by reductions in other benefits if they were also receiving e.g. income support).

9. **Estimated public expenditure cost:** £190m (1988/89).

10. **Administrative implications:** this method would complicate OPB and would require some programming changes to allow the recording of the different rates of OPB and the award of the lower rate where appropriate. There would be a take on cost of around £0.33m for the extra cases if OPB were awarded to recipients of currently precluding and overlapping benefits and an extra annual administrative cost of £70,000. This would be additional to the extra workload of up to 350,000 new cases that could result if all the single parent families receiving supplementary benefit but not OPB decided to claim OPB because of the higher rate.

<u>Method III - pay the higher rate of OPB (£12.30) but do not treat is as overlapping or precluding</u>

11. This would mean that all these taxpayers receiving overlapping or precluding benefits would receive the full OPB of £12.30 and would therefore be £4.90 a week better off (£12.30 - £7.40). The non tax-payers receiving overlapping or precluding benefits (approx 30,000) would be £12.30 a week better off as they had not in any case, been receiving the APA. There would therefore be no losers, only gainers; it could be difficult to justify giving this particular group of lone parents better treatment than the majority.

12. **Estimated public expenditure cost:** £210m (1988/89).

13. **Administrative implications:** less complicated than method II but would still require some programming. The additional caseload and manpower requirements would be as at para 10.

14. As well as the non-taxpaying recipients of overlapping and precluding benefits the non-taxpaying recipients of OPB (estimated at around 120,000) would also enjoy "windfall" gains of £7.40 a week under methods II and III.

TABLE 1 : COST OF SOCIAL SECURITY METHODS FOR WITHDRAWAL OF APA

1988/89 £M

	METHOD		
	I	II	III
One Parent Benefit	437	417	437
Widows Benefit	-28	0	0
Other CDA Precluding	- 2	0	0
Other CDA Offsetting	- 2	3	3
Income Support	-243	-245	-246
Housing Benefit	5	2	- 1
Family Credit	15	15	15
Total benefits cost	181	192	209
Increase in income tax receipts	(122)	(122)	(122)
Total increase in income tax receipts	175	175	175
PSBR cost	6	17	34

Notes

1. Based on 1985 FES uprated to 1988/89 (estimates subject to sampling error)
2. Before allowing for increased income tax received from cohabiting lone parents
3. IR figure for estimated revenue forgone as a result of the APA 1988/89
4. These figures can only be a rough guide as the £175m is calculated on a different basis from the other figures in the table.

TABLE 2 : HYPOTHETICAL GAIN/LOSS UNDER METHODS OF CONVERTING APA INTO INCREASED BENEFITS

(Social security gain - excluding means-tested benefit changes - less income tax loss for full basic rate taxpayer)

Non-income support recipients. 1988/89 benefit levels.

	METHOD I Hypothetical gain/loss(-)	METHOD II Hypothetical gain/loss(-)	METHOD III Hypothetical gain/loss(-)	No. of cases (000s)
	£pw	£pw	£pw	£pw
Lone parent taxpayers receiving:				
One Parent Benefit	nil	nil	nil	280
CDA Widows' benefit with CDAs	-3.50	nil	4.90	40 *(70)
Other benefits with CDAs	-3.50	nil	4.90	small
Lone parent Non-Taxpayers receiving:				
One Parent Benefit	7.40	7.40	7.40	120
Widows' benefits with CDAs	3.90	7.40	12.30	20
Other benefits with CDAs	3.90	7.40	12.30	10
				470

* The figure of 40,000 taxpaying widowed mothers does not tally with the IR figure, in brackets, for widows receiving the APA. The figure of 40,000 is derived from the FES and is subject to sampling error. Further, the FES figure does not include any of the approx 30,000 widows who receive the WMA without any CDAs. Many of these will be in employment and presumably eligible for the APA.

HOW THE GAINS AND LOSSES ARE CALCULATED

TABLE 3A

METHOD I - Increase OPB by the value of the APA (£4.90 + £7.40 = £12.30) but treat it as an overlapping benefit for the first child

a) Single parent taxpayer on OPB only:

loses £7.40 a week in tax allowance
gains £7.40 a week in OPB
and so breaks even.

b) Single parent taxpayer receiving benefits with child dependency additions of £8.40 (e.g. Widowed Mother's Allowance):

loses £7.40 a week in tax allowance
the new rate of OPB (£12.30) becomes payable but as it overlaps with the CDA of £8.40 the individual can receive only £12.30 - £8.40 = £3.90

when this is offset against the tax loss of £7.40 the individual is shown to be £3.50 (£7.40 - £3.90) a week worse off

LOSS: £3.50 a week.

c) Single parent non-taxpayer on OPB only:

receives new high rate OPB of £12.30 and is therefore £7.40 a week (£12.30 - £4.90 (the old rate of OPB)) better off

GAIN: £7.40 a week.

d) Single parent non-taxpayer receiving benefits with child dependency additions of £8.40:

the new higher rate of OPB (£12.30) becomes payable but as it overlaps with the CDA of £8.40 the individual can receive only £12.30 - £8.40 = £3.90

GAIN
~~LOSS~~: £3.90 a week.

HOW THE GAINS AND LOSSES ARE CALCULATED

TABLE 3B

METHOD II : Introduce a two-tier rate of OPB with a standard rate of £12.30 and a lower rate of £7.40 a week for recipients of overlapping and precluding benefits

a) Single parent taxpayer on OPB only:

loses £7.40 a week in tax allowance but
gains £7.40 a week in extra OPB
and so breaks even.

b) Single parent taxpayer receiving benefits with child dependency addition of £8.40:

loses £7.40 a week in tax allowance but
receives the lower rate of OPB (£7.40) in addition to any CDAs that are payable and therefore breaks even.

c) Single parent non-taxpayer on OPB only:

receives the new standard rate of OPB (12.30) and is therefore £12.30 - £4.90 (old rate of OPB) = £7.40 a week better off

GAIN: £7.40 a week.

d) Single parent non-taxpayer receiving benefits with child dependency addition :

receives the lower rate of OPB (£7.40) in addition to any CDAs that are payable and is therefore £7.40 a week better off

GAIN: £7.40 a week.

HOW THE GAINS AND LOSSES ARE CALCULATED

TABLE 3C

METHOD III : Pay the higher rate of OPB (£12.30) but do not treat it as overlapping or precluding

a) Single parent taxpayer on OPB only:

loses £7.40 a week in tax allowance
gains £7.40 a week in OPB
and so breaks even.

b) Single parent taxpayer receiving benefits with child dependency addition of £8.40 (e.g. Widows Mother's Allowance):

loses £7.40 a week in tax allowance
OPB at full value of £12.30 is payable because it is not held to be precluded by or to overlap with CDAs and so is £12.30 - £7.40 = £4.90 a week better off

GAIN: £4.90 a week.

c) Single parent non-taxpayer on OPB only:

receives full value of OPB (£12.30) and so is £12.30 - £4.90 (old value of OPB) = £7.40 a week better off

GAIN: £7.40 a week.

d) Single parent non-taxpayer receiving benefits with child dependency addition(s) of £8.40

OPB at full value of £12.30 is payable because it is not held to be precluded by or to overlap with CDAs and so the individual is £12.30 a week better off

GAIN: £12.30 a week.

TABLE 4 : BENEFIT RECEIPT AND INCOME TAXPAYERS

Change in number in receipt of specified benefits/paying tax.

1988/89 000s

	METHOD		
	I	II	III
Income Support	-40	-45	-45
Family Credit	11	11	11
Housing Benefit	7	5	5
Taxpayers	57	57	57

Notes

1. Based on 1985 FES uprated to 1988/89.

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1 of 4

FROM: ROBERT CULPIN
DATE: 13 January 1988

Presentation OK, but I wd like the 24p option done as a full Table 1A, & not as a footnote. 2. Line 8 numbers – for clarity the words 1989-90 as well as 1990-91. 3. What wd be the yield & RPI effect of double revalorisation of the tobacco & alcohol duties? N.

CHANCELLOR

cc Mr Scholar

SCORECARD

This is the post Chevening scorecard and minor starters table which we propose to circulate tomorrow. Are you happy with this presentation?

2. The usual staffing effects table will be added tomorrow, and the PSBR effects table incorporated next week.

RC

ROBERT CULPIN

I don't understand the numbers in line 8.

I'm asking.

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SCORECARD OF 13 JANUARY 1988

TABLE 1: DIRECT EFFECTS OF BUDGET MEASURES

All figures are net of cost or yield of indexation or revalorisation.

Proposal Number	Proposal	Cost(-) or Yield(+) in £ million (rounded to £5 million) 1988-89	1989-90	1990-91
1	Excise Duties	Nil	Nil	Nil
2	VAT Base	+280	+420	+440
3	Reduce basic rate of IT to 25p	-2550	-3200	-3450
4	Increase higher rate IT threshold to £20,000	-220	-420	-500
5	Abolish higher rates of IT above 40p	-840	-1690	-1920
6	Changes to Class 1 NICs at lower end in October 1988	-380	-800	-850
7	Independent taxation from 1990-91	Nil	Nil	-560
8	Exempt first £6,600 gains from CGT, add remaining gains to income and tax at IT rates (25%/40%)	Nil	-50	? +Neg
9	Rebase CGT to 1982 (cost includes rebasing CT on companies' gains)	Nil	-200	-300
10	Restrict MIR to residence basis and leave ceiling unchanged at £30,000	+10	+30	+50
11	Abolish tax relief on home improvement loans	+80	+200	+300
12	Abolish tax relief on new covenants between individuals; change rules for maintenance payments	+35	+100	+160
13	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91	Nil	Nil	*
14	Reduce corporation tax rate to 33p	Nil	Nil	*
15	Reduce small companies' CT rate to 25p in 1988-89	-Neg	-55	-95
16	Raise IHT threshold to £107,000 and set single rate of 40%	-120	-255	-300
17	Minor starters	+30	+30	+25
	TOTAL TAX MEASURES	-3675	-5890	-7000
	24p option (see note 3)	-750	-565	-560
		-4425	-6455	-7560

*See notes

Notes on the Scorecard

All figures highly provisional and show cost (-) or yield (+) in £ m billion unless otherwise indicated.

Excise Duties

1. The base forecast assumes excise duties revalorised by 3.8 per cent (the inflation rate assumed for the twelve months to December 1987). This would imply the following price increases.

Product	Unit	Price Increase (pence)
Beer	Pint	0.8
Cider	Pint	0.4
Table wine	75cl	3.2
Spirits	75cl	20.7
Cigarettes	20KS	3.6
Cigars	5 whiffs	1.9
Pipe tobacco	25 grams	2.6
Petrol (leaded)	Gallon	3.8
Derv	Gallon	3.3
VED (cars)	-	£ 3.80

If excise duties were not revalorised, RPI inflation would be 0.27 percentage points lower than in the base forecast.

An excise duties paper was submitted on 16 December, and a paper on the duty differential between leaded and unleaded petrol on 30 December. A further paper on excise duties is in preparation. These suggest the following departures from revalorisation:

Cider: increased by same pence per pint as beer.
Unleaded petrol: price differential of 10p per gallon.
Gas oil: duty increased by 10 per cent
Pipe tobacco, fuel oil, matches and mechanical lighters, betting and gaming: no change in duty.

This package would have the same RPI effect as revalorisation and the following revenue cost:

1988-89	1989-90	1990-91
+5	-25	-40

VAT

2. The base forecast assumes no change in the standard rate and assumes revalorisation by 3.8 per cent of the VAT registration threshold to £22,100 (from £21,300).

The yield shown in Table 1 arises from the changes to the VAT base discussed at Chevening and assumes the changes take effect from 1 May 1988. This would add an estimated 0.19 percentage points to RPI inflation. See paper by Mr Jefferson-Smith dated [ ] January.

The yield from and RPI effect of extending the VAT base to non-domestic construction (from 1 August 1988) and spectacles (from 1 May 1988) would be:

	1988-89	1989-90	1990-91	RPI effect
Construction	+100	+250	+400	Nil
Spectacles	+15	+25	+25	+Neg

Income Tax Rates and Personal Allowances

3. The base forecast assumes statutory indexation by 3.8 per cent of the main personal allowances.

If the basic rate of tax were instead reduced to 24p, the higher rate threshold revalorised to £18,600 and the NICs changes abandoned, the extra cost of the total tax measures would be £750 million in 1988-89, £565 million in 1989-90 and £560 million in 1990-91. A note by Mr Eason on this option is in preparation.

A 2p cut in the basic rate would add 0.12 percentage points to RPI inflation; a 3p cut would add 0.18 percentage points.

National Insurance Contributions

6. Assumes Option F (Macpherson 19 October) selected at the meeting on 19 November:

Earnings Bands	NIC rates: Employees now	Employees Oct 1988	Employers now	Employers Oct 1988
Under £41	Nil	Nil	Nil	Nil
£41- £70	5	5	5	5
£70-£105	7	5	7	7
£105-£130	9	5	9	9
£130-£155	9	7	9	9
£155-£305	9	9	10.45	10.45

Costings assume LEL uprated in April 1989 but no uprating of reduced rate bands. Benefit savings would be

1988-89	1989-90	1990-91
+15	+50	less than +50

A further paper on NICs options at the lower end is in preparation.

Independent Taxation

7. Assumes implementation from 1990-91 and:

- Disaggregation of all husband and wife's income
- Introduce Married Couples' Allowance equal to difference between MMA and single allowance with MCA transferable to wife if husband cannot use
- MCA withdrawn gradually when husband's total income exceeds £40,000 (assumes clawback will operate in-year; full year yield of £100 million included in Scorecard)

- Disaggregate husband and wife's capital gains with separate exemption of £6,600 each
- Only one CGT residence exemption per couple
- Abolish APA and replace by benefit in 1989-90 (yield not included in Scorecard) or review APA entitlement rules to remove tax penalty on marriage
- Transitional protection for breadwinner wives
- Give age allowance only on basis of taxpayer's own age

Capital Gains Tax

8. & 9. These costings are highly provisional and subject to review.

Mortgage Interest Relief

10. All costings ignore behavioural effects. They also assume residence basis and any change in ceiling take effect from 6 April 1988. In practice the residence basis and possibly any change in ceiling would probably take effect at a slightly later date, eg 1 August 1988.

If the MIR ceiling was increased to £35,000 on the residence basis the cost would instead be:

1988-89	1989-90	1990-91
-180	-230	-270

Covenants and maintenance

12. Assumes abolition of relief on all new covenants between individuals on basis of option 1 in Mr Stewart's paper of 7 January (meeting on 15 January will decide between remaining options). Assumes relief on maintenance payments to divorced/separated spouses only, limited to £2425. No tax on payee. Consideration being given to ways of avoiding losers among deserted unmarried mothers. See paper for meeting on 15 January.

Fringe Benefits Tax

13. Assumes non-deductible FBT on employers with comprehensive coverage (with rate to be decided) introduced in 1990-91. Car scales would be increased substantially.

First year receipts depend on payment arrangements for FBT. Options on FBT will be discussed in paper by Mr Lewis dated [ ] January; options on car scales in paper by Miss Rhodes dated [ ] January.

Corporation Tax

14. It is assumed that the CT rate is cut by 2p to 33p in the year before employers start paying the FBT so that the effects of each are felt at the same time. The timing of the cut in the CT rate thus depends on the payment arrangements chosen for FBT. The cost of a 2p cut in the CT rate would be -neg in the first year, -£800 million in the second year (ie the year when receipts of FBT start) and -£1,100 million in a full year. Timing to be discussed in the paper by Mr Lewis.

Minor Starters

17. See Table 4. Not included in Table 1 are starters which protect existing revenue and are thus already assumed in the base forecast.

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SCORECARD OF 13 JANUARY 1988

TABLE 4: MINOR STARTERS

(Items in Starters list which Ministers have agreed are now serious contenders, including all those with revenue effects of £5 million or more)

FB Starter Number	Proposal	Cost(-) or Yield(+) in £ million 1988-89	1989-90	1990-91
30	Keith package (Customs & Excise)	Neg	Neg	Neg
34	Tax on supply to be liability of person completing VAT invoice	+5	+5	+5
60	Disclosure of importers' details	Neg	Neg	Neg
61	Search of persons	Nil	Nil	Nil
62	Penalty for customs fraud	Nil	Nil	Nil
63	Prosecution time limits	Neg	Neg	Neg
103	Abolition of minor personal allowances	+10	+10	+10
111	Review of S79 unapproved employee share schemes	Neg	Neg	Neg
117	Redundancy payments: top-slicing	+5	+5	+5
118	Premiums for leases: top-slicing	Neg	Neg	Neg
151	Personal pensions: delay in commencement	+10	+10	+Neg
203	Business Expansion Scheme changes/limit		not yet known	
214	Lloyds: RIC leavers	Neg	Neg	Neg
216	Lloyds: reform of assessment system	Neg	Neg	Neg
354	North Sea Fiscal Regime		not yet known	
452	Keith package (Inland Revenue)		not yet known	
453	Forestry	Nil	Neg	+5
-	BES: Privated rented sector		not yet known	
	TOTAL	+30	+30	+25

Note

Not included above are the following minor starters which protect existing revenue and are thus already assumed in the base forecast

213 In-year assessment of Schedule D income

400 S482: company residence and migration

psl/85A

UNCLASSIFIED

Mr ACS Allan
Monday afternoons fine.

CEvans
18.11

FROM: A C S ALLAN
DATE: 16 November 1987

MISS C EVANS 1st

cc Mr Scholar

OVERVIEW MEETINGS

We should soon get the timing of overview meetings firmly in everyone's diaries. As you will have seen from my note of 6 May on the Budget post-mortem, I should prefer to stick to Monday afternoons. But I wanted to check with you before I put this to the Chancellor and Sir P Middleton.

ACSA

A C S ALLAN

psl/8A

c/ PMG's office has asked if you could bear in mind that PMG now lunches with PM on Mondays from 12.15 - 2.30pm so 3.00 - 6.00pm would be convenient for him

FROM: A C S ALLAN
DATE: 19 November 1987

CHANCELLOR

BUDGET OVERVIEW MEETINGS

We ought now to slot in a fixed time for the Budget Overview meetings after Chevening.

2. Last year, we had them on Monday afternoons, from 3.00-6.00pm. This was to some extent accidental (our earlier plan had been to have them on Monday mornings, but the Prime Minister's A-team meetings intervened). But I think it worked pretty well. It gave us flexibility about when the meetings ended: if there was not much to discuss one week, we could easily end them early. The alternative, of running them from Monday morning through to a sandwich lunch, is less flexible. And it would make it almost impossible to get quick answers to any queries you had when you read the papers over the weekend. Holding Overview meetings on Tuesday morning would allow that, but would make the timetable for getting papers in for the next weekend box very difficult indeed.

3. Are you content to go for Monday afternoons again?

Yes -

A C S ALLAN

(PEM & FP are content).

RA3.69 RESTRICTED

BE 25/11

~~1/12~~

FROM: A C S ALLAN

DATE: 23 November 1987

4/12

SIR P MIDDLETON

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir T Burns
Sir G Littler
Mr Scholar
Mr Culpin
Mr Odling-Smee
Miss C Evans
PS/IR
PS/C&E

BUDGET OVERVIEW MEETINGS

The Chancellor is content for Budget Overview meetings to be held next year on Monday afternoons, from 3.00pm to 6.00pm (ending earlier if the business does not require a full three hours). I should be grateful if you and copy recipients could let me know urgently if this causes any insuperable problems.

ACSA

A C S ALLAN

Julie

psl/26A RESTRICTED pwp

FROM: A C S ALLAN
DATE: 4 December 1987

PS/CHIEF SECRETARY

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Miss Mueller
Mr Wilson
Mr Byatt
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr Sedgwick
Miss Evans
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Unwin - C&E
Mr Knox - C&E

BUDGET OVERVIEW MEETINGS

Budget Overview Meetings will be held next year on Monday afternoons, from 3.00pm to 6.00pm, starting on 18 January. I should be grateful if you and all copy recipients could reserve the slot in your diaries.

ACSA

A C S ALLAN

4480/16

CONFIDENTIAL

FROM: MISS C E C SINCLAIR
DATE: 23 December 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Culpin o/r
Miss Peirson
Mr McIntyre
Miss Hay o/r
Mr Cropper
Mr Tyrie
Mr Call

Mr Isaac
Mr C Stewart - IR
Mr Mace
PS/IR

Thanks – I'd be most grateful for initial views of CST ASAP. N

SINCLAIR TO CH. 23 DEC

REPLACING THE ADDITIONAL PERSONAL ALLOWANCE (APA) AND TAX RELIEF ON CERTAIN MAINTENANCE PAYMENTS BY INCREASEED BENEFITS

You agreed with the Secretary of State for Social Services that officials should consider how abuse of the Additional Personal Allowance (APA) could be eliminated as a way of abolishing one of the current tax penalties on marriage. The specific option you put to Mr Moore was the conversion of APA into benefit, but you agreed that other options should also be examined. The attached report by DHSS/Treasury/Inland Revenue officials shows that conversion to benefit (enhanced One Parent Benefit - OPB) would not be without difficulties and Mr Moore is likely to be advised to resist. Although they also raise difficulties, you will want to consider other possible solutions, particularly Option 2 (introduction of a cohabitation test for the APA) and Option 3 (linking qualification for the APA to receipt of OPB/other benefits).

2. There is not an exact fit between the beneficiaries from tax relief via the APA on the one hand, and recipients of OPB

TASK FORCE SECRET

Inland Revenue

The Board Room
Somerset House
London WC2R 1LB

Copy no 1 of 27

I am hugely grateful to Mr Lewis for a most helpful note & [illegible] 2-[illegible] [illegible]

FROM: A J G ISAAC
23 December 1987

CHANCELLOR OF THE EXCHEQUER

FBT - BEHAVIOURAL EFFECTS

1. This is an important note from Mr Lewis, carrying forward the behavioural analysis first touched on in my original note to you of 23 September (paragraphs 6 to 10 and Annex B).

2. The figures which you have seen so far (for example in Mr Culpin's note for Chevening) are explicitly on an ex ante basis, ignoring behavioural effects. They show a gross cost to employers of about £1.4 billion, offset by a reduction in income tax on employees of £0.7 billion.

3. There is wide scope for judgment about precisely how employers will react to the new charge. As Mr Lewis says, however, the figures in paragraph 2 above lie outside any plausible range of likely real-world outcomes. They imply that employers generally, faced with a new £1.4 billion tax bill, will react by increasing their employees' take-home pay by £0.7 billion.

---

cc		
cc	Financial Secretary	Mr Battishill
	Chief Secretary	Mr Isaac
	Paymaster General	Mr Painter
	Economic Secretary	Mr Beighton
	Sir P Middleton	Mr Lewis
	Mr Scholar	Mr Prescott
	Mr Culpin	Miss Rhodes
	Miss Sinclair	Mr Northend
	Mr Riley	Mr Hodgson
	Mr Michie	Mr Allen
	Mr Cropper	Mr I Stewart
	Mr Tyrie	Mr Geraghty
	Mr Jenkins (OPC)	PS/IR

ISAAC TO CX 23 DEC

FBT BEHAVIOURAL EFFECTS

4. In practice, employers will have two possible strategies, by which they can protect themselves:

a. "Cashing out" - substituting cash wages for benefits.

b. "Tax switching". Thus, for March 1990 (the last month of the present system) employers will be deducting and remitting to the Revenue something like £60 million of PAYE tax on benefits (one-twelfth of £0.7 billion). On this approach, for April 1990 (the first month of the new system) they will seek new pay arrangements enabling them to deduct and make a similar £60 million provision to help fund their new FBT liability - leaving their employees (for the purpose of this very broad generalisation) with the same net take-home pay as before.

The analysis suggests that course b. is likely to be the more cost effective in most cases and, on the face of it, it looks to be something which quite a few employers could - and would - effect between their March and April 1990 pay days.

5. Thus, the suggestion is that the <u>additional</u> cost to employers is likely to be between one-third and two-thirds <u>less</u> than the ex ante figure of £1.4 billion quoted so far - with the long-term cost likely to be towards the lower end of that range. By the same token, the long-term <u>net</u> yield of FBT is likely to be not more than two-thirds of the ex ante estimate of £0.7 billion.

ie £½bn

6. This is still, of course, quite a lot of money.

A J G ISAAC

Inland Revenue

Policy Division
Somerset House

FROM: P LEWIS

DATE: 23 DECEMBER 1987

CHANCELLOR OF THE EXCHEQUER

FBT - BEHAVIOURAL EFFECTS: YIELD: CT RATE

1. My note of 4 December looked at the implications for neutrality of a 45 or 50% non deductible FBT rate and what the yield would be on the assumption that there were no behavioural changes.

LEWIS 23/12

2. Taking account of your (provisional) decision to go for a 50% rate, this note (which FP have seen in draft) takes a first look at

   - likely behavioural changes (important not only for the impact on yield but in assessing the extent to which

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cc	Financial Secretary	Mr Battishill
	Chief Secretary	Mr Isaac
	Paymaster General	Mr Painter
	Economic Secretary	Mr Beighton
	Sir P Middleton	Mr Lewis
	Mr Scholar	Mr Prescott
	Mr Culpin	Miss Rhodes
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	Mr Riley	Mr Hodgson
	Mr Michie	Mr Allen
	Mr Cropper	Mr I Stewart
	Mr Tyrie	Mr Geraghty
	Mr Jenkins (OPC)	PS/IR

FBT would encourage employers to move away from benefits towards cash pay)

- the implications for the net yield of FBT

- the implications for the increased net burden on employers, and what that might imply for offsetting corporation tax rate changes.

3. We will be sending you before Chevening a note on the CT rate generally, and will take account of the FBT implications brought out in this submission.

Behavioural changes

4. In looking at likely behavioural changes the starting point is to try to establish what would be the optimum financial position for both employer and employee.

5. This is fairly complex because there are so many possible variables to take into account

- the employee's tax position (3 main variants)

- the employer's tax position (4 variants)

- the extent to which benefits are fully valued for tax purposes (2 main variants)

- the different kinds of possible behavioural responses (we have identified 6 variants)

6. Of the 6 possible behavioural responses we have identified the first 2 are easy to analyse. They are either no change in the provision of benefits or - its exact opposite - the total withdrawal of benefits without any cash compensation. In the first case there would be no change to the FBT yield figures previously given and the employer's additional burden would be the whole of the FBT. In the second case there would be no FBT yield, there would be a loss of the

income tax previously paid, and the employer would gain the net cost of the benefit previously provided. Responses at either extreme are, we think, likely to be insignificant.

7. The remaining 4 variants fall into 2 groups. They involve the employer

- shifting the whole cost of FBT back to the employee (which would leave the employee worse off), or

- shifting the cost of FBT back to the employee to the extent that the employee's net income has increased because he is no longer paying tax on his benefits (which would leave the employer worse off).

In both cases this position can be reached either by withdrawing the benefits and giving an increase in cash remuneration ("cashing out") or by continuing to give benefits at the same level, but reducing the level of cash remuneration below what it would otherwise have been.

8. Of these two responses we think that, on balance, the "employee neutral" is likely to be much more comon than the "employer neutral". Employers may well feel that they should be able to pass back the whole of FBT to the employee since it is extra taxation in respect of benefits the employee receives (though it represents in part <u>employers'</u> NIC). The employee, on the other hand, may regard his own tax savings from the change as irrelevant to his remuneration package, and certainly not be prepared to see a reduction in his net income on account of the employer's increased tax liability. The "employee neutral" position is intermediate between these two "negotiating positions"; and it recognises the reality both of the switch in the basis of taxation and that the weight of tax on benefits has been increased. The following paragraphs look at

- the arithmetic of employee neutrality

- whether "cashing out" or retaining benefits would be advantageous in various circumstances

- the effect on yield and employer's burdens if eventually full "employee neutrality" were achieved.

<u>Employee Neutrality - the Arithmetic</u>

9. The table below illustrates how the employee's and the employer's position, and the tax/NIC yield, might change following the introduction of FBT. It assumes the benefit is worth £1,000, the employer is liable at 35% and the employee at 25%. It shows:

(a) what the position would be under the main package with no FBT;

(b) the ex ante position following the introduction of FBT;

(c) how the picture changes if the employer withdraws the benefit, but pays the employee extra cash of £1,136 to leave him with the same net income as in (a) (cashing out);

(d) what happens if the benefit is kept, but net pay reduced, again to leave the employee with the same net income as in (a).

	Value to Employee	Cost to Employer	Tax/NIC Yield From Introducing FBT
(a) 25/35 no FBT			
Benefits	+ 1,000	+ 1,000	
Income tax	- 250	-	
Corporation tax relief	-	- 350	-
Net value	+ 750	+ 650	
(b) 25/35 with FBT			
Benefits	+ 1,000	+ 1,000	
Income tax	-	-	
FBT	-	+ 500	
CT relief	-	- 350	
Net value	+ 1,000	+ 1,150	+ 250
(c) 25/35 with FBT and cashing out			
Benefits	-	-	
Earnings	+ 1,136	+ 1,136	
Income tax	- 284	-	
NIC	- 102	+ 119	
CT relief	-	- 439	
Net value	+ 750	+ 816	+ 166
(d) 25/35 with FBT & reduced earnings			
Benefits	+ 1,000	+ 1,000	
Earnings	- 379	- 379	
Income tax	+ 95	-	
NIC	+ 34	- 40	
FBT	-	+ 500	
CT relief	-	- 203	
Net value	+ 750	+ 878	+ 228

10. Under "cashing out" ((c) in the table) the yield from introducing FBT falls from £250 to £166, paid £136 by the employee and £30 by the employer. But the <u>whole</u> of the extra cost falls on the employer because he has to increase his employee's pay to cover his extra liability and maintain his net income.

11. If the benefit is continued but cash salary reduced to maintain the employee's net income, the increased yield from FBT is £228. This is made up of £607 extra tax paid by the employer, and £379 tax saved by the employee. Again, the employer's extra costs are the same as the extra yield because he saves £379 in gross salary to offset against his additional tax of £607.

12. In this particular case (basic rate taxpayer, employer paying CT at 35%, fully taxed benefit) "cashing out" is cheaper than retaining the benefit with a reduced cash salary. The effect is to reduce the ex ante yield of FBT from £250 to £166.

<u>Whether "cashing out" or retaining benefits with reduced cash remuneration is cheaper</u>

13. The outcome of calculations on the lines above will depend on the tax position of employee and employer. The following table summarises which option under "employee neutrality" saves the employer most (C = cashing out; B/C = retains benefit but reduces cash pay).

	Ordinary Benefits		Cars	
Employer's Tax Rate	Basic Rate	Higher Rate	Basic Rate	Higher Rate
Nil	B/C	B/C	B/C	B/C
25%	B/C	B/C	B/C	B/C
35%	C	B/C	B/C	B/C
37.5%	C	B/C	B/C	B/C

The fact that benefits still have the edge over cash in most cases in this table is unsurprising because of

a. the undervaluation of cars for tax purposes

b. the fact that the FBT rate is less than neutral for higher rate taxpayers.

14. The extent of the saving on the gross FBT cost varies from the marginal to more than 100% - this applies in the case of higher rate employees of employers whose tax rate is nil or 25%. In these cases the employer can provide the same net benefit at less than the cost under the present system because when salary is reduced to take account of the employee's tax savings there is either no loss or a smaller loss of CT relief to offset against the employer's savings from the reduction in gross salary and employer's NIC liability.

15. We would expect about 5% of benefits (by taxable valuable) to be in this position. For about 25% to 30% of benefits "cashing out" would be the best "employee neutrality" option; for the rest retaining the benefit but with reduced cash pay would be cheaper for the employer.

a significant reduction in benefits, if it happens.

Effect on yield

16. We have fairly good information about the marginal tax rates of employees who receive benefits. But our information about the marginal tax rates of their employers is much less reliable. The best estimate we can make is as follows:-

Non-taxpayers - 15% of benefits
25% taxpayers - 5%
35% taxpayers - 75%
37.5% taxpayer - 5%

17. On this footing, and using a 50% non-deductible FBT rate, the yield would change as follows if, in all cases, pay arrangements were rearranged to an "employee neutral" position, either by cashing out or by retaining benefits and with reduced cash pay, whichever was cheaper:-

Ex ante	£m	Ex post (employee neutrality)
FBT + 1450		FBT + 1060
IT - 750		IT - 780
Net + 700		CT + 190
		Net + 470 say + £450m

18. We are reasonably confident that the bulk of benefits are provided by employers paying tax at 35%. If the proportion were as high as 90%, the yield would be £530m. If it were as low as 65% the yield would be £420m.

Employers' net additional costs

19. At your meeting on 10 December we discussed the additional burden on employers (which might be compensated for by a CT reduction) in terms of the gross FBT yield ie £1,450m on the figures in paragraph 17. But, as explained in paragraphs 9 to 11, in the ex post situation the employer's additional burden is limited to the net yield. This follows, of course, from the assumption on which these figures are constructed that the employee is left with the same net income after the introduction of FBT as he was before.

How much should the CT offset be?

20. This analysis suggests that the additional net burden on employers might be about £450m. To the extent that some employers managed to pass on the full cost of FBT to employees, this figure would fall. But there are also a number of reasons why this might be too low a figure on which to base a CT offset. It assumes that everyone has moved to the optimum position adopting "employee neutrality" as the yard- stick. But in practice

- some employers may not identify the optimum position (the calculations are complex) or have good commercial reasons for not attempting to move (fully) to it.

- in some cases it will be impracticable to withdraw benefits even if the arithmetic pointed to "cashing out" eg in the case of a benefit which is also required for business purposes.

- in some cases, particularly perhaps small family companies, it may be decided simply to continue the benefits and for the company to pay the full tax.

- even where employers seek to move to the optimum position, there may be substantial employee resistance to reductions (or smaller increases) in cash pay, or the cashing out of benefits, to offset the employee's income tax savings. Income tax savings do not normally play a prominent part in pay negotiations. Pension entitlements may complicate the issue.

- although, given the long lead time, many employers may be ready to change their arrangements "overnight" when FBT becomes effective, the process of adjustment is unlikely to be fully accomplished for some time.

21. It is thus a matter of judgement where, between the £1,450m ex ante figure and the theoretical ex post figure of about £450m the actual net additional burden on employers would initially turn out to be. A reasonable working assumption might be that at the start of FBT it would fall in the range £500 to £1,000m.

22. On the footing that you might consider a two point reduction in the CT rate, we have checked all the above calculations with a 33% CT rate (marginal CT rate 35%). That would make no significant difference to the behavioural pattern, but would shade about £10m off the aggregate ex post net yield from introducing FBT.

Timing of FBT

23. You have not yet decided the timing of FBT payments. If

they were made quarterly, up to three quarters of the 1990/91 liability should be received in 1990/91, thus off setting, or rather more, the loss of income tax on benefits currently received with monthly PAYE payments. If, on the other hand, payments were made annually, there would be no receipts until 1991/92, thus resulting in a loss of revenue of some £700m in 1990/91 from the introduction of FBT. We will cover the payment options in our next note on the operational side of FBT.

24. What you decide will have implications for the year for which any off setting CT deduction would need to be made. If FBT is payable during 1990/1991, it will be necessary to reduce the CT rate for the preceding financial year ending 31 March 1990. But if FBT were only payable annually, the CT reduction could be left until the following year.

25. A CT reduction would, of course, only help corporate employers. But the amount of the additional cost attributable to unincorporated businesses is relatively small - and they will receive "compensation" from the main "Task Force" package.

What if employers succeeded after all in achieving the "employer neutral" position?

26. While we think this outcome unlikely in most cases, it is worth considering briefly what difference it would make to the figures, if it were adopted in the working assumptions. The answer is that it would not make a great deal of different to the net yield - it might fall by £50m or so. Broadly speaking, the loss of IT/NIC on the employer's reduced income will be largely balanced by the reduction in CT relief.

27. By definition, the additional costs on employers would fall - to nil - if all employers achieved this result. No question of compensation through the CT rate would then arise.

Summary

28. This note discusses the behavioural response to FBT. Many variations are possible, but the most likely outcome, in the longer term, seems to be that employers will generally seek to recover the employee's tax savings to cover part of their extra costs. To the extent that happens

- "cashing out" benefits would be the cheapest option for about 25%-30% of benefits (but for about 5% the new system could actually be cheaper than the old)

- the aggregate net yield might eventually settle not at £700m but about £500m

- employer's additional costs would, in the longer term and with complete adjustment on the basis of "employer neutrality", equal the net yield; but in the shorter term might more realistically be expected to be some £500 - £1,000m

- to offset these additional costs, which would fall very largely on employers paying CT at 35% or 37.5%, a reduction in the CT rate of 1 or perhaps 2 points would be required

- it would need to be effective either for the financial year 1990, or 1991, depending on the payment pattern for FBT on which you decide.

Peter Lewis

P LEWIS

 6

Inland Revenue

Policy Division
Somerset House

Copy no of

FROM: P LEWIS
DATE: 4 DECEMBER 1987

Chancellor

FRINGE BENEFITS TAX: IMPLICATIONS OF A 45% NON-DEDUCTIBLE RATE

1. At your meeting on 6 November you decided that planning should proceed on the basis of a 45%, tax exclusive, non-deductible rate.

2. That discussion proceeded on the basis of two important simplifying assumptions

- that all employers providing benefits pay corporation tax at 35%

- that the cost of a benefit to the employer, its value to the employee and its taxable value are all the same.

3. This note looks first at what happens when these simplifying assumptions are relaxed and how the position would compare with Australia and New Zealand. It then goes on to look at how the picture would change with a 50% EBT rate and/or a 30% higher rate; considers what the yield from an FBT might be; and, finally, discusses briefly the possibility of an extra charge on higher rate taxpayers to produce greater neutrality between cash and benefits.

A <u>How far will a 45% non-deductible FBT be neutral as between the payment of cash and benefits?</u>

4. With a <u>deductible</u> tax rate, the only variable it is necessary to consider in looking at neutrality between cash and benefits is the employee's tax rate. With a <u>non-deductible</u> rate, it is necessary to look in addition at the tax position of the employer.

5. Table 1 below sets out the relative saving or cost to an employer paying tax at different marginal rates from giving a benefit rather than paying in cash to employees at different income levels. The table shows first the advantage to the employer of benefits now, then what that advantage would become under the 25/35 package without FBT; and finally how the picture would change with FBT. The line on which we were focussing at your meeting was the fifth line - companies actually paying tax at 35%.

Table I

Savings from paying in kind rather than cash

Employee

Tax Rate -	< Basic rate (25%)		><	Higher Rate (35%) >
Earnings -	(Below P11D limit)	(Above P11D limit up to UEL)	(Above UEL up to HR threshold)	(Above HR threshold)
Current system	42%	21%	9%	9%
25/35 Package without FBT	40%	20%	20%	22%
25/35 Package with FBT				
Non-taxpaying employer (a)	13%	13%	13%	26%
25% employer (b)	4%	4%	4%	19%
35% employer (c)	-1%	-1%	-1%	14%
37.5% employer (d)	-3%	-3%	-3%	13%

Footnotes:

(a) Public sector bodies plus all chargeable employers who for any reason have no tax liability.

(b) Small companies with profits up to £100,000, and partnerships and self-employed employers liable at BR.

(c) Large Companies with profits over £500,000, and partnerships and self-employed employers liable at HR.

(d) Companies with profits between £100,000 and £500,000.

6. The main messages of the table are

- without an FBT the package gives a substantially increased incentive for benefits for employees whose incomes are above the UEL (last 2 columns of table)

- with an FBT, benefits generally become less attractive, as compared with now, for basic rate taxpayers, particularly for those with earnings below the UEL, and even more so for those below the P11D limit;

- but above the HR threshold there is still a significant increase in the advantage of benefits.

7. The number of employees expected to be receiving benefits in 1990/91 in the 4 categories shown in the table is broadly as follows:-

Below present P11D threshold	150,000
Above P11D threshold but below UEL	1,100,000
Above UEL threshold but below HR threshold	550,000
HR	350,000

8. It is not possible to analyse the 250,000 or so employers who give benefits into the four tax ranges in the table. But we can analyse the total number of companies/self-employed businesses in each of the four tax ranges to give a broad indication of the marginal tax rates faced by businesses generally.

Table II

Approximate number of companies and self-employed people paying tax at various rates under the 25/35 package

	Companies	Self-employed
Non-taxpayers	650,000 amazingly high	260,000
25%	225,000	1,950,000
35%	5,000	180,000
37.5%	20,000	-

9. This table indicates that only a relatively small number of employers are likely to be paying tax at 35%, though the majority of benefits are probably provided by large companies. Most employers are likely to be either non-taxpayers or to pay at 25%.

B <u>Benefits not charged at their full value</u>

10. The discussion so far has proceeded on the basis that the cost of the benefit to the employer, its value to the employee and the amount which is taxable are all the same.

11. There will, clearly, be cases where the value of a benefit to an employee is different from the cost of it to his employer because, for example, he is preferred to have it but does not particularly want it. We have not attempted to analyse this, partly because it would be largely a subjective matter, varying from employee to employee, and partly because, on the whole, the differences are likely to be fairly small.

12. In some cases the value of the benefit to the employee may be different from its taxable value. For example, where the employer can buy goods or services in bulk at a discount, the amount chargeable to tax - generally based on cost to the employer - may well be less than the value of the benefit to the employee. Again, in general, such differences are likely to be small. But there is one important case - cars - where the taxable value of the benefit varies by a very wide margin from the cost to the employer of providing it and, in general, its value to the employee.

13. As Miss Rhodes note of 22 October brought out, the current car scales charge the employee on approximately 25% of the cost to the employer of providing a car for average private use (taking 100% of standing charges into account). If cars are reckoned to be taxed on only about 25% of their value to the employer, the advantage of cars over cash is as follows:-

Basic rate taxpayers with earnings below UEL

?

The relative advantage to the employer is 38% under the present system, 30% on the 25/35 package without FBT, falling to 30% with an FBT for an employer paying tax at 35%.

Taxpayer whose marginal rate is 60% at present

The corresponding figures for top rate taxpayers are 57% at present, 44% with the 25/35 package and no FBT, and 41% with an FBT for an employer paying tax at 35%.
(Annex A sets out the picture in more detail.)

14. This analysis suggests that, in the case of cars, there would generally be a significant reduction in the tax advantages cars at present enjoy. However, so long as the scale charge remains broadly at its present level, there would continue to be a large incentive to provide cars rather than cash, and a much greater incentive to provide cars rather than other benefits.

15. If you were to phase in higher car scales reflecting 50% of standing charges over 3/4 years - the leading option discussed in the Financial Secretary's note of 30 October - cars would be taxed on about 60% of their value. On that basis, the figures in paragraph 13 showing the advantage of cars over cash would become

Basic rate taxpayers with earnings below UEL

31% under the present system, 30% on the 25/35 package without FBT, and 15% (instead of 30%) for an employer paying tax at 35% with an FBT.

Taxpayers whose marginal rate is 60% at present

43% under the present system, 36% on the 25/35 package without FBT, and 28% (instead of 41%) for an employer paying tax at 35% with an FBT.
(Annex B gives further details).

Thus even with FBT <u>and</u> revised scales there would continue to be a substantial advantage, at all income levels, in providing a car rather than cash; and in providing a car in preference to other benefits. But the present distortion in favour of cars would be markedly reduced.

C <u>Comparison with Australia and New Zealand</u>

16. As the figures in Table I show, a 45% tax rate with a 25/35 package would, for benefits other than cars, be considerably closer to neutrality for basic rate taxpayers than for higher rate taxpayers. Broadly speaking this is the opposite of the situation in Australia and New Zealand where the FBT rate is equal to the highest rate of personal taxation.

17. Ignoring the tax position of the employer - which is in any case simpler than here since both countries only have one rate of corporation tax - an FBT rate equal to the highest personal tax rate provides virtually complete neutrality at that income level because there is really nothing comparable to our NIC problem.

18. In Australia this means that the rate has been aligned with the rate paid by the top 10% of taxpayers, a rate which begins to be payable at roughly 1.5 times average earnings. The Australians did not get to this position in one go - at the time FBT was announced in September 1985 the rate was equal to the middle band in the five personal tax bands; but the same announcement foreshadowed major reductions in personal tax rates thus making it clear that FBT would soon be in line with the top personal tax rates. The present position, and the process of getting there, have been broadly similar in New Zealand.

19. Linking the rate with the top rate of personal income tax has been justified on the grounds that benefits tend to be more frequent, and of greater value, to people with higher incomes. Criticisms that employers are over-taxed in relation to people further down the income scale are met by the argument that the exemptions - such as the provision of cheap goods to shop staff - apply particularly to the lower paid and that in some other important cases - particularly cars in Australia - the taxable amount is less than the true value.

ps3/6T

CONFIDENTIAL

bf. 11/1

PS/CH TO PS/FST 4 JAN

FROM: J M G TAYLOR
DATE: 4 January 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Miss Sinclair
Mr Michie
Mr Cropper
Mr Tyrie

Mr Isaac - IR
Mr Lewis - IR
Mr Prescott - IR
PS/IR

FRINGE BENEFITS TAX: COVERAGE

The Chancellor was grateful for the Financial Secretary's minute of 22 December, and the enclosed submissions from Mr Prescott (15 December) and Miss Sinclair (18 December).

2. The Chancellor commented that he did not agree with the less radical approach outlined in Miss Sinclair's minute - ie maintaining all, or nearly all, of the present exemptions. He thought that an important argument for an FBT was that it would enable us to tax fringe benefits more effectively. This would obviously apply to benefits enjoyed by those below the P11D limit, but it should also mean that benefits which it is not practicable to tax on the present basis would be caught by the FBT. There would still, of course, need to be some benefits that were exempted even from the FBT, but each case would need to be looked at on its merits.

3. The Chancellor has commented, therefore, that the proposals in the Financial Secretary's minute seem to be very much along the right lines. He has noted, however, that there is a curiosity in the proposal relating to "miners' coal" in that it would bring a pure cash benefit into FBT rather than simply tax the employee. He would be happy to tax "miners' coal", but unless the Financial

Secretary has strong feelings to the contrary he thinks that a meeting with all Treasury Ministers present would be the most sensible next step in the handling of these issues.

J M G TAYLOR

42.2.BTW.4373/34

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bf. with pps. for tax overview mtg. on 18/1

PS/FST To PS/CH 6 JAN

FINANCIAL SECRETARY TO THE TREASURY

FROM: J J HEYWOOD
DATE: 6 January 1988

PS/CHANCELLOR ✓

Ch / We shall arrange a meeting, post-Chevening.

Noted

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

FRINGE BENEFITS TAX: COVERAGE

The Financial Secretary has seen your note of 4 January and agrees with the Chancellor that the next step should be a meeting of all Treasury Ministers.

J.H.

JEREMY HEYWOOD
Private Secretary

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MR A ALLAN ✓
pay

Copy No. 22(b) of 22
FROM: ROBERT CULPIN
DATE: 7 January 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Mr Byatt
Mr Scholar
Miss Sinclair
Mr Riley
Miss Evans
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill:IR
Mr Mace:IR

Mr Unwin: C&E

SUPPLEMENTARY MATERIAL FOR CHEVENING

Before Chevening, there will be two updates to the paper I circulated on 18 December.

- Mr Scotter will circulate a revised edition of Annex C - **The distributional effects of the reforms of social security, income tax and local government finance.** That was foreshadowed in the paper.

- This minute may be taken as a new Annex I - **Options retaining the National Insurance ceiling.** You asked for it. It expands on points which are in the main paper.

There will be no further changes to the tax paper before Chevening (even to correct mistakes).

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Keeping the National Insurance ceiling

2. As the paper says, the leading option so far has been to abolish the National Insurance ceiling, set a top rate of income tax of only 35 per cent, and raise substantially the threshold for higher rate tax. This has a number of advantages: a smooth progression of marginal rates, a big cut in the top rate, and a reduction in the value of tax breaks. It also facilitates the alignment of capital gains tax with income tax.

3. But it raises the marginal rate for a lot of people, creates losers, transfers money from Principals to Permanent Secretaries, increases the incentive to pay benefits in kind, and so on. Retaining the National Insurance ceiling would eliminate many of these problems, though it would lose some of the advantages. The natural trade-off would be less generosity on the top rate - setting it above 35 per cent, perhaps with a lower threshold than otherwise.

4. Table 1 shows some alternatives you suggested. Other permutations are possible.

5. Table 2 compares the broad effects on people with different incomes. It hides differences in timing: paragraph 18 below.

6. The common features are that there are no losers; people near the middle do better than if the National Insurance ceiling is abolished; but people at the top still get very large gains.

7. Compared with the leading option in paragraph 2:

- **Capital gains tax** would be more difficult to align with income tax: the higher the top rate, the more losers alignment would create. In practical terms, it would probably be ruled out if the top rate were more than 40 per cent.

- There would no longer be any case for raising the limit on **mortgage tax relief** to buy out losers on National Insurance, because there would be no such losers.

8. Under the two alternatives which have a 25p basic rate and a 40p or 45p top rate:

- **Tax reliefs** would be worth more, because they would run against a higher top rate. For a given threshold, every 5 per cent on the top rate adds roughly £¼ billion to the total cost of reliefs. Much of this goes on the basic personal allowances. It happens automatically: it is not an additional cost, over and above the costs in Table 1.

- **Independent taxation** would cost more. That is because independent taxation frees some income from being taxed at the top rate. The extra cost might be roughly of the order of £100-200 million. That is additional: the figures in Table 1 make no allowance for it. (Independent taxation would still be cheaper, though, than with the present top rate of 60 per cent.)

The two alternatives in Table 1 which have a 24p basic rate would (I think) avoid these effects.

Benefits in kind: Cars

9. If you decide to keep the National Insurance ceiling, you will:

(a) avoid increasing the incentive to pay benefits in kind, and

(b) find it easier to tackle quickly one of the worst anomalies of the present system, which is that company cars are grossly and obviously under-valued for tax purposes.

The main constraint so far has been that increasing the car scales would aggravate the losers problem.

10. As the paper says, there are in principle two different questions about cars:

- What valuation should be put on them for the purpose of taxing the benefits they provide?

- Should these benefits be taxed in the hands of employees, as now, or employers, through a new fringe benefits tax?

The next few paragraphs are concerned entirely with the first question.

11. Table 3 shows the extra yield of the options you have suggested. They illustrate the effects of raising the valuation of cars under the <u>present</u> system. Doubling car scales raises <u>roughly</u> £1/3 billion.

12. The extra cost to taxpayers depends on:

- what sort of car they drive (by engine size and cost)

- whether they are basic or higher rate taxpayers

- what the rates of tax are.

13. Most of those affected are basic rate payers: they have about four-fifths of all company cars. And most company cars are in the Sierra/Cavalier/Montego range (1.4-2 litres.)

14. For most of those affected, therefore, car benefit tax will be about £3.70 a week if the basic rate is 25p and there is no change in the valuation of cars. So:

- a 25 per cent increase would cost them less than a pound a week

- a 100 per cent increase would cost them about £3.70 a week.

Basic rate taxpayers with smaller cars would pay about a quarter less.

15. Higher rate taxpayers would obviously pay more. So would people with bigger cars. For example:

- if the top rate were 45 per cent, and car scales were doubled, a well-paid Cavalier driver would pay an extra £6.70 a week, and

- a well-paid Rover/Grenada driver an extra £10.50 a week.

Only about 100,000 people have fancier cars than that, and they are likely to be substantial gainers from the higher rate reductions.

16. Even if the valuation of cars is doubled, we shall probably still be valuing them at a bit less than half what they are worth.

17. If you decide to jack up car scales and then move to a **fringe benefits tax,** you will clearly be shifting a greater burden on to employers when the new tax comes in. In principle, though, this could be offset by a larger reduction than otherwise in corporation tax. And the other arguments for a fringe benefits tax would remain valid.

Timing

18. The options on National Insurance, income tax and car benefits would affect people at different times. Briefly:

- Income tax and National Insurance can be changed in 1988-89, though the income tax changes are bound to come before any National Insurance ones.

- The car scales cannot be changed until 1989-90: the rules for 1988-89 have already been set.

- A fringe benefits tax could not be introduced until 1990-91.

So it is impossible to match gains on income tax with losses on cars.

19. The timetable for some basic rate taxpayers could look like this, simplifying somewhat and ignoring altogether budgets after 1988.

	If National Insurance ceiling abolished	If National Insurance ceiling kept
1988 June	Tax refund	Tax refund
" October	NI increase	-
1989 April	Second NI increase (No income tax offset)	Increase in tax on cars
1990 April	Third NI increase (No income tax offset)	Reduction in tax on cars and other benefits, if burden shifted to employers through new fringe benefits tax

20. If the National Insurance ceiling is abolished:

- some basic rate payers get one tax refund and three National Insurance increases

- losses mount up: about 300,000 tax units lose an average of roughly £2 a week for half the year in 1988-89 and then more than that for a full year in 1989-90.

21. If, on the other hand, the National Insurance ceiling is retained, but car scales jacked up, people will get their income tax gains in 1988-89 but their car benefit losses in 1989-90.

22. If, in 1990-91, you then move to a fringe benefits tax on employers, those employees who enjoy benefits in kind will see a windfall reduction in tax.

RC

ROBERT CULPIN

V2710.27

TABLE 1

INCOME TAX AND NATIONAL INSURANCE OPTIONS

National insurance ceiling	Basic rate(%)	Higher rate(%)	Higher rate threshold(£)	1988-89 cost (£ billion)	Full+ year cost(£ bn)	Number with higher marginal rates(tax units)*	Number of losers** (tax units)	Average loss (£ pa)	Average gain above £50,000 (£ pa)	Number of higher rate taxpayers
Abolish with phasirg	25	35	25,000	3.6	4.1	1.3 million	300,000	105	7,000	700,000
Keep	25	40	18,700	3.5	4.5	0	0	NA	7,100	1,300,000
Keep	25	45	21,300	3.4	4.3	0	0	NA	5,500	900,000
Keep	24	45	17,900	4.1	5.1	600,000	0	NA	5,000	1,500,000
Keep	24	44	17,900	4.3	5.3	600,000	0	NA	5,400	1,500,000

+ at 1988-89 income levels
* compared with indexation in 1988-89
** compared with 1987-88

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TABLE 2

Average gain/loss in 1988/89: £p.a.

Basic/higher rate

Range of Total Income (lower limit)	25/35* no UEL HR t'hold £25,000	25/40 HR t'hold £18,700	25/45 HR t'hold £21,300	24/45 HR t'hold £17,900	24/44 HR t'hold £17,900
0	91	91	91	119	119
10,000	180	180	180	247	247
15,000	227	254	254	355	355
20,000	231	351	361	475	477
25,000	476	534	664	556	572
30,000	914	815	944	658	711
40,000	1767	1683	1505	1088	1227
50,000	6943	7116	5508	4979	5424
TOTAL	261	273	263	294	302

* net gain after taking account of £32 million loss of 300 thousand tax units

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TABLE 3

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

YIELD FROM THE TAXATION OF COMPANY CARS IN 1989-90

£ MILLION

Tax regime	Yield if no change to 1988-89 scale charges	Additional yield if scale charges increased by: 25%	50%	75%	100%
25/35/25000	290	80	150	240	320
25/40/18700	320	90	170	270	350
25/45/21300	330	90	170	270	360
24/45/17900	330	90	180	280	360
24/44/17900	330	90	180	270	360

NOTE 1. Tax regime A/B/C has a basic rate of A, a higher rate of B and a basic rate band of C in 1988-89 prices.

2. These estimates are based on the assumption that the increase in scale charges does not lead to any reduction in the provision of company cars.

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REF No J 88/1

COPY NO. 1 OF 22.

FROM: J M G TAYLOR
DATE: 8 January 1988

MR CULPIN

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Mr Byatt
Mr Scholar
Miss Sinclair
Mr Riley
Miss Evans
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill - IR
Mr Mace - IR

Mr Unwin - C&E

SUPPLEMENTARY MATERIAL FOR CHEVENING

The Chancellor was most grateful for your minute of 7 January.

2. He has commented that his main quarrel is with your comment that it is impossible to match gains on income tax with losses on cars (your paragraph 18). Unless we (a) go to a FBT and (b) do nothing on cars until then, the only time there can be a substantial increase in tax on car benefits is in the same Budget as sizeable reductions in income tax - even though the new car benefit tax rates will come in a year later. Thus it is vital to "match" the losses from one against the gains from the other.

J M G TAYLOR

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Inland Revenue

Policy Division
Somerset House

FROM: C STEWART

DATE: 8 JANUARY 1988

1. Mr Corlett
2. Mr Isaac
3. Chancellor

MAINTENANCE - UNMARRIED MOTHERS (STARTER 150)

STEWART TO CH. 8JAN

1. Your meeting on 25 November discussed the effect of the maintenance proposals in denying relief in future for maintenance payments to unmarried mothers or their children. You wanted a possible scheme of compensation to be examined. You commented that the only promising solution seemed to be to increase social security benefits; but recognised that it would have a deadweight cost. You asked the Chief Secretary to consider this further.

2. In the meantime we have been giving more thought to possible fallback positions on the tax side. This note considers the various options. None of the tax ones are attractive - for the reasons already identified at earlier meetings - since they would all, to a greater or lesser extent, reintroduce the tax relief for children on a discriminatory basis, largely to the comparative disadvantage of married couples.

---

cc Chief Secretary
FInancial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Miss Sinclair
Mr McIntyre
Mr Gibson
Mr Cropper
Mr Tyrie
Mr Jenkins (Parliamentary Counsel)

Mr Battishill
Mr Isaac
Mr Corlett
Mr Lewis
Mr Beighton
Mr Calder
Mr Mace
Mr Davenport
Mr Golding
Mr Yard
Mr R H Allen
Mr J C Jones
Mr Boyce
Mr I Stewart
Mrs Fletcher
Mr C Stewart
PS/IR

The basic proposal

3. The basic proposal is to confine relief (up to a limit) to maintenance payments between divorced and separated spouses. On that basis there would be no relief in future for payments to children, or to unmarried parents for their children. But relief under the old rules would continue, without time limit, for maintenance Orders etc made before the Budget, unless subsequently varied. (Under the proposed transitional rules, Orders applied for before Budget Day and made by 30 June 1988 would also stay on the old rules).

Potential losers

4. Since existing Orders are being protected, there is no problem about unmarried mothers who get maintenance at present. So in looking at whether something needs to be done for unmarried mothers we are concerned primarily with future losers - ie maintenance Orders made on or after Budget Day, which would be less favourably treated than if the old rules had continued.

5. Unmarried mothers with Orders in the future may be less well off as a result of the tax changes because

- the father will not get tax relief for the maintenance;
- so the Courts may award lower maintenance than they would have done under the present rules;
- the mother will be exempt from tax on the maintenance, but this will not always help her - for example if she is a non-taxpayer. Present social security benefits may not necessarily compensate fully for the loss.

6. Perhaps about 75,000 (15%) of the maintenance payments which qualify for tax relief are made to unmarried mothers or their children. The father may or may not be living with the mother; we have no reliable estimate of the number who may be cohabiting.

There are likely to be around 15,000 new Orders made each year, for which relief would not run under the new regime. A small sample suggests that the average payment under Affiliation Orders is about £700 a year; and that about 80% are below £1,000 and about 90% below £1,370

7. Even so, these mothers with new Orders will not necessarily lose, for a variety of reasons.

8. First, the Court may not necessarily award less maintenance than before merely because the father will not be entitled to tax relief. The Court will be concerned with the needs of the child. It may consider that the father can afford to make the same gross payment as would have been awarded under the old rules. But no doubt there will be some cases where the Court awards less because the father can afford less; or where the father is less able to keep up the payments awarded by the Court.

9. Secondly, where the maintenance is less than would have been given under the old rules, the mother may be fully compensated by the new tax exemption for the maintenance. This will be so if the maintenance is payable to her and she is fully using all her personal allowances against other income (eg earnings). Otherwise, the tax exemption will not fully compensate her; for example -

a. if all or part of the maintenance would be covered by her personal allowances anyway, so that she would not be paying tax on it all under the present rules; or

b. if it would not suffer tax under the present rules because it would have been made payable to the child (as is now very common) and would have been covered by the child's personal allowance. (This example raises a hypothetical question about whether payments under a future Order would have been made to the mother or to the child if the present rules had continued. But anyone who wanted to argue that unmarried mothers were made worse off by the change would assume that the payments would have been made to the child).

10. Thirdly, even where the tax exemption does not fully compensate, social security benefits may do so wholly or partly. Without consulting DHSS we cannot check fully on this, but our understanding is that:

a. If the mother is working 24 hours or more per week, she may be entitled to family credit (which is to replace family income supplement). If her net income (including maintenance but after tax/NIC) goes down, extra family credit will compensate for 70% of the loss. This of course depends on her income being within the family credit range; but even a lone parent with one child can get family credit on an income of a little more than £100 a week. (At this level she would be above the tax threshold and would gain from the tax exemption unless the maintenance was payable to the child.) At the margin some mothers might be pushed on to family credit by the reduction in maintenance. The 70% rule means that family credit will not generally compensate for the full loss of maintenance; so some will still be at least slightly worse off.

b. If the mother is not working full-time, she may be on income support (which is to replace supplementary benefit). If so, a reduction in maintenance which is not offset by a tax reduction will be fully compensated instead by an increase in income support. (For a lone parent with one child under 11 income support is available up to a net income (including child and one-parent benefits) of £53.65 a week; and her first £15 earnings are disregarded for that purpose). Again some mothers at the margin might be pushed on to income support by the reduction in maintenance.

11. In either case, it has to be recognised that there is less than 100% take-up of means-tested benefits; and the number of losers and amount of their loss will be greater than the theoretical minimum.

12. We cannot estimate the number of unmarried mothers who would not be fully compensated. But since the number of new Orders is about 15,000 a year, and at most only a proportion of these would be worse off, the number is not large. And the hardest cases - with the lowest incomes - are the most likely to be compensated by social security benefits.

Compensation for losers

13. The issue is whether any further compensation should be considered for those who will lose, and if so what form it should take.

Option 1 - increase OPB

14. The leading option, in accordance with your views, would be to increase one-parent benefit (OPB). This would assist losers without making them more dependent on means-tested benefits.

15. It would not be possible to relate the OPB increase to any loss of maintenance on an individual basis; it would be broad-brush compensation.

16. Cost. Part of the cost of an increase in OPB would be deadweight cost because -

a. not all recipients of OPB are unmarried mothers;

b. some unmarried mothers will have maintenance under pre-Budget Orders and will not be affected by the tax change; but it would not be feasible to deny them the OPB increase (and in some cases the father might ask the Court to reduce the maintenance);

c. some unmarried mothers with post-Budget Orders will get full or partial compensation in the various ways described above (paragraphs 8-10). (Where the mother is on income support, the increase in OPB will simply reduce the support by the same amount, so that there will be no extra cost except at the margin where the extra OPB is more than enough to float her off income support.)

17. APA link. Because of the deadweight cost an increase in OPB, if made in isolation, to compensate future unmarried mothers who receive lower maintenance looks unattractive. But it could look very different if the additional personal allowance (APA) were replaced by increased OPB. The net cost might be £m20-30. An APA/OPB switch would help cushion the effects of both the APA removal and the maintenance changes.

18. Distribution effects. It would not necessarily provide full compensation for all future losers; for example where -

a. the mother already used her full APA against earnings, but the maintenance would (under the present rules) be paid to the child and covered by the child's personal allowance; or

b. the reduction in maintenance was more than the increase in OPB. For example, if the Courts would award £30 per week under the old rules but £22 under the new rules, the loss of £8 would be more than the increase in OPB (£7.40 to buy out APA).

19. On the other hand, it would particularly help unmarried mothers who were not using - or fully using - their APA at present. These are among the cases most likely to be adversely affected by the change in the maintenance rules, because the tax exemption for the maintenance does not fully compensate them.

20. Temporary relief. There is a timing problem here. On present plans, the new maintenance rules will apply to Orders made on or after Budget Day 1988, but DHSS would not be able to implement an APA/OPB switch until April 1989 or (more likely) 1990.

21. The question is whether some temporary tax relief for the payer should be given for post-Budget Orders until then to take the heat out of any immediate political opposition.

22. <u>One</u> course would be to provide no temporary relief. This could be defended on the grounds that it was by no means clear that there was a significant number of people who would get less maintenance than if the old rules had continued, and who were not adequately compensated by the tax exemption and/or existing social security benefits. Those with very low incomes would generally be on social security benefit already. This course would also avoid the administrative costs of a temporary relief, the complications for recipients and the inevitable pressure to make it permanent.

23. On the other hand, critics would say that as the Government accepted the case for increasing one-parent benefit from 1990, it would be harsh to expose unmarried mothers in the meantime to the risk of getting lower maintenance because the father got no tax relief. It would also increase dependency on benefits.

24. A <u>second</u> possibility would be to have a narrowly targeted relief, as a temporary exception to the general rule that there would be no relief for payments under new Orders. Thus relief might be allowed, up to £1,370 (the equivalent of the APA), for payments under an Affiliation Order by one unmarried parent to the other, provided that the child was not living with the payer. Divorced and separated parents would already be catered for by the new relief for payments by one spouse to the other for his/her maintenance and the maintenance of their children. (This does not however cover the case where a third party is looking after the children because the wife has died).

25. This should avoid any risk that the Court would award less maintenance because of the new tax rules, particularly in a case where the mother was not able to use her own APA because she did not have enough income.

26. But this approach would also have disadvantages:

- it would discriminate against married couples and families;

- it would require a cohabitation test which we would be in no position to police effectively;

- it would involve some administrative cost and, for a period, muddle the simplification achieved by the new scheme, which is one of its main political attractions.

27. A <u>third</u> possibility would be to allow the present relief for maintenance to continue in all cases until 1990. This would avoid the problem of having to draw a precise line between more and less deserving cases for the purposes of a temporary relief. But it would continue - for a time - the situation of unmarried couples getting much more relief than married couples - again a fundamental reason for reform. And it is possible that even a married couple might succeed in getting a Court Order and therefore relief, following Sherdley (see paragraph 39 below). It is difficult to predict how many cases there would be, but the result might not be easy to defend.

28. If, however, you wish to pursue the possibility of some form of temporary relief on paragraph 24 or 27 lines to cover the period until 1990, we will work it up in more detail.

29. The remaining sections of this note consider possible fall-back positions on the tax side, if Ministers do not find the OPB approach acceptable.

<u>Option 2 - no compensation</u>

30. If an increase in OPB proves unacceptable, one alternative course would be to have <u>no</u> special provision to compensate losers from the maintenance changes. As explained above, many unmarried mothers should get full or partial compensation <u>either</u> through the tax changes <u>or</u> through <u>existing</u> means-tested benefits.

31. This option would

a. be simple,

b. minimise extra public expenditure on benefits.

c. make clear the Government's determination not to see continuing encouragement for children outside marriage, particularly where the couple do not intend to live together.

32. But it would be criticised as

a. increasing dependency on means-tested social security benefits,

b. pushing some people at the margin on to these benefits,

c. failing to compensate some future losers adequately,

d. and, therefore, exposing the Government to charges of an uncaring attitude to the "deserted" mother.

Option 3 - relief for payments for child living with lone unmarried mother

33. So far as we have yet been able to see, the only other course would be to devise some kind of permanent but limited tax relief for maintenance of children in particular circumstances where hardship was likely. A general problem with this approach is that any relief specifically for maintenance of children is bound to introduce a penalty on marriage or on the family generally. Furthermore, a difficult line has to be drawn between "deserving" cases and others, and the boundary, wherever drawn, is bound to come under pressure. The question is whether a tax solution can be devised which contains that problem at an acceptable and defensible level.

34. The most limited solution would be to give relief for payments by an unmarried father for a child who is neither resident with him, nor in his custody, but is with the mother. The relief could be limited to a maximum of £1,370 (the equivalent of the APA given to the parent with whom the child was living), or £2,425 (the same amount as for separated or divorced wives).

35. A relief on these lines would be targeted on the cases where the parents were not living together. But there would be a number of problems -

a. it would impose a tax penalty on the father if he had the child in his household, or wished to live with the mother. This would appear to discriminate not only against marriage but against the family and responsible parenthood generally;

b. the conditions for relief would include a form of cohabitation rule as the relief would not be due to couples living together. It would not be easy to construct a simple rule applicable in all cases to determine whether a child was living with one parent or with both. It would be very difficult and contentious and it would probably be realistic to accept from the outset that we could not police it effectively, bearing in mind that there may be two different tax offices dealing with the two parents and they may be a long way away from where the parents live. This would put a premium on dishonesty and would no doubt attract the attention of the PAC in due course;

c. at the lower level, there would be pressure from other lone parents that they should get equivalent relief. In particular - and this point arises also in the following 2 options - where children were living with divorced and separated parents, the parents would argue - with some conviction - that they should get relief for payments for their children in addition to the £2,425 relief for payments to the other spouse for her own maintenance. Our view is that the £2,425 should be regarded as subsuming all maintenance, whether for the ex-wife or any children, but there is no special technical or administrative issue at stake, and a further tranche of relief could be given if that was what was wanted.

Option 4 - relief for all children not living with the payer

36. If such a limited relief could not be sustained, the next fall-back would be to allow the relief in all cases where the child was not living with, or in the custody of, the payer. In practice this would mean reversing the Sherdley decision. But it would also exclude the cohabiting couple.

37. Thus relief would still be available for payments to/for children where the mother was divorced, separated or unmarried, but not living with the father. But by reversing the Sherdley decision, relief would be withheld in the case where the child was living with, or in the custody of, the payer (who would generally get APA already). Relief might be limited to £1,370 (APA equivalent).

38. This option would allow relief more widely than Option 3 in cases where the parent with the child had been deserted. But -

a. like Option 3, it would amount to a tax penalty on the father who took his child into his household - discriminating against marriage and the family;

b. it would still in effect require a cohabitation rule, with all the difficulties referred to above;

c. it would therefore lead to pressure for relief to be extended to divorced parents (like Mr Sherdley) who are maintaining children in their own custody (eg because the other parent is unable or unfit to do so).

Option 5 - relief for all children except those of married couples but with an upper limit

39. If the line could not be held against pressure from "Sherdley" parents (paragraph 38c above), the final fallback would be to

- continue relief for payments to/for children by all divorced, separated and unmarried parents (whether cohabiting or not), but impose a £1,370 monetary limit on relief; and

- legislate to prevent similar relief going to married couples living together as defined for married allowance. This safeguard would be required because it is not yet clear how far the Courts might use their powers to give an Order for maintenance of children of an ordinary married couple where there is no marital breakdown. The Law Society of Scotland have already raised points of detail with us which imply that this possibility is in their minds. In Scotland it is not necessary to get a formal Court Order; it is sufficient for an agreement between the parties to be registered in the Court's books. So relying on the Courts to take a robust view of cases which come before them does not give us much defence; and in any event the House of Lords' remarks in the Sherdley case suggest that the Courts will regard a tax advantage as a legitimate reason for seeking a maintenance Order even though there is no question of failure to maintain the children.

40. This option does not require a cohabitation rule and does not impose any tax penalty on the unmarried or divorced father who wishes to take custody of his own child. In effect, it legislates to set in concrete the present (uncertain) practice, following Sherdley. The only change is that it puts an upper limit on relief. But it is the option which discriminates in the most extreme form against marriage.

CS

C STEWART

Inland Revenue

Policy Division
Somerset House

FROM: P LEWIS
DATE: 14 JANUARY 1988

Consider 45% & sharp rise in car scales & wide coverage

Chancellor

RATE YIELD CT RATE

FBT: RATE/YIELD/CT RATE

1. This note looks at the implications for FBT of the 25/40 package with the higher rate threshold set at £20,000 and no abolition of the UEL discussed at Chevening.

2. On the yield, and the implications of that for employers' costs and the corporation tax rate, it is necessarily a preliminary look since the yield, and its timing, will be affected by decisions on the other papers

- FBT: car scales (Angela Rhodes' note)
- FBT: coverage (Michael Prescott's note)
- FBT: payment dates (myself)

A <u>FBT rate</u>

3. Taking the main case (an employer paying corporation tax at 35% and benefits charged at their full value) the rates which are neutral under the Chevening package are as follows

higher rate taxpayers - 55%
basic rate taxpayers - 44%

In other words, the position has not changed for the basic rate taxpayer, but the neutral rate for the higher rate taxpayer has come down from 63% to 55%.

4. This suggests 3 possible options for the FBT rate:-

a. <u>Keep the rate at 50%</u>

5. The argument for this would be that 50% is a good round number; it is almost exactly intermediate between the neutral rate for the basic rate and the higher rate taxpayer; it improves the neutrality of FBT as compared with the previous IT package since the position of basic rate taxpayers is unchanged and it is more neutral for higher rate taxpayers (the employer savings from paying benefits rather than cash are 4% instead of 14%).

b. <u>Reduce the rate to 45%</u>

6. This would get the rate clearly below 50% and is almost neutral for basic rate taxpayers. But it would leave the present substantial incentive to benefits for HR taxpayers virtually unchanged - and the number of HR taxpayers would go up from 0.65 million under the 25/35 package to some 1.15 million under the 25/40 package (allowing for independent taxation). The net FBT yield would be reduced by about £150 million (ex ante) and perhaps some £100 million ex post, as compared with a 50% rate.

c. <u>Some intermediate rate such as 48% or 49%</u>

7. These would inevitably look less robust than round figures; but they would still have the presentational advantage of being below 50% and would be closer to neutrality for higher rate taxpayers than 45%. Like 50%, 49% could be presented as almost exactly intermediate between 44% and 55%.

8. Under the alternative income tax package (24/40 and £18,700 higher rate threshold) the picture changes a little. The neutral rate for basic rate taxpayers would be 42%; the neutral rate for higher rate taxpayers would be the same (55%) but would become more important with the higher rate threshold at only £18,700 as the number of HR taxpayers would increase to 1.35 million.

9. You will wish to consider tactics as well as substance and presentation; where you want to end up, as well as where you wish to start. If you feel that the FBT rate, whatever it is, will

come under strong pressure, or if you simply wish to retain some flexibility in case it does, there is a case for starting with the highest possible figure. Against that background 45% looks unattractive, because you could hardly give ground without slipping below BR neutrality (44%); and if you had to concede 40% ie alignment with the top income tax rate as in Australia and New Zealand, the bias towards benefits would be significantly greater than it is now for HR taxpayers.

10. The previous paragraphs look only at the main case (basic and higher rate taxpayers who are employees of an employer who pays corporation tax at 35%). In reality, the position is more complicated because employers in particular may be in a number of different positions. Annex A, therefore, sets out the savings from paying in kind rather than in cash for 3 FBT rates (45%, 49% and 50%) in all the possible combinations of employee/employer circumstances on the same lines as Table 1 of my note of 4 December.

11. One point which is, perhaps, worth noting from the annex is that now that the UEL is not to be abolished, there is a "kink" in the FBT neutral rates for basic rate taxpayers in the UEL kink. Since no employees' NIC is being paid, the neutral rate is only about 30% instead of 44%. Applying the sort of FBT rates discussed above to people in the kink would mean that, in effect, through FBT we would be getting employees' NIC on "kink" income. There is no way in which such cases could be given special treatment for FBT; and you may feel, in any event, that that is not an unhappy result. Given that the kink is itself an anomaly, it would be odd to reproduce it in FBT. But it would mean that FBT would be a particular disincentive to benefits for those earning (in 1988/89 terms) between about £16,000 and £24,000 (for a married man).

NL.

B Yield

12. The starting assumptions in looking at yield are that

- the £8,500 threshold disappears

- the car scales continue to have the same rules and are increased by 10% in both 1989/90 and 1990/91

- the fuel scales remain at their present level

- the coverage of the tax is the same as now, and

- there are no behavioural changes.

13. On that footing, the following table sets out what the gross and net yield of FBT would be on the three rates discussed above, and compares it with the yield of the present system under the present rates and the present system under the IT package rates.

Yield of FBT (Accruals, with no behavioural changes)

		£ million		
		45%	49%	50%
(a)	FBT yield	1300	1420	1450
(b)	Present system - current rates	950	950	950
	Increase (a)-(b)	+350	+470	+500
(c)	Present system - 25/40 package	820	820	820
	Increase (a)-(c)	+480	+600	+630

Even at the 50% rate FBT produces somewhat less net yield than before because the 25/40 package produces more income tax than the 25/35 package.

14. But, as indicated in my note of 23 December, behavioural effects seem likely significantly to reduce the yield, particularly in the longer term. Applying the same approach to behavioural changes as in the earlier note, we would expect that

- the aggregate net yield might eventually settle (assuming everyone adopted the theoretical optimum employee neutral position) at about £240 million (45%) £320 million (49%) or £340 million (50%).

- but that realistically that theoretical position would never be reached, and particularly in the shorter term, employers' additional aggregate labour costs would therefore be higher perhaps (for the 50% rate) in the range £500m to £1000m. (This is the same broad range as we envisaged previously)

15. These yield figures will increase if you decide to go for

- radically increased car scales in 1990/91

- increased coverage of FBT since some items (eg subsidised canteen meals) could have a significant yield.

16. In my note of 23 December employee neutrality was achieved either by "cashing out" the benefit, or by retaining the benefit and the employee's cash salary being reduced to take account of the increase in his disposable income through no longer being liable to tax himself on his benefits. Since then we have looked at a further variant under which neutrality is achieved through the employee in effect using his tax savings to make a contribution to his employer towards the cost of the benefits he receives. This made only a marginal difference to the results. We could, if you wished, further refine these - already complex - calculations. For example we have not so far taken into account pension contributions in looking at changes in cash remuneration. But, unless we have not yet identified an important type of behavioural response, it seems doubtful if further refinement of this kind is a good use at the present time of the statistical resources available since there is such a large degree of judgement entailed in any event in interpreting the results.

C Corporation tax rate

17. In considering the appropriate corporation tax rate, you will need to

What will sympathetic [illegible]?

- Form a judgement as to how far you should move from the ex-ante figures in the table in paragraph 13 towards the ex-post figures suggested in paragraph 14 as a possible broad indication of the actual net additional burden on employers likely to arise from the introduction of FBT.

- Adjust the figures for decisions on car scales/coverage.

18. In considering the amount of employers' additional costs to be taken into account for the CT rate, we need to bear in mind that

   a. No adjustment is needed for unincorporated businesses, or incorporated businesses liable at the small companies CT rate, or in the marginal band, all of whom will receive "compensation" through the main package or its consequentials.

   b. No help can be given through the tax system to employers either not liable to, or not paying, tax (including those in the public sector).

The only group left to be taken into account are employers paying tax at the main CT rate (35%).

19. The best estimate we can make at this stage is that perhaps 70% of the total additional costs will fall on such employers. That would imply, taking the figures in paragraph 14, that costs in the range £350-700 million should be taken into account, subject to any adjustment for decisions on car scales and coverage.

20. The timing of the additional burden arising from FBT will depend largely on whether you go for in-year FBT payments - as discussed in the companion note - or payment only after the end of the year. If the former, a significant part of the burden will arise in 1990/91; if the latter, not until 1991/92. That

implies action on the CT rate either for the financial year 1989 (the year to 31 March 1990, if you go for in-year payments) or the financial year 1990 (the year to 31 March 1991, if you go for annual payments) since CT reductions have no effect for the financial year to which they apply, and 2/3rds of the effect comes through in the following year.

21. As a broad indication of possible adjustments, a 1% reduction in the main CT rate for the financial year 1989* would cost about £400m in 1990/91 and £600m in following years. This would roughly cover the figures in paragraph 19.

22. But these costs are based on estimated ex post FBT yields which attempt to take into account behavioural effects the magnitude of which is, at best, highly uncertain in amount and timing. If therefore you preferred to focus on the ex ante FBT yield (70% of which, at a 50% rate, would be about £1,000m) this would point towards a two point reduction in the CT rate. In reality, as there would obviously be <u>some</u> behavioural effects, that would over compensate for FBT. But a two point cut in the CT rate could be presented more generally as responding, at least in part, to the pressure from the CBI and others for a cut in corporate as well as personal taxes.

POINTS FOR DECISION

23. i. Subject to any further changes in the main income tax packages, should the FBT rate be 50%, 45%, 49%, or some other rate (paragraphs 3 to 11)?

ii. a. Should we plan on the assumption that the likely initial net additional cost to employers paying corporation tax at 35% from the introduction of FBT will be in the range £350 to 700 million (subject to adjustment for decisions on cars and coverage). (Paragraphs 12 to 16)?

* These figures may need revision in the light of the January forecast - we should know by Monday whether this is so.

[illegible]?

ii b. Or do you wish to focus on the equivalent ex ante FBT yield (£1000m on the same basis) in considering the CT rate (paragraph 22)?

iii. Depending on your decisions on the due dates of payment for FBT, what adjustment to the CT rate do you wish to make in the light of the figures in (ii), and for what financial years (paragraphs 17 to 22)?

Peter Lewis

P LEWIS

Annex A

ANNEX A

Savings to employers from paying in kind rather than cash

Employee Tax Rate –	< Basic rate (25%)		>< Rate (40%) >	
Earnings –	(Below P11D limit)	(Above P11D limit up to UEL)	(Above UEL up to HR threshold)	(Above HR threshold)
Current system (and IT rates)	42%	21%	9%	9%
25/40 Package without FBT	40%	20%	9%	9%
FBT rate 45%				
Non-taxpaying employer (a)	13%	13%	2%	21%
Small biz 25% employer (b)	4%	4%	-9%	13%
mkt gp 35% employer (c)	-1%	-1%	-15%	8%
37.5% employer (d)	-3%	-3%	-17%	7%
40% employer (e)	-5%	-5%	-19%	5%
FBT rate 49%				
Non-taxpaying employer (a)	11%	11%	-1%	19%
25% employer (b)	1%	1%	-12%	10%
35% employer (c)	-5%	-5%	-19%	5%
37.5% employer (d)	-7%	-7%	-21%	3%
40% employer (e)	-9%	-9%	-23%	1%
FBT rate 50%				
Non-taxpaying employer (a)	10%	10%	-2%	19%
25% employer (b)	0%	0%	-13%	9%
35% employer (c)	-6%	-6%	-20%	4%
37.5% employer (d)	-8%	-8%	-22%	2%
40% employer (e)	-10%	-10%	-24%	0%

Footnotes:

(a) Public sector bodies plus all chargeable employers who for any reason have no tax liability.

(b) Small companies with profits up to £100,000, and partnerships and self-employed employers liable at BR.

(c) Large companies with profits over £500,000.

(d) Companies with profits between £100,000 and £500,000.

(e) Partnerships and self-employed employers liable at HR.

Inland Revenue

Policy Division
Somerset House

look @ figs for annual wr 1% ~ yr ①, 2% ~ yr ② (35% 1988-89, 34% 1989-90, 33% 1990-91?.)

FROM: P LEWIS
DATE: 14 JANUARY 1988

Chancellor

FBT: PAYMENT DATES

1. Further work on the operational side of FBT suggests that linking it to PAYE, at least in the first instance, would be the best course both for us and employers. We will be sending the Financial Secretary a note explaining why this is so and its implications.

2. Meanwhile, since it has important implications for several aspects of FBT, it would be helpful if we could have at least your preliminary views on what the due dates of payment for FBT should be.

PAYE

3. Under PAYE the employer deducts tax (and NIC) from pay and remits it to us monthly, 14 days after the end of the month. During the year there are no returns, simply payments. At the end of the year the employer sends a return which reconciles his monthly payments with the liability for the whole year, and gives pay and tax details for each employee.

FBT due dates

4. The choice - for both returns and payments, though the two need not necessarily go together - is monthly, quarterly, or annually.

Annual payments

5. One possibility would be for FBT to be paid annually, and the return to be made annually, at the same time as the annual PAYE end of year return.

6. The advantages would be

- this would tie in with the present PAYE timetable

- the employer would only be troubled once a year with a return and calculation of his liability (but the bulk of the compliance effort for employers will generally be in maintaining records, rather than making returns and payments)

- it gives the employer the longest possible delay before he has to pay FBT (which might help with the presentation of the tax)

- it means the minimum number of returns for the Revenue to process, and facilitates collection/compliance because the return and payment come together.

7. Its disadvantages are

- during the first year of FBT there are no FBT receipts to offset the loss of tax receipts - about £700m on the 25/40 package - from the monthly income tax on benefits which would otherwise have been received

- change in yield, following legislative change or changes in the provision of benefits, would take longer to come through

- having payment only once a year will - especially in the early years - cause additional collection problems, particularly with small businesses, which have over-looked or under-estimated FBT liabilities and then find themselves faced with in some cases quite large FBT bills for the whole year.

Payments at less than yearly intervals

8. As soon as you contemplate payment at less than yearly intervals two new sets of questions arise

- Should a return be made with each payment, or should returns be at longer intervals than payments?

- Are the payments which are made in-year provisional (they could be either estimates of a proportionate part of the year's liability, or, as under the Australian system, related - once the system is up and running - to a proportion of the previous year's liability; or are they the final liability for the month or quarter (as in the New Zealand system). That might imply monthly or quarterly returns also and a shorter basis period for the tax which would make some of the FBT rules we are contemplating - for example the annual mileage rules for cars and the annual exemption limit for small employers/providers - more awkward.

Quarterly payments

9. The advantages of quarterly payments would be

- the cash flow loss of annual payments would largely be avoided - about three quarters of the annual yield of FBT should be received in 1990/91 - and subsequent changes in yield would be reflected in tax receipts more quickly

- quarterly accounting would not allow the liabilities of small firms in particular to build up in the way they would for annual payments

- both the Australian and New Zealand systems adopt quarterly accounting; and it seems a reasonable period to adopt, intermediate between the other two possibilities

10. Its disadvantages are

- in compliance terms a requirement to make quarterly payments (and possibly returns also) would be more burdensome than annual payments

- quarterly payments do not fit so naturally into the PAYE system

- quarterly payments, whether the final liability or on some provisional basis, would lead to a more complex system.

Monthly payments

11. The advantages would be

- 11/12ths of the FBT liability should come in in 1990/91, resulting in a net yield

- the problem of large liabilities building up is further reduced

- monthly payments would tie in with the monthly PAYE remittances.

12. The disadvantages are

- the compliance burden on employers looks even heavier

- a monthly basis period for benefits looks very difficult; so there might be no alternative to a system of provisional payments which would be more complex, particularly for the first year.

Evaluation

13. Although it has some cash flow advantages and fits in well with the pattern of PAYE payments, we would be inclined to

discard the monthly basis as both too complex and too burdensome for employers.

14. The choice then comes down to annual or quarterly payments. If you are prepared to accept the cash flow loss in the first year, the annual basis would look better in terms of employers' compliance and would enable us to retain the, simpler, annual basis for the tax. It would also fit in better with the reality of our enforcement powers in the early days of the tax since until we have an automatic system in place some years after the introduction of FBT we will be able to identify and deal with only the most blatant of in-year non-compliance.

15. If, however, the cash flow loss in the first year is unacceptable, you would need to go for quarterly payments. That also has the advantage of stopping large liabilities building up, but it means greater employer compliance burdens.

16. You would need to decide whether the quarterly payments were

- simply the employers' estimate of the proportional part of his annual liability which had accrued to date

- a proportion of the previous year's liability as in Australia

- his final liability with the tax having a quarterly basis period (as in New Zealand). That means either adapting annual limits to a quarterly basis, or accepting favourable assumptions about such limits during the year, with the employer making adjustments as necessary in the final quarter when all the relevant information is available.

17. The first we think is unattractive. The conscientious employer would have to do virtually all the same work as if the tax had a quarterly basis period. But the slap-dash employer would not bother, and would pay us nothing or a minimum amount; and there would be very little we could do to put him right.

Employers would soon realise that the estimates were effectively voluntary creating entirely the wrong compliance atmosphere not only for FBT but for PAYE also.

18. A system based on the previous year's liability also looks unattractive. First, you need a special regime for the in-year payments for the first year; second, once you have a basis for previous year payments, you have to create a new set of rules to allow employers whose circumstances have changed to make lower payments. This would add to the complexity and administrative cost of FBT.

19. The quarterly basis period looks more viable because it would make employers calculate their precise liability each quarter, and with that obligation we would be likely to receive more tax during the year. It would also give us a precise figure which could be used for compliance work if employers had signally failed to make proper in-year payments. To reduce the amount of paper work, our preliminary view is it that, even with quarterly payments, we might have only an annual return, but one which would specify each quarter's liability, not just the liability for the whole year. We would need to consider how best to adapt the present annual limits to a quarterly basis period, and any other consequences of switching from an annual tax to a quarterly one.

20. But a quarterly basis would be likely to be unwelcome to employers. They would compare it unfavourably with the present once-a-year P11D work. And for big employers keeping records in different places, the extra work of bringing the records together 4 times a year, and establishing the liability in those cases which are not straightforward, could be substantial.

Conclusion

21. Our preliminary conclusion is that in complexity, employer compliance, and administration a clear balance of advantage points to the annual basis. If you agree, but find the initial cash flow loss a big stumbling block, it might just be possible

to make it bearable by some offsetting action elsewhere. For example, if you would otherwise have decided on a 2% cut, you might shade it down to 1% in the first year, with the full 2% in the following year. (Reductions of less than 1% look trivial.) Alternatively if you decide upon a 1% reduction in the rate, this could be held back for a year (though this might be less attractive presentationally). And you would not be able exactly to "balance the books" in this way because the year in which there is a cash flow loss precedes the year in which you would want compensation to start; so the effect would be to give you extra receipts in (on the annual basis) 1991/92 to set against the loss of receipts in 1990/91.

Points for decision

22. Is it agreed that the monthly basis should not be pursued?

23. If you prefer the quarterly basis to the annual basis, are the in-year payments to be based on

(a) estimates,

(b) the previous year's liability, or

(c) the final liability for the quarter (with annual limits either put on a quarterly basis, or left as now with liabilities adjusted in the final quarter as necessary)?

24. If you prefer the annual basis, is any other action to be taken to off-set, in whole or part, the £700m cash flow loss in 1990/91?

Peter Lewis

P LEWIS

need x at p4?

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

BUDGET SECRET: TASK FORCE LIST

Copy No. 1 of 22

FROM: B H KNOX
DATE: 14 January 1988

cc. Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Call
PS/Inland Revenue

CHANCELLOR

BUDGET 1988: EXCISE DUTIES

1. It was agreed at Chevening that, this year, the basic approach to the excise duties should be revalorisation, with over-and under-revalorisation of some duties to be considered further later. For comparative purposes, this note includes updated information on across the board revalorisation and over-revalorisation, but its main purpose is to look at possible candidates for special treatment. (Betting and gaming duties and matches and mechanical lighter duties have been excluded from this note, because it has already been agreed that they should not be changed this year).

International Circulation: CPS, Mr Jefferson Smith, Mr Allen, Mr McGuigan, Mr Whitmore, Ms French, Mrs Hamill

!!!

BUDGET SECRET: TASK FORCE LIST

2. **Revalorisation factor:** We have assumed revalorisation by 3.7%.

3. **Across the board revalorisation:** Across the board revalorisation of the excise duties would raise about £555 million in the financial year 1988-89 and would add 0.28% to the RPI. Annexe A gives a breakdown of prices changes, yield and RPI impact effects of revalorisation for each of the duties.

4. **Over-revalorisation across the board:** If you wish to raise additional revenue from the excise duties, double revalorisation across the board would bring in about £1140 million in 1988-89 and would add 0.55% to the RPI. Annexe B gives a breakdown of price changes, yield and RPI impact effects of double revalorisation for each of the duties. Double revalorisation is an extreme example of over-indexation, which we have included for illustrative purposes. We can work up other possibilities when we have a steer.

all VAT & Sask

If over-indexation were to be used, it could best be justified (on health and social grounds) if applied to the tobacco and alcohol duties. A "health" package consisting of double revalorisation of the tobacco and alcohol duties, together with straight revalorisation of the motoring taxes (the duties on petrol, derv and VED) would raise about £775 million in 1988-89 with an RPI impact effect of 0.44%. With sales of petrol and derv remaining buoyant, however, there is little doubt that their market could stand double revalorisation if necessary. It would, in our view, be difficult to present a package which increased motoring taxes overall, by more than the duties on tobacco and alcohol.

Over-indexation does carry penalties, however. The tobacco and alcohol duties bear relatively heavily on the RPI for every £million of additional revenue raised; and the duties on petrol and derv add directly to business costs.

BUDGET SECRET: TASK FORCE LIST

5. **Candidates for special treatment:** The candidates for special treatment within any overall package are relatively minor. Annexe C shows the price changes, yield and RPI impact effect of a revalorisation package which included the "frills" discussed below.

i. **Tobacco products:** At least revalorisation of the cigarette (and hand-rolling tobacco) duty is fully justified on health grounds following last year's standstill. Although consumption of cigars remains flat, we can see no good reason for excluding cigars from any increase in the tobacco duty this year, after three years without change. But we do think continuation of the five year standstill in pipe tobacco duty is justified - consumption is not buoyant, it is smoked proportionately more by the elderly, and is produced in areas of high unemployment (notably Northern Ireland) - and we recommend no change. Leaving pipe tobacco unchanged would have a negligible effect on both revenue and RPI.

Cigars on whatever (esp cf. ...) [also health: people don't inhale] ? give further £100m on cigs (+ h.r.t.). how much [5% — 3½p a pack]

ii. **Alcoholic drinks:** Alcoholic drinks have now enjoyed two years standstill (and spirits have received favourable treatment over a longer period). Revalorisation is expected by the industry and will be accepted, as a minimal increase by the alcohol misuse lobby who would prefer more. Final decisions on the alcoholic drinks duties will have to await the outcome of your meeting with the Lord President of the Council, Home Secretary and the Secretary of State for Health and Social Services, which has now been arranged for 9 February. A candidate for special treatment, in any case, is cider. Not only has it been identified as a problem, in the context of alcohol misuse, but it bears a relatively low rate of duty and competes directly with beer. The duty on average strength beer is about double that on cider

Michael & Jim £110 from ~~...~~ wine, cider or ... short ... ?

and cider is stronger. We propose, as has been done on previous occasions, that cider duty should go up by the same pence per pint as beer. This would raise about £5 million above straight revalorisation in 1988-89 and have a negligible impact on the RPI.

iii. **Motoring taxes:** Revalorisation of petrol and derv is expected after last year's standstill and should cause no undue difficulties. Over-indexation of petrol and derv to pay for a VED standstill is dealt with in paragraph 6. We have already recommended (Mr Jefferson Smith's note of 30 December) that the differential in favour of unleaded petrol (currently standing at 5p per gallon) should be increased to 10p per gallon. This change will reduce revenue in 1988-89 compared to across the board revalorisation by about £5 million, assuming a Budget day start date. The RPI effect is negligible. (Our submission on unleaded petrol recommended a 1 June 1988 start date, and there are good arguments for allowing a few months for publicity and education of the public. But, on further reflection, we think we have understated the case for a Budget day change and agree with the Economic Secretary's decision conveyed in his PS's minute of 13 January. Because the duty differential is created by means of a rebate on deliveries of unleaded petrol, delaying the change would mean that the effective duty on (and price of) unleaded petrol would rise on Budget day, in line with leaded petrol duty, and then fall again when the bigger differential - and the higher rebate - took effect in June).

Standstill on VED & unleaded: back from £345m from petrol & derv

iv. **Minor oils:** We assume that the link with the Frigg contract still precludes any change in the fuel oil duty this year. The duty on gas oil was unchanged last year, with the prospect left open of revalorisation back to 1986 in the 1988 Budget. We doubt whether over-indexation of a duty which falls on business costs could be justified if other duties are to be increased by smaller amounts. But straight revalorisation would produce awkward price changes and negligible revenue and, in that context, we would recommend no change this year. If neither gas oil nor fuel oil duty were changed about £5 million of revenue would be forgone. These items are not in the RPI.

no price ^ on gas oil

The overall effect on revenue in 1988-89 of the "frills" suggested above would be a reduction of about £5 million compared with across the board revalorisation. The overall RPI impact would be negligible.

6. __VED:__ You may, in due course and in the light of decisions yet to be taken on __VED,__ also wish to consider special treatment of the petrol/derv duties. If you decided not to revalorise car and light van VED, petrol duty would need to go up by an additional 1.8p per gallon (1.7%) to compensate; and if you decided against revalorisation of lorry VED, the revenue lost could be recouped by increasing derv duty by an additional 1.3p per gallon (1.6%). The petrol/derv option would have the same RPI impact effect as revalorisation of VED.

ie 5½p a gallon (1p a litre)

7. __**Conclusion:**__ Although the domestic industries producing excise goods are for the most part sluggish (the exception being petrol and derv) we believe that all the major excises could bear at least indexation in the light of last year's standstill. We do recommend, however, that the minor variants outlined in paragraph 5 be included, whatever the overall shape of your excise package. If your revenue needs mean that you want to go for over-indexation, we think the tobacco and alcohol duties should take the lead, but over-indexation of petrol/derv should cause no particular problems.

Bryce Knox

B H KNOX

ANNEXE A

REVALORISATION at 3.7%

	Price change including VAT on typical item (1)	Yield 1988-89 £m (2)(3)	RPI impact effect (4) %
Beer	0.8p per pint	65	0.04
Cider	0.4p per pint	neg	neg
Wine - table wine	3.1p per 75cl	15	0.02
- sherry	5.0p per 70cl)	5	neg
- port	5.8p per 70cl)		
Spirits	20.1p per 75cl	25	0.03
Tobacco			
- Cigarettes	3.4p per 20 KS	95	0.08
- Cigars	1.9p on 5 whiffs	5	0.01
- Pipe tobacco	2.7p on 25 grams	neg	neg
Petrol			
leaded	3.7p per gallon	195	0.07
unleaded	3.6p per gallon	neg	neg
Minor Oil Duties			
- Fuel oil	0.1p per gallon	neg	nil
- Gas oil	0.2p per gallon	5	nil
Derv(5)	3.2p per gallon	45	neg
VED - cars	£3.70 per year	80	0.03
- other		20	nil
TOTAL		555	0.28

neg = negligible

(1) VAT is payable in addition to the duty except in the case of VED.
(2) Rounded to nearest £5m.
(3) Assuming mid-March Budget .
(4) Based on latest RPI (November).
(5) Most derv consumers can reclaim VAT.
Revenue estimates assume 9% offset for bus fuel grants.

110 0.09
100 0.09
Equivalent per litre
3?5

Duty factor
·04
·02
·03
·08
·01
210 ·18

ANNEXE B

2 x REVALORISATION (7.4%)

	Price change including VAT on typical item (1)	Yield 1988-89 £m (2)(3)	RPI impact effect (4) %
Beer	1.5p per pint	130	0.07
Cider	0.8p per pint	5	neg
Wine - table wine	6.3p per 75cl	35	0.03
- sherry	10.1p per 70cl)	5	0.01
- port	11.6p per 70cl)		
Spirits	40.3p per 75cl	50	0.06
Tobacco			
- Cigarettes	6.9p per 20 KS	195	0.16
- Cigars	3.7p on 5 whiffs	5	0.01
- Pipe tobacco	5.1p on 25 grams	5	neg
Petrol			
leaded	7.5p per gallon	390	0.14
unleaded	7.1p per gallon	10	neg
Minor Oil Duties			
- Fuel oil	0.3p per gallon	5	nil
- Gas oil	0.4p per gallon	10	nil
Derv(5)	6.3p per gallon	90	0.01
VED - cars	£7.40 per year	165	0.06
- other		40	nil
TOTAL		1140	0.55

neg = negligible

(1) VAT is payable in addition to the duty except in the case of VED.
(2) Rounded to nearest £5m.
(3) Assuming mid-March Budget .
(4) Based on latest RPI (November).
(5) Most derv consumers can reclaim VAT. Revenue estimates assume 9% offset for bus fuel grants.

ANNEXE C

REVALORISATION at 3.7% , with minor adjustments

	Price change including VAT on typical item (1)	Yield 1988-89 £m (2)(3)	RPI impact effect (4) %
Beer	0.8p per pint	65	0.04
Cider	0.8p per pint	5	neg
Wine - table wine	3.1p per 75cl	15	0.02
- sherry	5.0p per 70cl)	5	neg
- port	5.8p per 70cl)		
Spirits	20.1p per 75cl	25	0.03
Tobacco			
- Cigarettes	3.4p per 20 KS	95	0.08
- Cigars	1.9p on 5 whiffs	5	0.01
- Pipe tobacco	nil	nil	nil
Petrol			
leaded	3.7p per gallon	190	0.07
unleaded	-1.1p per gallon	neg	neg
Minor Oil Duties			
- Fuel oil	nil	nil	nil
- Gas oil	nil	nil	nil
Derv(5)	3.2p per gallon	45	neg
VED - cars	£3.70 per year	80	0.03
- other		20	nil
TOTAL		550	0.27 (6)

neg = negligible

(1) VAT is payable in addition to the duty except in the case of VED.
(2) Rounded to nearest £5m.
(3) Assuming mid-March Budget .
(4) Based on latest RPI (November).
(5) Most derv consumers can reclaim VAT. Revenue estimates assume 9% offset for bus fuel grants.
(6) Individual items do not sum to total due to rounding.

psl/9A

BUDGET CONFIDENTIAL

FROM: A C S ALLAN
DATE: 14 January 1988

CHIEF SECRETARY
FINANCIAL SECRETARY
PAYMASTER GENERAL
ECONOMIC SECRETARY
SIR P MIDDLETON
SIR T BURNS
SIR G LITTLER
MR ANSON
SIR A WILSON
MR SCHOLAR
MR CULPIN
MR SEDGWICK
MR ODLING-SMEE
MISS EVANS
MR CROPPER
MR TYRIE
MR CALL
MR BATTISHILL - INLAND REVENUE
MR ISAAC - INLAND REVENUE
MR PAINTER - INLAND REVENUE
MR UNWIN - CUSTOMS & EXCISE
MR KNOX - CUSTOMS AND EXCISE

cc PS/IR
Mr P R H Allen - C&E
Mr Mace - IR
(items (i) & (ii))
Mr Jefferson Smith - C&E
(items (iii) & (iv))
Mr Monck)
Mr P Lewis IR) item (ii)
Mr McGivern IR)
Mr Prescott IR)

BUDGET OVERVIEW MEETING: AGENDA FOR FIRST OVERVIEW MEETING ON MONDAY, 18 JANUARY

The first overview meeting will be held on Monday, 18 January at 3.30pm. The agenda is as follows:

(i) Budget scorecard:

Circulated with Mr Culpin's note of 14 January.

(ii) Income Tax Options

Mr Eason's note of 14 January.

(iii) Excise duties

Mr Knox's note of 14 January.

(iv) VAT base

Mr Knox's note of 14 January.

(v) Fringe Benefits

Mr Lewis's note of 14 January.

ACSA

A C S ALLAN

(i) <u>Budget scorecard</u>:

Circulated with Mr Culpin's note of 14 January.

(ii) <u>Income Tax Options</u>

Mr Eason's note of 14 January.

(iii) <u>Excise duties</u>

Mr Knox's note of 14 January.

(iv) <u>VAT base</u>

Mr Knox's note of 14 January.

(v) <u>Fringe Benefits</u>

Mr Lewis's note of 14 January.

ACSA

A C S ALLAN

V2715.14

BUDGET SECRET: BUDGET LIST ONLY

Copy No. 1 of 44
FROM: ROBERT CULPIN
DATE: 14 January 1988

CHANCELLOR OF THE EXCHEQUER

cc PPS/Chancellor
Chief Secretary(2)
Financial Secretary(2)
Paymaster General(2)
Economic Secretary(2)
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Scholar
Mr Sedgwick
Mr Odling-Smee
Miss Evans
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill: IR
Mr Isaac: IR
Mr Painter: IR
Mr Unwin: C&E
Mr Knox: C&E

BUDGET SCORECARD

I attach the first Budget Scorecard which takes account of the Chevening discussions. Table 2 (PSBR Effects) will be incorporated next week.

RC

ROBERT CULPIN

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Additional copies for Scorecard work to:

Miss Sinclair	)	
Mr Riley	)	
Miss Hay	)	
Mr Michie	)	FP
Mr Sparkes	)	
Mr Sedgwick	)	
Mr Davies	)	MP
Mr Bredenkamp	)	
Mr Beighton	)	
Mr Calder	)	
Mr Marshall	)	IR
Mr Ko	)	
Mr McManus	)	
Mr Boyce	)	
Mr Allen	)	C&E
Miss French	)	

BUDGET SECRET

B.L.O.

w/s APA

Re [illegible] –

What [illegible] ?

When [illegible] ?

When [illegible] (i.e. 1988 or 1990)

How much [illegible] FRSs; what [illegible] yield from upper [illegible] on [illegible] scales?

w/s [illegible] FRS payments

Is [illegible] ?

SECRET

SCORECARD OF 14 JANUARY 1988

TABLE 1: DIRECT EFFECTS OF BUDGET MEASURES
assuming a 25p basic rate of income tax

All figures are net of cost or yield of indexation or revalorisation.

Proposal Number	Proposal	Cost(-) or Yield(+) in £ million (rounded to £5 million) 1988-89	1989-90	1990-91
1	Excise Duties	Nil	Nil	Nil
2	VAT Base	+280	+420	+440
3	Reduce basic rate of IT to 25p	-2550	-3200	-3450
4	Increase higher rate IT threshold to £20,000	-220	-420	-500
5	Abolish higher rates of IT above 40p	-840	-1690	-1920
6	Changes to Class 1 NICs at lower end in October 1988	-380	-800	-850
7	Independent taxation from 1990-91	Nil	Nil	-560
8	Exempt first £6,600 gains from CGT, add remaining gains to income and tax at IT rates (25%/40%)	Nil	-50	Neg
9	Rebase CGT to 1982 (cost includes rebasing CT on companies' gains)	Nil	~~-200~~ -100 Late change	-300
10	Restrict MIR to residence basis and leave ceiling unchanged at £30,000	+10	+30	+50
11	Abolish tax relief on home improvement loans	+80	+200	+300
12	Abolish tax relief on new covenants between individuals; change rules for maintenance payments	+35	+100	+160
13	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91	Nil	Nil	*
14	Reduce corporation tax rate to 33p	Nil	Nil	*
15	Reduce small companies' CT rate to 25p in 1988-89	-Neg	-55	-95
16	Raise IHT threshold to £107,000 and set single rate of 40%	-120	-255	-300
17	Minor starters	+25	+25	+20
	TOTAL TAX MEASURES	-3680	~~-5895~~ -5795	-7005

*See notes

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SCORECARD OF 14 JANUARY 1988

TABLE 1A: DIRECT EFFECTS OF BUDGET MEASURES
assuming a 24p basic rate of income tax

All figures are net of cost or yield of indexation or revalorisation.

Proposal Number	Proposal	Cost(-) or Yield(+) in £ million (rounded to £5 million) 1988-89	1989-90	1990-91
1	Excise Duties	Nil	Nil	Nil
2	VAT Base	+280	+420	+440
3	Reduce basic rate of IT to 24p	-3830	-4800	-5170
4	Revalorise higher rate IT threshold to £18,600	Nil	Nil	Nil
5	Abolish higher rates of IT above 40p	-900	-1820	-2080
6	No change to NICs	Nil	Nil	Nil
7	Independent taxation from 1990-91	Nil	Nil	-600
8	Exempt first £6,600 gains from CGT, add remaining gains to income and tax at IT rates (24%/40%)	Nil	-50	+Neg
9	Rebase CGT to 1982 (cost includes rebasing CT on companies' gains) Late change	Nil	~~-200~~ -100	-300
10	Restrict MIR to residence basis and leave ceiling unchanged at £30,000	+10	+30	+50
11	Abolish tax relief on home improvement loans	+80	+200	+300
12	Abolish tax relief on new covenants between individuals; change rules for maintenance payments	+35	+95	+150
13	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91	Nil	Nil	*
14	Reduce corporation tax rate to 33p	Nil	Nil	*
15	Reduce small companies' CT rate to 24p in 1988-89	-Neg	-85	-145
16	Raise IHT threshold to £107,000 and set single rate of 40%	-120	-255	-300
17	Minor starters	+25	+25	+20
	TOTAL TAX MEASURES	-4420	~~-6440~~ -6340	-7635

*See notes

B.L.O.

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Notes to Tables 1 and 1A

All figures show cost (-) or yield (+) in £ million unless otherwise indicated.

Excise Duties

1. The base forecast assumes excise duties revalorised by 3.7 per cent (the inflation rate for the twelve months to December 1987). This would imply the following price increases.

Product	Unit	Price Increase (pence)
Beer	Pint	0.8
Cider	Pint	0.4
Table wine	75cl	3.1
Spirits	75cl	20.1
Cigarettes	20KS	3.4
Cigars	5 whiffs	1.9
Pipe tobacco	25 grams	2.7
Petrol (leaded)	Gallon	3.7
Derv	Gallon	3.2
VED (cars)	-	£ 3.70

If excise duties were not revalorised, RPI inflation would be 0.28 percentage points lower than in the base forecast.

Excise duties papers were submitted on 16 December and 14 January, and a paper on the duty differential between leaded and unleaded petrol on 30 December. These suggest the following departures from revalorisation:

Cider: increased by same pence per pint as beer.
Unleaded petrol: price differential of 10p per gallon. Why?
Gas oil: duty increased by 10 per cent
Pipe tobacco, fuel oil, matches and mechanical lighters, betting and gaming: no change in duty.

This package would have the same RPI effect as revalorisation and cost:

1988-89	1989-90	1990-91
-5	-40	-50

If alcohol and tobacco duties were double revalorised, the yield would be:

	1988-89	1989-90	1990-91
Alcohol	+105	+115	+125
Tobacco	+100	+110	+110

Double revalorisation would add 0.17 percentage points to RPI inflation (alcohol) and 0.17 percentage points (tobacco).

V. odd. This is extra yield, but RPI appears to include what is in the base – the extra is ½ of this

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VAT

2. The base forecast assumes no change in the standard rate and assumes revalorisation by 3.7 per cent of the VAT registration threshold to £22,000 (from £21,300).

The yield shown in Table 1 arises from the changes to the VAT base discussed at Chevening and assumes the changes take effect from 1 May 1988. This would add an estimated 0.19 percentage points to RPI inflation.

The yield from and RPI effect of extending the VAT base to non-domestic construction (from 1 August 1988) and spectacles (from 1 May 1988) would be:

On what basis?

	1988-89	1989-90	1990-91	RPI effect
Construction	+100	+250	+400	Nil
Spectacles	+15	+25	+25	+ 0.01

Specs / Wt persuade go

Income Tax Rates and Personal Allowances

3. The base forecast assumes statutory indexation by 3.7 per cent of the main personal allowances.

Mr Eason's paper of 14 January discusses the option shown in Table 1A, ie a 24p basic rate of income tax, revalorisation of the higher rate threshold to £18,600 and no changes to NICs at the lower end.

A 2p cut in the basic rate would add 0.12 percentage points to RPI inflation; a 3p cut would add 0.18 percentage points.

National Insurance Contributions

6. Assumes Option F (Macpherson 19 October) selected at the meeting on 19 November:

Earnings Bands	NIC rates: Employees now	Employees Oct 1988	Employers now	Employers Oct 1988
Under £41	Nil	Nil	Nil	Nil
£41- £70	5	5	5	5
£70-£105	7	5	7	7
£105-£130	9	5	9	9
£130-£155	9	7	9	9
£155-£305	9	9	10.45	10.45

Costings assume LEL uprated in April 1989 but no uprating of reduced rate bands. Benefit savings would be

1988-89	1989-90	1990-91
+15	+50	less than +50

A further paper on NICs options at the lower end is in preparation.

Independent Taxation

7. Assumes implementation from 1990-91 and:

- Disaggregation of all husband and wife's income
- Introduce Married Couples' Allowance equal to difference between MMA and single allowance with MCA transferable to wife if husband cannot use it fully
- MCA withdrawn gradually when husband's total income exceeds £40,000 (assumes clawback will operate in-year; full year yield of £100 million included in Tables 1 and 1A)
- Disaggregate husband and wife's capital gains with separate exemption of £6,600 each
- Only one CGT residence exemption per couple
- Abolish APA and replace by benefit in 1989-90 (yield not included in Tables 1 and 1A) or review APA entitlement rules to remove tax penalty on marriage
- Transitional protection for breadwinner wives
- Give age allowance only on basis of taxpayer's own age

Capital Gains Tax

8. & 9. These costings are highly provisional and subject to review. They make behavioural assumptions, in particular that the increase in the effective CGT rate reduces disposals in 1989-90 but that this effect diminishes in subsequent years.

Mortgage Interest Relief

10. All costings ignore behavioural effects. They also assume residence basis and any change in ceiling take effect from 6 April 1988. In practice the residence basis and possibly change in ceiling would probably take effect at a slightly later date, eg 1 August 1988.

If the MIR ceiling was instead increased to £35,000 on the residence basis the cost would be:

	1988-89	1989-90	1990-91
25p Basic Rate:	-180	-230	-270
24p Basic Rate:	-170	-220	-260

Covenants and maintenance

12. Assumes abolition of relief on all new covenants between individuals on basis of option 1 in Mr Stewart's paper of 7 January (meeting on 15 January will decide between remaining options). Assumes relief on maintenance payments to divorced/separated spouses only, limited to £2425, and no tax on payee. Consideration being given to ways of avoiding losers among deserted unmarried mothers. See paper by Mr Stewart of 8 January.

Fringe Benefits Tax

13. Assumes non-deductible FBT on employers with comprehensive coverage (with rate to be decided) introduced in 1990-91. Car scales would be increased substantially.

First year receipts depend on payment arrangements for FBT. Options on FBT are discussed in paper by Mr Lewis of 14 January; options on car scales in paper by Miss Rhodes of same date.

ws X

Unattractive (why raise tax to reduce yield?)

quarterly payment desirable

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Corporation Tax

14. It is assumed that the CT rate is cut by 2p to 33p in the year before employers start paying the FBT so that the effects of each are felt at the same time. The timing of the cut in the CT rate thus depends on the payment arrangements chosen for FBT. The cost of a 2p cut in the CT rate would be -neg in the first year, -£800 million in the second year (ie the year when receipts of FBT start) and -£1,100 million in a full year. Timing to be discussed in the paper by Mr Lewis.

Minor Starters

17. See Table 4. Not included in Table 1 are starters which protect existing revenue and are thus already assumed in the base forecast.

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SCORECARD OF 14 JANUARY 1988

TABLE 3: STAFFING EFFECTS[a]

Proposal Number	Proposal	Effect on manpower numbers at April 1989	April 1990	April 199
1	Excise Duties	Nil	Nil	Nil
2	VAT Base[b]	+10	+10	+10
3	Reduce basic rate of IT to 24p or 25p	Nil	Nil	Nil
	Indexation of personal allowances and first higher rate threshold	+10	+70	+70
4	Increase higher rate IT threshold to £20,000	Nil	-60	-60
5	Abolish higher rates of IT above 40p	Nil	Nil	Nil
6	Changes to Class 1 NICs at lower end in October 1988[c]	Nil	Nil	Nil
7	Independent taxation from 1990-91			
	- independent taxation of husband and wife[d]	+420	+770	+1425 to +1475
	- convert APA into benefit[e]	Nil to -125	Nil to -125	Nil to -12
8	Freeze CGT exempt amount	Nil	+10	+10
	Add remaining gains to income and tax at IT rates	Nil	+Neg	+Neg
9	Rebase CGT to 1982	Nil	+5	+5
10	Restrict MIR to residence basis and leave ceiling unchanged at £30,000[f]	+25	+25	+25
11	Abolish tax relief on home improvement loans[g]	-150	-200	-250
12	Abolish tax relief on new covenants; change rules for maintenance payments[h]	-140	-320	-400
13	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91[i]	Nil	+150 to +250	Nil to +15
14	Reduce corporation tax rate to 33p	Nil	Nil	Nil
15	Reduce small companies' CT rate to 25p	Nil	Nil	Nil
16	Raise IHT threshold to £107,000 and set single rate of 40%	-5	-10	-15
17	Minor starters[j]	-75	-100	-100
	No change in stamp duty threshold	+10	+10	+10
	TOTAL[k]	+105	+460	+930

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Notes to Table 3

(a) Health Warning. The conventional assumption used in costing Budget changes is that nothing else is changing at the same time. But there are, of course, other factors which will affect the Revenue's and Customs' manpower over the same period. The correct approach in principle is to take all the changes into account in the order in which they should happen but, among other things, the need to maintain Budget security makes this difficult. So there is a risk of some double counting of both savings and costs. Pluses or minuses could turn out larger or smaller and some figures could change sign. The total is (like the PSBR) the difference between large plus and minus components.

(b) The effect on manpower numbers of extending VAT to non-domestic construction would be an additional 60 units in each of the three years.

(c) Staff effects at DHSS are not known.

(d) Setting up costs - some of the staffing need may be covered by use of overtime and casual staff.

(e) Saving Revenue staff depends on whether APA is converted to one parent benefit, etc. (Policing the increased OPB could require additional DHSS staff.) If APA is retained and the qualifying rules changed to deal with the tax penalty on marriage there could be a staff cost for the Revenue.

(f) If the ceiling is increased to £35,000, there would be a transitional effect on manpower of +65 units in April 1989, falling to +15 in April 1990 and April 1991.

(g) Further staff savings in later years.

(h) Figures under review.

(i) These are setting up costs. Will produce staff savings in later years.

(j) The staff savings shown are entirely accounted for by abolition of minor personal allowances.

(k) Total uses maximum staff additions possible under proposals 7 and 13.

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7-3K

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BUDGET

SCORECARD OF 14 JANUARY 1988

TABLE 4: MINOR STARTERS

(Items in Starters list which Ministers have agreed are now serious contenders, including all those with revenue effects of £5 million or more)

FB Starter Number	Proposal	Cost(-) or Yield(+) in £ million 1988-89	1989-90	1990-91
30	Keith package (Customs & Excise)	Neg	Neg	Neg
34	Tax on supply to be liability of person completing VAT invoice	+5	+5	+5
60	Disclosure of importers' details	Neg	Neg	Neg
61	Search of persons	Nil	Nil	Nil
62	Penalty for customs fraud	Nil	Nil	Nil
63	Prosecution time limits	Neg	Neg	Neg
103	Abolition of minor personal allowances — 1st there	+10	+10	+10
111	Review of S79 unapproved employee share schemes	Neg	Neg	Neg
117	Redundancy payments: top-slicing	Neg	Neg	Neg
118	Premiums for leases: top-slicing	Neg	Neg	Neg
151	Personal pensions: delay in commencement	+10	+10	+Neg
203	Business Expansion Scheme changes/limit		not yet known	
214	Lloyds: RIC leavers	Neg	Neg	Neg
216	Lloyds: reform of assessment system	Neg	Neg	Neg
354	North Sea Fiscal Regime — What are we at on this?		not yet known	
452	Keith package (Inland Revenue)		not yet known	
453	Forestry	Nil	Neg	+5
-	BES: Privated rented sector		not yet known	
	TOTAL	+25	+25	+20

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Note

Not included above are the following minor starters which protect existing revenue and are thus already assumed in the base forecast

213 In-year assessment of Schedule D income

400 S482: company residence and migration

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INLAND REVENUE
STATISTICS DIVISION
SOMERSET HOUSE

FROM: R J EASON

DATE: 14 JANUARY 1988

1. MR CALDER Seen in draft

2. MR ISAAC

3. CHANCELLOR OF THE EXCHEQUER

INCOME TAX OPTIONS

1. This note gives direct revenue costs and an initial distributional analysis of the two options for income tax and NIC proposed at Chevening. The options, which we have called simply Options 1 and 2 are specified for 1988-89 as follows:

---

cc. PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Evans
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Call
Mr Unwin (Customs & Excise)
Mr Knox (" & ")

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

Option 1 Basic rate 25p

A single higher rate of 40p starting at £20,000 taxable income

NIC contributions for employees, starting October 1988

Weekly Earnings (£)	Rate (%)	(previous rate %)
Under 41	Nil	(Nil)
41-70	5	(5)
70-105	5	(7)
105-130	5	(9)
130-155	7	(9)
155-305	9	(9)

Option 2 Basic rate 24p

A single higher rate of 40p starting at £18,600 taxable income

No change to NIC scales

In both options, personal allowances are increased by statutory indexation of the 1987-88 allowances, based on the increase in the RPI from December 1986 to December 1987. The latter is due to be published on Friday, 15 January; latest information suggests that it will show an increase of 3.8 per cent. The higher rate threshold of £18,600 in Option 2 is also based on indexation of 3.8 per cent.

In fact, 3.7%

Costs

2. Estimates of the direct revenue costs of Options 1 and 2, compared with indexation (i.e. on the same basis as the scorecard) are as follows:

	Direct Revenue Costs			
	£ billions			Full year at 1988-89
	1988-89	1989-90	1990-91	income levels
Option 1				
Reduce basic rate by 2p	-2.55	-3.20	-3.45	-2.85
Increase higher rate threshold from £18,600 to £20,000	-0.22	-0.42	-0.50	-0.39
Reduce higher rates to 40p	-0.84	-1.69	-1.92	-1.58
Total Income Tax cost	-3.61	-5.31	-5.87	-4.82
Low level NIC changes from October 1988*	-0.38	-0.80	-0.85	-0.99
Total cost	-3.99	-6.11	-6.72	-5.81
Option 2				
Reduce basic rate by 3p	-3.83	-4.80	-5.17	-4.27
Reduce higher rates to 40p	-0.90	-1.82	-2.08	-1.70
Total Income Tax cost	-4.73	-6.62	-7.25	-5.97

v similar (3% diff)

*Costings assume no uprating of reduced rate bands

Diff 0·74 0·51 0·53 0·16

The total direct revenue costs of Option 1 in 1988-89 are just under £4 billion. This is almost the same as the cost of the main option in the scorecard for Chevening. Costs of Option 1 become considerably higher at £6.1 billion and £6.7 billion in 1989-90 and 1990-91; some £400 million and £900 million higher than the previous package. Option 2 costs about £750 million more than Option 1 in 1988-89 and about £500 million more in subsequent years. All costs exclude social security flowback effects which are expected to be small (although the impact on some individuals will be large).

Distributional Effects

... 3. The graph and tables attached show the distributional effects of Options 1 and 2 for a married man with no reliefs and allowances other than the married man's allowance. Gains at each income level will be less where taxpayers do have further reliefs and allowances. These are the effects of the changes as if they were in place for a full year, although the lower level NIC changes would not be introduced until October 1988. There are no losers under these options (except for the half-million non-taxpaying MIRAS mortgagors whose interest payments would rise).

At Low Incomes

4. Under Option 1, the income tax changes produce steadily increasing gains as incomes rise. However, the reductions in NIC rates by either 2% or 4% for those earning between £70 and £155 per week produce much larger gains. The combined impact is to produce large gains for those earning up to £155 per week (£8,000 per year), but for those with slightly larger incomes the size of the gain is much smaller. For example a single person earning £125 per week will gain £260 in a full year from the reduction in NIC rate of 4 per cent and about £80 from the basic rate cut, giving a total of £340. By contrast, a married man on earnings of £180 per week does not benefit from the NIC changes and his gain will be about £110 in a full year from the basic rate cut. The tables show this irregular pattern of gains against indexation, against the 1987-88 regime, and as the percentage increase in after tax income. Under Option 2, gains increase steadily with the basic rate cut of 3p so that the married man on £180 per week gains £162 per annum. Neither option helps people with incomes below the tax thresholds (£48.50 per week for single people, £75.90 for married) unless they earn more than £70 per week when they will benefit from the NIC changes in Option 1.

At Middle Incomes

5. For basic rate taxpayers earning more than £155 per week, the gains, compared with indexation, under Option 1 increase from about £80 to £372 for those with taxable income at the basic rate limit of £18,600 under indexation. A married man with no reliefs other than the married allowance on average male earnings in 1988-89 (forecast to be £244.70 per week) would gain £175.59 per annum from the basic rate cut (£3.38 per week). His gain from indexation would be 78p per week, giving a total of £4.16 per week. Under Option 2, the extra 1p reduction in the basic rate increases the gain against indexation by 50 per cent.

At High Incomes

6. For the 200,000 tax units with taxable incomes between £18,600 and £20,000, the two Options have different impacts. Under Option 1 they would be liable at only the basic rate and they would gain over £372 from the basic rate cut of 2p and the increase in the higher rate threshold. Under Option 2 these tax units remain liable at the higher rate of 40p (as they would under indexation) but their gain from the 3p cut in the basic rate is over £588.

7. At the highest incomes, the gains from Option 1 and 2 are very similar because the lower level of the higher rate threshold in Option 2 roughly offsets the benefit of the extra 1p cut in the basic rate. Both options produce very large gains because of the 20 point reduction in the rate of tax. Against the 1987-88 regime gains of over £1,000 are obtained by married man with incomes over £30,000 and gains of over £10,000 are made by those with incomes over £90,000. In terms of after-tax income, the gains amount to increases of over 10 per cent at £45,000 and 20 per cent at £70,000 for married men with no reliefs.

8. An indication of the numbers of taxpayers who would obtain large gains can be obtained from the table below.

Taxable Income lower limit	Tax Units in range	Tax Units above lower limit	Approximate Gains at lower limit compared with indexation
£ per year	000s	000s	£ per year
25,000	338	861	700
30,000	275	523	1,100
40,000	108	248	2,500
50,000	86	140	4,500
70,000	31	54	8,500
100,000	23	23	14,500

Average Rates of Tax and NIC

9. In 1987-88 average rates of tax and NIC for a married man are higher than in 1978-79 at income levels up to about 80% of average earnings. Under Option 1, average rates are substantially reduced compared with 1987-88 and only exceed 1978-79 levels for a small band of earnings around £155 per week. This is the result of the changes to NIC at the lower end. Under Option 2, average rates of tax and NIC remain above 1978-79 levels below around 60% of average earnings.

as 1/2 avge earnings

Higher Rate Taxpayers

10. Estimates of the numbers of higher rate tax units are set out below.

as 2 given tax units?

	1987-88	1988-89	1989-90	1990-91
				millions
Indexation	1.17	1.34	1.47	1.60
Option 1		1.11	1.22	1.36
Option 2*		1.32	1.42	1.57

*The small difference from indexation arises because there are more cases where wife's earnings election is beneficial.

11. Option 1 reduces the number of higher rate tax units in 1988-89 and subsequently by about 230,000. Under Option 2 (and indexation) the number in 1988-89 would be at its highest level since 1976-77, about 100,000 short of that record level.

Variations to Options 1 and 2

12. For illustration, we have also looked at some variants of the main options.

(a) Raising the higher rate threshold in Option 1 to £22,000 would reduce the number of higher rate taxpayers by a further 200,000, to about 900,000 in 1988-89, but at a full year cost of some £300 million (about £170 million in 1988-89). It would increase the gains of everyone with taxable income above that level by £300 per annum (15% of £2,000).

(b) Raising the higher rate threshold in Option 2 to £20,000 would reduce the number of higher rate taxpayers by 210,000, cost about £280 million in a full year (£160 million in 1988-89) and increase gains above that level by £224 per annum.

(c) Increasing the higher rate from 40p to 45p would reduce gains by £500 for every £10,000 of income taxed at the higher rate. It would reduce the cost of the Options by about £700 million in a full year (£390 million in 1988-89). It would however have implications for the CGT package.

Summary

13. This preliminary analysis of Options 1 and 2 shows the following features:-

(a) the costs profile increases significantly over the 3 years;

(b) the pattern of gains under Option 1 for those below average earnings is irregular; but average rates of tax and NIC at low levels of earnings are substantially reduced;

Cost in 88 – but see table on p3

(c) Option 2 is significantly more costly, with the middle income groups deriving the benefit;

(d) at the highest levels of incomes, taxpayers gains will be very large;

(e) under both indexation and Option 2, the number of higher rate taxpayers in 1988-89 will approach the record levels of 1976-77.

R J EASON

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

TABLE 1

Yearly income(£)	OPTION 1	OPTION 2
3000	.00	.00
4000	81.10	1.65
5000	121.10	31.65
6000	281.10	61.65
7000	201.10	91.65
8000	241.10	121.65
9000	101.10	151.65
10000	121.10	181.65
15000	221.10	331.65
20000	321.10	481.65
25000	582.00	558.00
30000	824.75	800.75
35000	1307.50	1283.50
40000	1875.25	1851.25
45000	2625.25	2601.25
50000	3528.00	3504.00
60000	5528.00	5504.00
70000	7528.00	7504.00
80000	9528.00	9504.00
90000	11528.00	11504.00
100000	13528.00	13504.00

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

Yearly income(£)	OPTION 1	OPTION 2
3000	.00	.00
4000	121.60	42.15
5000	161.60	72.15
6000	321.60	102.15
7000	241.60	132.15
8000	281.60	162.15
9000	141.60	192.15
10000	161.60	222.15
15000	261.60	372.15
20000	361.60	522.15
25000	773.25	749.25
30000	1063.50	1039.50
35000	1563.50	1539.50
40000	2208.75	2184.75
45000	2959.00	2935.00
50000	3959.00	3935.00
60000	5959.00	5935.00
70000	7959.00	7935.00
80000	9959.00	9935.00
90000	11959.00	11935.00
100000	13959.00	13935.00

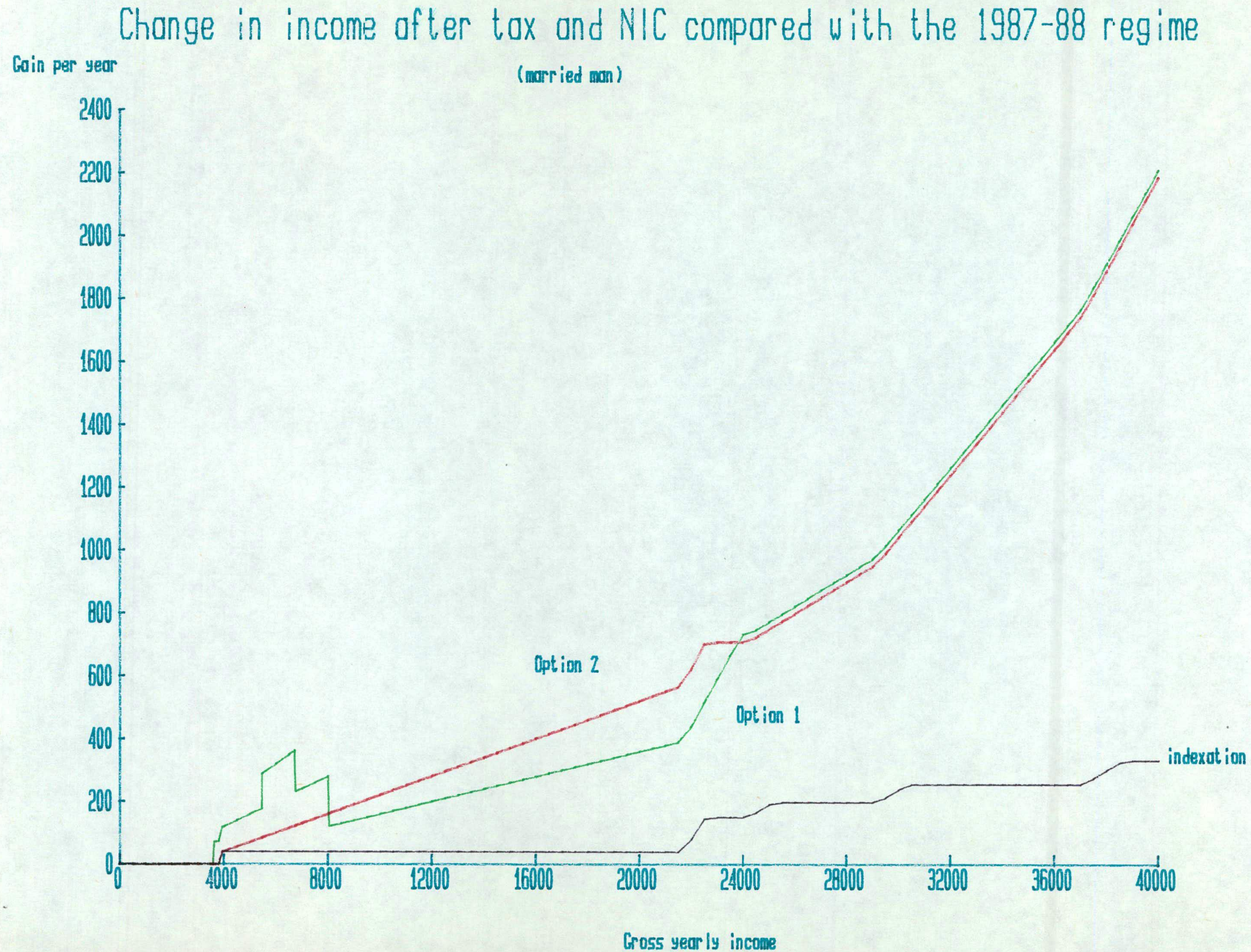
TABLE 2

Percentage change in income after tax and NIC
compared with indexation
(married man)

Yearly income(£)	OPTION 1	OPTION 2
3000	.0	.0
4000	2.2	.0
5000	2.8	.7
6000	5.7	1.3
7000	3.6	1.7
8000	3.9	2.0
9000	1.5	2.2
10000	1.6	2.4
15000	2.1	3.1
20000	2.3	3.4
25000	3.3	3.2
30000	4.1	3.9
35000	5.7	5.6
40000	7.4	7.3
45000	9.5	9.5
50000	11.9	11.8
60000	16.4	16.4
70000	20.0	19.9
80000	22.9	22.8
90000	25.3	25.2
100000	27.3	27.2

Percentage change in income after tax and NIC
compared with the 1987-88 tax regime
(married man)

Yearly income(£)	OPTION 1	OPTION 2
3000	.0	.0
4000	3.3	1.2
5000	3.7	1.7
6000	6.6	2.1
7000	4.4	2.4
8000	4.6	2.6
9000	2.1	2.8
10000	2.2	3.0
15000	2.5	3.5
20000	2.5	3.7
25000	4.4	4.3
30000	5.3	5.2
35000	6.9	6.8
40000	8.9	8.8
45000	10.9	10.8
50000	13.6	13.5
60000	18.0	17.9
70000	21.4	21.3
80000	24.2	24.1
90000	26.5	26.4
100000	28.4	28.3


Change in income after tax and NIC compared with the 1987-88 regime
Gain per year
(married man)
2400
2200
2000
1800
1600
1400
1200
1000
800
600
400
200
0
Option 2
Option 1
indexation
0
4000
8000
12000
16000
20000
24000
28000
32000
36000
40000
Gross yearly income

LEWIS TO CH. 14 JAN

Inland Revenue

Policy Division
Somerset House

COPY NO 1 OF 38

FROM: P LEWIS
DATE: 14 JANUARY 1988

Chancellor

FBT - OVERVIEW 18 JANUARY

1. I attach the following papers

- FBT and cars (Angela Rhodes)
- FBT: coverage (Michael Prescott)
- FBT: rate/yield/ct RATE (myself)
- FBT: payment dates (myself)

2. You have already formed (with the Financial Secretary) some preliminary views on the complex questions on FBT coverage. Even so, there is a lot of material here for decision at the tail-end of an overview meeting, and further discussions may be necessary.

3. But it would certainly be useful to look at all these topics together on Monday so far as possible because they are all inter-related.

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cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Odling-Smee
Miss Sinclair
Mr Riley
Mr Michie
Miss Evans
Mr Cropper
Mr Tyrie
Mr Call
Mr Jenkins (OPC)
Mr Unwin (Customs and Excise)
Mr Knox (Customs and Excise)
Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr McGivern
Mr Lewis
Mr Prescott
Miss Rhodes
Mr Reed
Mr Northend
Mr Hodgson
Mr R H Allen
Mr I Stewart
PS/IR

4. In going on from a decision on the FBT rate to look at the yield and burden on employers and the implications of that for the corporation tax rate, account will need to be taken of

- any radical changes to the car scales and
- decisions on coverage, (both affecting the yield),
- decisions on the due dates of payment of FBT which would affect the timing of the CT reduction and, perhaps, its magnitude.

5. I hope the note on FBT rate/yield/CT rate will enable you to see the way forward on the CT rate a little more clearly; but a further note picking up all the yield/timing implications of decisions on the other papers may be necessary before you can reach a final view on the implications of FBT for the CT rate.

Peter Lewis

P LEWIS

Inland Revenue

Policy Division
Somerset House

xxx Some worth-, benefits some not
exemptions? or rates of tax?

FROM: M PRESCOTT
DATE: 14 JANUARY 1988

FBT

[Cost of benefits plus [illegible] taxable profits [illegible] before tax?]

FBT COVERAGE

CHANCELLOR

FRINGE BENEFITS TAX: COVERAGE

1. You and other Treasury Ministers are to consider the outstanding points on Coverage, in the light of comments and recommendations from the Financial Secretary's (his minute to you of 22 December). This note is by way of an annotated agenda for that meeting.

2. Annex A attached provides a check list of the benefits and expenses payments referred to in the Financial Secretary's minute, and shows the present position (ie whether the benefit is exempted, and if so how, or taxed), and in one or two cases gives an estimate (very rough) of the possible total value of the benefit in question. For completeness, we also touch below on various other benefits and expenses payments which are also exempted at present (either statutorily, or by Extra Statutory Concession (ESC)) and which, on the assumption that they too are to be retained, would need to be picked up and exempted from FBT as well.

3. Also attached - Annex B - is a note which considers how benefits like subsidised canteens, workplace nurseries and sports facilities might be valued for FBT purposes, assuming these benefits are to be included. We have hitherto assumed that the measure to be used would be the true value of the benefit, including any subsidy from the employer in respect of indirect fixed costs such as accommodation etc and not just any subsidies in respect of the direct, variable costs such as - in the case of a canteen - wages of the canteen staff and the cost of food and ingredients. As indicated in the note, however, a number of arguments might be adduced for excluding subsidies in respect of such indirect costs, so making it possible to scale down the measure of the benefit in these cases. However,

whether or not this was an option would depend on what view Ministers took about the credibility and persuasiveness of the arguments in question.

Canteens, LVs and directors' lunches

4. Item 1 of the check list, and paragraphs 4-6 of FST's note refer.

5. Points for decision

(a) Is it agreed, as suggested by FST, that these three exemptions hang together, so that if one is dropped they should all be?

(b) Should canteens be included in FBT and the associated ESCs dropped? If so

(c) should they be valued on the basis of full costs or excluding any subsidy in respect of indirect costs

"On-site" sports facilities and work place nurseries

6. These are similar to canteens in that they are all (more or less) collectively provided benefits, and if exemption were to apply it would be restricted to cases where the benefit was provided on the employer's own premises. On the other hand, there is already a statutory exemption for canteens, but not for sports facilities or nurseries.

7. Points for decision

(a) Should they be included or excluded from FBT?

(b) If included, as for canteens, what should be the basis of valuation?

Car parking

8. Points for decision: Though there again certain similarities between this and other collectively provided on-site benefits, is it agreed as recommended by FST that this benefit should be excluded from FBT? Is it also agreed that the benefit of car parking paid for or provided off the employer's own business premises should be included in FBT?

Entertainment and Gifts under £100

9. Items 5 and 6 of the check list, and paragraph 13(3) and (iv) of FST's note refer.

10. Points for decision: Is it agreed, as recommended by FST, that

(a) the recently announced exemptions for third party entertainment and gifts up to £100 should be carried over in to FBT?

(b) entertainment and gifts provided by the employer himself should be taxable under FBT (except where the employee would have been entitled to an expenses deduction), and continue to be a disallowable expense of the employer? and

(c) as a consequence of (b), that the present £35 a head exemption in respect of Christmas parties - given by way of ESC - should cease and not be carried over in to FBT?

Accommodation and related benefits

11. There are number of different benefits that can be grouped under this heading - see item 7 of check list.

12. No decisions are required at this stage on the future of the two ESCs - at 7(a) - which relate respectively to certain

removals and additional housing costs expenses incurred by an employee who is required to move as part of his job. It has already been decided that these concessions should be reviewed after the Budget, though of course it will be necessary to say as much.

13. The next four items - 7(b)-(d) - are linked statutory exemptions concerning benefits in respect of provided accommodation. The present statutory rules for valuing the benefit of non-exempted provided accommodation need changing anyway because of the phasing out of domestic rates and the introduction of Community Charge, and we are preparing a separate paper for the Financial Secretary about this. We shall also in that paper consider whether these residual exemptions - some of which are now somewhat obscure and difficult to justify - should be retained and carried over in to FBT, or dropped.

14. The remaining three items under this head - 7(e)-(g) - concern certain heating, lighting and other expenses of "lower paid" clergymen who live in provided accommodation, and board and lodging provided to "lower paid" agricultural workers who nevertheless have an entitlement to a higher cash wage in lieu and who strictly speaking, therefore, ought to be taxed on the benefit.

15. FST has recommended that the two exemptions provided by ESC should be dropped under FBT. The third, statutory exemption is on a par with these and logically should be dropped as well.

16. A further argument in support of dropping all three exemptions is that under FBT there will be no "earnings threshold" - FBT will apply to all benefits, not just to those provided to directors and "higher paid" employees. If these concessions were retained, therefore, it would either be necessary to retain the earnings threshold just for this purpose, or to extend the exemption to people who have not benefited in the past - ie "higher paid" employees.

17. Point for decision

(a) Is it agreed that these three exemptions in respect of clergymen and agricultural workers should not be carried forward to FBT? (As noted the first of them is covered by a statutory exemption and that would need to be repealed; the other two are given by way of ESC and these could simply be withdrawn).

Miners free coal

18. Item 8 of check list, and paragraph 10 of FST's note refer.

19. On the basis of firm figures recently obtained from British Coal, we now know that virtually all of the 98,000 serving employees currently in receipt of this benefit do actually get coal or smokeless fuel. Only 532 get cash in lieu, mainly on health grounds. (There are a further 285,000 people getting the benefit - 80% of whom get coal - but these are former workers or their widows, and the benefit in those cases would not be taxable anyway).

20. As regards those serving employees who get cash instead of coal, you asked (Mr Taylor's note of 4 January) whether it would not make more sense simply to tax the employee on the benefit under Schedule E, and only apply FBT to cases where the employee is getting coal or fuel. This difference in treatment would, of course, be possible. However, it would mean that the 500 odd employees affected would be the only employees in the entire country whose personal tax bill actually increased as a result of the introduction of FBT! And, as noted, these people only get cash in lieu for special - largely medical - reasons. You may feel, therefore, that for these reasons and because this is such a tiny minority of the total anyway, it would be better to apply FBT in all cases.

21. Point for decision: Is it agreed that the concessionary exemption in respect of miners free coal should not be carried

over to FBT, and that FBT should apply to all such benefits including cases of cash in lieu?

Other concessionary exemptions reviewed by FST

22. These are listed at item 9 of check list.

23. Points for decision: Is it agreed that, as recommended by FST, all of these exemptions should be carried over into FBT?

Miscellaneous

24. In addition to canteens, there are a number of benefits for which there is a statutory exemption from IT and which we assume Ministers will want to be exempted from FBT as well. Because FBT will be a new tax, there will need to be explicit provisions for this. The benefits involved here include

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

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

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

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

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

25. Point for decision: Is it agreed that all of the above benefits should similarly be exempt from FBT?

26. For completeness, I should mention that there is one other ESC, and an administrative practice with a concessionary element which, on the assumption that they are to be retained, would be affected by FBT. These are

(a) ESC A65 - relating to the benefit of free transfers to and from the mainland for workers on offshore oil and gas rigs or platforms (technically, such journeys are part of "home to work" travel and, therefore, under normal rules, taxable)

(b) Construction and Allied Industries "Working Rule Agreements" (WRA). Strictly, these are agreements between employers and employees, and cover matters such as accommodation allowances and/or travelling expenses for employees working at sites far away from their home/normal place of work. As a matter of administrative convenience, we allow the employer to pay these expenses wholly or partly tax-free on the grounds that in many cases the individual would be entitled to an offsetting deduction anyway. Where this is not the case, however, the practice will contain a concessional element. But this will vary as between the 28 or so separate Agreements and as between one employee and another under the same agreement, and for this reason it is simply not practicable to set this out as a formal ESC (though the practice is mentioned in the IR publication of ESCs), let alone on a full statutory basis.

27. Points for decision: Is it agreed that

- the exemption for oil rigs workers should carry over to FBT?

- as regards any concessional element in the WRA practice, the general principle under FBT should be that of a "mirror image" - ie such that only those amounts which at present are taxable on the employee would be chargeable on the employer under FBT?

FORM IN WHICH CONCESSIONARY EXEMPTIONS TO BE CARRIED OVER TO FBT

28. For those exemptions at present covered by ESC which are to be carried over to FBT, the question is then whether this should be done by

- putting the concession on to a full statutory basis

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

29. As mentioned by the Financial Secretary in his note, the statutory route would be the more defensible given that ESCs ought in principle to be put onto a statutory footing when the opportunity arises. This obviously means that the legislation would be that bit more complicated, and there would thereby also be an opportunity created for debate on the particular exemptions in question. (On the other hand, if the ESC route was adopted, it would still be necessary for the Government to announce its intention concerning these exemptions). And in some cases it may not be all that easy to frame the exemption in the sort of clear and unambiguous way that is necessary when setting things down in statute.

rd.

30. As a general rule, however, it seems preferable wherever practicable that we should opt for the statutory route. Is this agreed?

M. Prescott

M PRESCOTT

ANNEX A

ANNEX A

FBT: COVERAGE

	BENEFIT etc	**Present position***	**Estimated total value of benefit**
1.	**Subsidised canteens** where meals provided for staff generally on premises ..	S	£2bn - highly tentative and would need checking carefully, but based on figures quoted by LV Ltd - 6m employees receiving at least one subsidised meal a day at average subsidy of £1.50. Allowing for LV Ltd's estimates of subsidy towards fixed costs as well, figure would roughly treble.
	.. or off the premises if rest of staff given LVs up to value of 15p a day and no more.	ESC - unpublished	
	Luncheon Vouchers up to 15p a day.	ESC	£20m: Based on LV Ltd figures suggesting ½m employees receive 15p LV per working day.
2.	**Sports facilities** (on premises owned/leased by employer)	T/NT	N/A
3.	**Workplace nurseries**	T	£5m - Based on estimated 2000 places at average cost of £2500
4.	**Carparking** (on premises owned/leased by employer)	T/NT	Estimate that approx 4.5m employees get employer provided parking, on and off premises. Assuming only 50% on own premises (probably higher) and average annual value of, say, £100, total value would be £200m.

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

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

	BENEFIT etc	Present position*	Estimated total value of benefit
	(d) Payments to clergymen living in provided accommodation owned by a charity/ ecclesiastical corporation in respect of statutory amounts payable payable in connection with property (eg rates, maintenance requirements etc), and	S	"
	(e) ... Value, in case of a "lower paid" clergyman, of provision of living accommodation for him in the premises concerned.	S	
	(f) Heating, lighting, etc, bills of "lower paid" clergymen living in and performing duties from accommodation owned/leased by charity or ecclesiastical corporation.	ESC	
	(g) Board and lodging provided to "lower paid" agricultural workers even where they have entitlement to take a higher cash wage in lieu.	ESC	
8.	**Miners free coal**	ESC	£50m - estimate based on B. Coal figures for number of recipients and average entitlement.

9. **Other ESCs reviewed by FST**

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

- extra home to work travel costs incurred by employee when public transport disrupted and borne by employer
- long service awards (eg gold watch)
- expenses of certain externally provided training courses borne by employer.

ANNEX B

Annex B

FBT: VALUATION OF CANTEENS AND SIMILAR BENEFITS

1. Benefits such as canteens, sport facilities and car parking that are provided collectively, and on premises owned or leased by the employer, are at present either statutorily exempt from tax (some canteens), exempt extra statutorily (other canteens), or are not in practice taxed because of difficulties in determining the value of the benefit and/or because the amounts involved on an individual basis will usually be small anyway. Car parking provided on the employer's premises is to be excluded from FBT, but on the assumption that Ministers do decide to include other collectively provided "in house" benefits like canteens, sport facilities, work place nurseries, etc, it is perhaps worth pausing to consider the question of the valuation rules for these benefits.

2. Specifically, while the measure of the benefit will obviously include the cost to the employer of any subsidy towards the direct, variable costs of the facility (eg in the case of a canteen, the cost of the food and ingredients, and the wages of the canteen staff), it is for consideration whether it should also include any subsidy by way of indirect, fixed costs borne by the employer such as the cost of the accommodation itself, maintenance, insurance, heating and lighting, and so on.

3. There are a number of considerations and possible arguments that might be deployed in favour of excluding any such subsidy in respect of indirect costs. They are

(a) If the subsidy in respect of indirect costs is included, it may in many cases add substantially to the measure of the benefit and so to the employer's FBT bill. That would make the extension of FBT to collective benefits of this kind more controversial than otherwise. This will of course depend on the facts (location of the premises, size of the facilities in question, etc) in each particular case, but the amounts involved could be substantial. For example, in some material the company promoting luncheon vouchers in this country sent us recently they quote figures suggesting that the average daily subsidy in staff canteen in Britain is £1.50, and that the total subsidy per meal increases to £4 if the cost of rent/rates is taken into account.

(b) As a matter of <u>perception</u>, many employers - and their employees - may simply not regard the contribution of eg accommodation as part of the benefit.

(c) Arguably, there would in any event be a case for taking a more relaxed view over this kind of collectively provided benefit, on social and "good employer" grounds and/or where there are no alternative outside lunching facilities close by; this in contrast to benefits given on an individual basis which are difficult to view other than as another form of remuneration.

(d) One of the options open to employers when FBT is introduced will be to cash out the benefits and, where this is possible, FBT can be presented as a voluntary tax which employers can avoid if they wish. But in practice it would be more difficult with collectively provided benefits to phase them out for some employees but not others - and indeed a qualifying condition for exemption would be that these benefits should be provided on similar terms to all employees. Reducing the measure of the benefit by excluding any subsidy in respect of accommodation etc would at least mitigate the size of the adjustment problem for employers in these cases.

4. There are also resource implications for employers and ourselves. While all employers are likely to know what is the cost to them of any subsidy towards the direct costs of a staff canteen etc, and of overheads such as accommodation for the business as a whole, they may not necessarily know the proportion of fixed costs that should properly be apportioned to the facility in question - particularly in the case of smaller companies, or where the accommodation comprises part of the main business premises as distinct from eg a sports club occupying separate premises. This could no doubt usually be ascertained, but this might well involve the companies concerned in extra work - contrary to the Government's wider deregulation objectives. Moreover, there is no single, universally applicable or correct way of apportioning this kind of cost, and there would in some cases be considerable scope for argument about this.

5. Moreover, there are perhaps as many as one million properties with one or more such facilities (this includes those with car parking) and we clearly could not produce separate valuations - ie based on the existing or the new Rating Valuation Lists, or on individual rental valuations for each item - except at very heavy resource cost for the Valuation Office; bearing in mind also that this would be happening at a time when the VO was at full stretch anyway defending the New Valuation List. In practice, therefore, we would have to rely on a form of self-assessment by companies on a current use annual value basis, subject to sampled checking of the property element by District Valuers. This would obviously make the resources problem more manageable but there would still be some extra cost. It would also be necessary to set out in some detail the rules to be followed if a company valuation was to be acceptable, but again there would in practice be numerous "problem cases" that would inevitably both complicate the rules and give rise to scope for argument.

6. Against all this, there are some fairly obvious arguments for not excluding any subsidy in respect of the indirect costs. The main arguments are

(a) The true measure of the benefit clearly is that which takes account of all subsidies from the employer, not just those in respect of direct variable costs.

(b) Any employer with even the most rudimentary cost and management accounts will be able - and indeed, will usually want for his own purposes - to put a figure on the cost of any subsidy in respect of overheads like accommodation etc; and, although there are different ways in which this might be done and there would undoubtedly sometimes be scope for argument, it should often be possible to accept the employer's figures where these seemed reasonable, without further ado.

(c) One of the advantages claimed for FBT is that it will make it easier than under the present system to tax benefits such as this; having decided to switch to an FBT, it might seem perverse to start scaling down the measure of the benefit being taxed.

(d) In practice, the distinction between indirect or fixed costs on the one hand, and direct or variable costs on the other will not always be clear cut, and there might be some awkward cases at the margin - ie where exactly the line should be drawn. For example, in addition to the obvious indirect costs like accommodation, it would be necessary to decide on which side of the line to put heating and lighting (which may or may not be metered separately), insurance, maintenance, and various other overheads like any support from the company's accounts department in drawing up the accounts of the canteen, sports club, or whatever.

7. Ministers would also want to be sure of being able to hold the line as between this kind of case and other cases where we certainly would want to argue for full cost. An example might be provision of free cars by eg Fords to their employees. We would certainly want to resist any argument that the value of the benefit did not include anything for fixed costs like those in respect of the factory, machinery, research and design and perhaps even labour force, and that it included only the direct, additional costs of the extra materials etc used in producing that particular car. But, having conceded the principle for benefits like canteens it would be that much more difficult to resist its extension elsewhere.

CONCLUSION

8. There is no doubt that the true measure of the benefit in these cases should take account of any subsidy in respect of indirect costs such as accommodation, and not just any subsidy for the direct costs - ie in just the same way that the true measure of car benefits needs to take account of the standing, fixed cost of the car and not just the variable running costs, or that the true measure of provided accommodation needs to take account not just of anything the employer might pay towards maintenance of the property, but also the underlying rental value of what is being provided.

9. On the other hand, extension of FBT to include collectively provided benefits like canteens and sports facilities will no doubt provoke criticism over and above the controversy that FBT is likely to provoke more generally and there could be resource implications for employers and ourselves. Restricting the measure of the benefit to subsidies in respect of direct, variable costs only might help to temper some of those criticisms and concerns. Whether or

not to adopt this course, however, would depend on whether or not Ministers considered the arguments at paragraphs 3-5 above to be persuasive, and to outweigh those at paragraphs 6 and 7.

PB1/9A

PMG 15 JAN 1988 -5

BUDGET CONFIDENTIAL

FROM: A C S ALLAN
DATE: 14 January 1988

CHIEF SECRETARY
FINANCIAL SECRETARY
PAYMASTER GENERAL
ECONOMIC SECRETARY
SIR P MIDDLETON
SIR T BURNS
SIR G LITTLER
MR ANSON
SIR A WILSON
MR SCHOLAR
MR CULPIN
MR SEDGWICK
MR ODLING-SMEE
MISS EVANS
MR CROPPER
MR TYRIE
MR CALL
MR BATTISHILL - INLAND REVENUE
MR ISAAC - INLAND REVENUE
MR PAINTER - INLAND REVENUE
MR UNWIN - CUSTOMS & EXCISE
MR KNOX - CUSTOMS AND EXCISE

cc PS/IR
Mr P R H Allen - C&E
Mr Mace - IR
(items (i) & (ii))
Mr Jefferson Smith - C&E
(items (iii) & (iv))
Mr Monck)
Mr P Lewis IR) item (ii)
Mr McGivern IR)
Mr Prescott IR)

BUDGET OVERVIEW MEETING: AGENDA FOR FIRST OVERVIEW MEETING ON MONDAY, 18 JANUARY

The first overview meeting will be held on Monday, 18 January at ~~3.30pm~~ 3.00pm. The agenda is as follows:

(i) Budget scorecard:

Circulated with Mr Culpin's note of 14 January.

(ii) Income Tax Options

Mr Eason's note of 14 January.

(iii) Excise duties

Mr Knox's note of 14 January.

(iv) VAT base

Mr Knox's note of 14 January.

(v) Fringe Benefits

Mr Lewis's note of 14 January.

ACSA

A C S ALLAN

Copy No. 2 of 44
FROM: ROBERT CULPIN
DATE: 14 January 1988

CHANCELLOR OF THE EXCHEQUER

cc PPS/Chancellor
Chief Secretary(2)
Financial Secretary(2)
Paymaster General(2)
Economic Secretary(2)
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Scholar
Mr Sedgwick
Mr Odling-Smee
Miss Evans
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill: IR
Mr Isaac: IR
Mr Painter: IR
Mr Unwin: C&E
Mr Knox: C&E

BUDGET SCORECARD

I attach the first Budget Scorecard which takes account of the Chevening discussions. Table 2 (PSBR Effects) will be incorporated next week.

RC

ROBERT CULPIN

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Additional copies for Scorecard work to:

Miss Sinclair Mr Riley Miss Hay Mr Michie Mr Sparkes Mr Sedgwick	FP
Mr Davies Mr Bredenkamp	MP
Mr Beighton Mr Calder Mr Marshall Mr Ko Mr McManus Mr Boyce	IR
Mr Allen Miss French	C&E

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SCORECARD OF 14 JANUARY 1988

TABLE 1: DIRECT EFFECTS OF BUDGET MEASURES
assuming a 25p basic rate of income tax

All figures are net of cost or yield of indexation or revalorisation.

Proposal Number	Proposal	Cost(-) or Yield(+) in £ million (rounded to £5 million) 1988-89	1989-90	1990-91
1	Excise Duties	Nil	Nil	Nil
2	VAT Base	+280	+420	+440
3	Reduce basic rate of IT to 25p	-2550	-3200	-3450
4	Increase higher rate IT threshold to £20,000	-220	-420	-500
5	Abolish higher rates of IT above 40p	-840	-1690	-1920
6	Changes to Class 1 NICs at lower end in October 1988	-380	-800	-850
7	Independent taxation from 1990-91	Nil	Nil	-560
8	Exempt first £6,600 gains from CGT, add remaining gains to income and tax at IT rates (25%/40%)	Nil	-50	Neg
9	Rebase CGT to 1982 (cost includes rebasing CT on companies' gains)	Nil	-200	-300
10	Restrict MIR to residence basis and leave ceiling unchanged at £30,000	+10	+30	+50
11	Abolish tax relief on home improvement loans	+80	+200	+300
12	Abolish tax relief on new covenants between individuals; change rules for maintenance payments	+35	+100	+160
13	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91	Nil	Nil	*
14	Reduce corporation tax rate to 33p	Nil	Nil	*
15	Reduce small companies' CT rate to 25p in 1988-89	-Neg	-55	-95
16	Raise IHT threshold to £107,000 and set single rate of 40%	-120	-255	-300
17	Minor starters	+25	+25	+20
	TOTAL TAX MEASURES	-3680	-5895	-7005

*See notes

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SCORECARD OF 14 JANUARY 1988

TABLE 1A: DIRECT EFFECTS OF BUDGET MEASURES
assuming a 24p basic rate of income tax

All figures are net of cost or yield of indexation or revalorisation.

Proposal Number	Proposal	Cost(-) or Yield(+) in £ million (rounded to £5 million) 1988-89	1989-90	1990-91
1	Excise Duties	Nil	Nil	Nil
2	VAT Base	+280	+420	+440
3	Reduce basic rate of IT to 24p	-3830	-4800	-5170
4	Revalorise higher rate IT threshold to £18,600	Nil	Nil	Nil
5	Abolish higher rates of IT above 40p	-900	-1820	-2080
6	No change to NICs	Nil	Nil	Nil
7	Independent taxation from 1990-91	Nil	Nil	-600
8	Exempt first £6,600 gains from CGT, add remaining gains to income and tax at IT rates (24%/40%)	Nil	-50	+Neg
9	Rebase CGT to 1982 (cost includes rebasing CT on companies' gains)	Nil	-200	-300
10	Restrict MIR to residence basis and leave ceiling unchanged at £30,000	+10	+30	+50
11	Abolish tax relief on home improvement loans	+80	+200	+300
12	Abolish tax relief on new covenants between individuals; change rules for maintenance payments	+35	+95	+150
13	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91	Nil	Nil	*
14	Reduce corporation tax rate to 33p	Nil	Nil	*
15	Reduce small companies' CT rate to 24p in 1988-89	-Neg	-85	-145
16	Raise IHT threshold to £107,000 and set single rate of 40%	-120	-255	-300
17	Minor starters	+25	+25	+20
	TOTAL TAX MEASURES	-4420	-6440	-7635

*See notes

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Notes to Tables 1 and 1A

All figures show cost (-) or yield (+) in £ million unless otherwise indicated.

Excise Duties

1. The base forecast assumes excise duties revalorised by 3.7 per cent (the inflation rate for the twelve months to December 1987). This would imply the following price increases.

Product	Unit	Price Increase (pence)
Beer	Pint	0.8
Cider	Pint	0.4
Table wine	75cl	3.1
Spirits	75cl	20.1
Cigarettes	20KS	3.4
Cigars	5 whiffs	1.9
Pipe tobacco	25 grams	2.7
Petrol (leaded)	Gallon	3.7
Derv	Gallon	3.2
VED (cars)	-	£ 3.70

If excise duties were not revalorised, RPI inflation would be 0.28 percentage points lower than in the base forecast.

Excise duties papers were submitted on 16 December and 14 January, and a paper on the duty differential between leaded and unleaded petrol on 30 December. These suggest the following departures from revalorisation:

Cider: increased by same pence per pint as beer.
Unleaded petrol: price differential of 10p per gallon.
Gas oil: duty increased by 10 per cent
Pipe tobacco, fuel oil, matches and mechanical lighters, betting and gaming: no change in duty.

This package would have the same RPI effect as revalorisation and cost:

1988-89	1989-90	1990-91
-5	-40	-50

If alcohol and tobacco duties were double revalorised, the yield would be:

	1988-89	1989-90	1990-91
Alcohol	+105	+115	+125
Tobacco	+100	+110	+110

Double revalorisation would add 0.17 percentage points to RPI inflation (alcohol) and 0.17 percentage points (tobacco).

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VAT

2. The base forecast assumes no change in the standard rate and assumes revalorisation by 3.7 per cent of the VAT registration threshold to £22,000 (from £21,300).

The yield shown in Table 1 arises from the changes to the VAT base discussed at Chevening and assumes the changes take effect from 1 May 1988. This would add an estimated 0.19 percentage points to RPI inflation.

The yield from and RPI effect of extending the VAT base to non-domestic construction (from 1 August 1988) and spectacles (from 1 May 1988) would be:

	1988-89	1989-90	1990-91	RPI effect
Construction	+100	+250	+400	Nil
Spectacles	+15	+25	+25	+ 0.01

Income Tax Rates and Personal Allowances

3. The base forecast assumes statutory indexation by 3.7 per cent of the main personal allowances.

Mr Eason's paper of 14 January discusses the option shown in Table 1A, ie a 24p basic rate of income tax, revalorisation of the higher rate threshold to £18,600 and no changes to NICs at the lower end.

A 2p cut in the basic rate would add 0.12 percentage points to RPI inflation; a 3p cut would add 0.18 percentage points.

National Insurance Contributions

6. Assumes Option F (Macpherson 19 October) selected at the meeting on 19 November:

	NIC rates			
Earnings Bands	Employees		Employers	
	now	Oct 1988	now	Oct 1988
Under £41	Nil	Nil	Nil	Nil
£41- £70	5	5	5	5
£70-£105	7	5	7	7
£105-£130	9	5	9	9
£130-£155	9	7	9	9
£155-£305	9	9	10.45	10.45

Costings assume LEL uprated in April 1989 but no uprating of reduced rate bands. Benefit savings would be

1988-89	1989-90	1990-91
+15	+50	less than +50

A further paper on NICs options at the lower end is in preparation.

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Independent Taxation

7. Assumes implementation from 1990-91 and:

- Disaggregation of all husband and wife's income
- Introduce Married Couples' Allowance equal to difference between MMA and single allowance with MCA transferable to wife if husband cannot use it fully
- MCA withdrawn gradually when husband's total income exceeds £40,000 (assumes clawback will operate in-year; full year yield of £100 million included in Tables 1 and 1A)
- Disaggregate husband and wife's capital gains with separate exemption of £6,600 each
- Only one CGT residence exemption per couple
- Abolish APA and replace by benefit in 1989-90 (yield not included in Tables 1 and 1A) or review APA entitlement rules to remove tax penalty on marriage
- Transitional protection for breadwinner wives
- Give age allowance only on basis of taxpayer's own age

Capital Gains Tax

8. & 9. These costings are highly provisional and subject to review. They make behavioural assumptions, in particular that the increase in the effective CGT rate reduces disposals in 1989-90 but that this effect diminishes in subsequent years.

Mortgage Interest Relief

10. All costings ignore behavioural effects. They also assume residence basis and any change in ceiling take effect from 6 April 1988. In practice the residence basis and possibly change in ceiling would probably take effect at a slightly later date, eg 1 August 1988.

If the MIR ceiling was instead increased to £35,000 on the residence basis the cost would be:

	1988-89	1989-90	1990-91
25p Basic Rate:	-180	-230	-270
24p Basic Rate:	-170	-220	-260

Covenants and maintenance

12. Assumes abolition of relief on all new covenants between individuals on basis of option 1 in Mr Stewart's paper of 7 January (meeting on 15 January will decide between remaining options). Assumes relief on maintenance payments to divorced/separated spouses only, limited to £2425, and no tax on payee. Consideration being given to ways of avoiding losers among deserted unmarried mothers. See paper by Mr Stewart of 8 January.

Fringe Benefits Tax

13. Assumes non-deductible FBT on employers with comprehensive coverage (with rate to be decided) introduced in 1990-91. Car scales would be increased substantially.

First year receipts depend on payment arrangements for FBT. Options on FBT are discussed in paper by Mr Lewis of 14 January; options on car scales in paper by Miss Rhodes of same date.

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Corporation Tax

14. It is assumed that the CT rate is cut by 2p to 33p in the year before employers start paying the FBT so that the effects of each are felt at the same time. The timing of the cut in the CT rate thus depends on the payment arrangements chosen for FBT. The cost of a 2p cut in the CT rate would be -neg in the first year, -£800 million in the second year (ie the year when receipts of FBT start) and -£1,100 million in a full year. Timing to be discussed in the paper by Mr Lewis.

Minor Starters

17. See Table 4. Not included in Table 1 are starters which protect existing revenue and are thus already assumed in the base forecast.

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SCORECARD OF 14 JANUARY 1988

TABLE 3: STAFFING EFFECTS[(a)]

Proposal Number	Proposal	Effect on manpower numbers at April 1989	April 1990	April 199[illegible]
1	Excise Duties	Nil	Nil	Nil
2	VAT Base[(b)]	+10	+10	+10
3	Reduce basic rate of IT to 24p or 25p	Nil	Nil	Nil
	Indexation of personal allowances and first higher rate threshold	+10	+70	+70
4	Increase higher rate IT threshold to £20,000	Nil	-60	-60
5	Abolish higher rates of IT above 40p	Nil	Nil	Nil
6	Changes to Class 1 NICs at lower end in October 1988[(c)]	Nil	Nil	Nil
7	Independent taxation from 1990-91			
	- independent taxation of husband and wife[(d)]	+420	+770	+1425 to +1475
	- convert APA into benefit[(e)]	Nil to -125	Nil to -125	Nil to -12
8	Freeze CGT exempt amount	Nil	+10	+10
	Add remaining gains to income and tax at IT rates	Nil	+Neg	+Neg
9	Rebase CGT to 1982	Nil	+5	+5
10	Restrict MIR to residence basis and leave ceiling unchanged at £30,000[(f)]	+25	+25	+25
11	Abolish tax relief on home improvement loans[(g)]	-150	-200	-250
12	Abolish tax relief on new covenants; change rules for maintenance payments[(h)]	-140	-320	-400
13	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91[(i)]	Nil	+150 to +250	Nil to +15
14	Reduce corporation tax rate to 33p	Nil	Nil	Nil
15	Reduce small companies' CT rate to 25p	Nil	Nil	Nil
16	Raise IHT threshold to £107,000 and set single rate of 40%	-5	-10	-15
17	Minor starters[(j)]	-75	-100	-100
	No change in stamp duty threshold	+10	+10	+10
	TOTAL[(k)]	+105	+460	+930

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Notes to Table 3

(a) Health Warning. The conventional assumption used in costing Budget changes is that nothing else is changing at the same time. But there are, of course, other factors which will affect the Revenue's and Customs' manpower over the same period. The correct approach in principle is to take all the changes into account in the order in which they should happen but, among other things, the need to maintain Budget security makes this difficult. So there is a risk of some double counting of both savings and costs. Pluses or minuses could turn out larger or smaller and some figures could change sign. The total is (like the PSBR) the difference between large plus and minus components.

(b) The effect on manpower numbers of extending VAT to non-domestic construction would be an additional 60 units in each of the three years.

(c) Staff effects at DHSS are not known.

(d) Setting up costs - some of the staffing need may be covered by use of overtime and casual staff.

(e) Saving Revenue staff depends on whether APA is converted to one parent benefit, etc. (Policing the increased OPB could require additional DHSS staff.) If APA is retained and the qualifying rules changed to deal with the tax penalty on marriage there could be a staff cost for the Revenue.

(f) If the ceiling is increased to £35,000, there would be a transitional effect on manpower of +65 units in April 1989, falling to +15 in April 1990 and April 1991.

(g) Further staff savings in later years.

(h) Figures under review.

(i) These are setting up costs. Will produce staff savings in later years.

(j) The staff savings shown are entirely accounted for by abolition of minor personal allowances.

(k) Total uses maximum staff additions possible under proposals 7 and 13.

SCORECARD OF 14 JANUARY 1988

TABLE 4: MINOR STARTERS

(Items in Starters list which Ministers have agreed are now serious contenders, including all those with revenue effects of £5 million or more)

FB Starter Number	Proposal	Cost(-) or Yield(+) in £ million 1988-89	1989-90	1990-91
30	Keith package (Customs & Excise)	Neg	Neg	Neg
34	Tax on supply to be liability of person completing VAT invoice	+5	+5	+5
60	Disclosure of importers' details	Neg	Neg	Neg
61	Search of persons	Nil	Nil	Nil
62	Penalty for customs fraud	Nil	Nil	Nil
63	Prosecution time limits	Neg	Neg	Neg
103	Abolition of minor personal allowances	+10	+10	+10
111	Review of S79 unapproved employee share schemes	Neg	Neg	Neg
117	Redundancy payments: top-slicing	Neg	Neg	Neg
118	Premiums for leases: top-slicing	Neg	Neg	Neg
151	Personal pensions: delay in commencement	+10	+10	+Neg
203	Business Expansion Scheme changes/limit		not yet known	
214	Lloyds: RIC leavers	Neg	Neg	Neg
216	Lloyds: reform of assessment system	Neg	Neg	Neg
354	North Sea Fiscal Regime		not yet known	
452	Keith package (Inland Revenue)		not yet known	
453	Forestry	Nil	Neg	+5
-	BES: Privated rented sector		not yet known	
	TOTAL	+25	+25	+20

Note

Not included above are the following minor starters which protect existing revenue and are thus already assumed in the base forecast

213 In-year assessment of Schedule D income

400 S482: company residence and migration

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

FROM: B H KNOX

DATE: 14 JANUARY 1988

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Odling-Smee
Miss Evans
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR

? Spms

BUDGET OVERVIEW MEETING 18 JANUARY : THE VAT BASE

1. We were asked for a note on two matters: on influencing the timing of the ECJ decision on the zero-rates case and on the statement in the evidence to the Treasury and Civil Service Committee about not taxing information.

Judgment of the European Court of Justice

2. We were asked to consider whether the ECJ could be influenced so that its judgment was either given in good time for the 1988 Budget or was delayed, to avoid embarrassing conflict with the Finance Bill.

Internal distribution: CPS
Mr Jefferson Smith
Mr Allen
Mr Cockerell
Mr G F Taylor

3. We doubt if hastening is possible. The ECJ is a multi-lingual Court of 14 Judges, who have a backlog of work and are faced with a difficult and evidently sensitive case. It is unlikely that they could speed up even if they wished to accommodate us. They might resent what they saw as interference, and would certainly resent any suggestion of delay.

4. The Court like all European institutions is leaky, and we have to reckon with the consequences of the UK's activities becoming public knowledge. If it became known that UK had tried to accelerate the Court's procedures, this would certainly be interpreted as an acknowledgment by the Government that following the Advocate General's opinion the UK had lost the case. It could possibly even be seen as indicating a wish to tax items not presently taxed. Such a wish would fly in the face of the Government's widely proclaimed insistence, in both Houses of Parliament and in Ministerial correspondence, that it has robustly and vigorously defended the zero-rates case before the European Court.

5. We conclude that an attempt to influence the European Court would be hazardous, likely to open the door to potential political embarrassment and have little chance of success. The furthest we think it would be reasonable to go would be to ask the Treasury Solicitor to seek guidance from the Court authorities on when judgment could be expected. This request should be in completely neutral terms - as a 'practical' matter of sensible contingency planning in relation to our normal budgetary timetable - but even this would run a risk of misinterpretation in the event of a leak.

To this

<u>"In the Government's opinion tax should not be imposed on information"</u>

6. This statement was part of a memorandum summarising the Government's position in the zero rates infraction case which was submitted to the Treasury and Civil Service Committee in December 1986. The memorandum was cleared with EQO(L) and at Ministerial level under cover of a letter from you to colleagues on OD(E).

we think 8 weeks or June

7. The sentence is, of course, a condensation of a longer argument put in the UK's statement of defence in relation to zero-rating of news services. This has not been published because of reasons of confidentiality, though once the case has been heard, pressure to publish may resume and the reasons of confidentiality would be no longer valid. However, the longer argument is less harmful. It runs on the lines that as the Commission does concede that there are valid social reasons for zero-rating newspapers it should in logic also accept the same argument in relation to news services. The defence statement concludes:

> Of the items which together comprise a newspaper, photographs, advertisements and non-news items (such as short stories and competitions) are subject to the standard-rate of tax. The dominant item, and the one which gives newspapers their essential characteristic, is the supply of information, and the social reasons which justify the zero-rating of newspapers equally apply to this item.

Are they?

8. The argument of course goes back to the inception of the tax. At the1969 Conservative Party Conference, Mr MacLeod said "on the general principle of avoiding a tax on knowledge, we intend that books, journals, newspapers and broadcasting shall be at a zero rate". The argument was much used in the early days of the tax, for example to justify taxing records but not books, and has continued to serve as the general basis of the Government's approach to this issue ever since.

Subtlety

9. To counter it now, we think that arguments on the following lines could reasonably be deployed:

(a) the statement must be seen in context, which was that of adducing reasons at the time, in the face of the Commission's challenge to UK practice on zero rating in several areas, for not taxing newspapers or news services;

(b) the statement was in no sense a pledge for all time;

but [illegible] in 1986!

(c) in fact many information media are already subject to tax - examples are films, audio/visual cassettes, micro- fiche and micro-film and computer tapes;

(d) there remain, of course, arguments for not taxing newspapers or news services, which is why they have not been taxed in the past; but the balance of argument has changed. The printed media no longer have a unique position; the imposition of tax on newspaper advertising has manifestly not adversely affected the newspaper industry which has performed strongly in the last two years; and the argument for not taxing knowledge/-information is only acceptable now in the limited area of books and learned journals.

10. In summary, we suggest that although the statement might give rise to some embarrassment, it is not a serious impediment to what you have in mind.

Bryce Knox

B H KNOX

COPY NO. 3 OF 4.

FROM: A C S ALLAN
DATE: 14 January 1988

MR CULPIN cc Mr Scholar

SCORECARD

The Chancellor was grateful for your minute of 13 January with the post-Chevening scorecard.

2. He was content with the presentation, but would like the 24p option done as a full Table 1A, and not just relegated to a footnote.

3. He thinks line 8 must clearly be wrong - for 1989-90 as well as 1990-91.

4. He would be grateful to know what the yield and RPI effect would be of double revalorisation of the tobacco and alcohol duties. This could be covered either in the scorecard or in the paper which Customs are preparing for the Overview meeting.

5. You probably will not yet know that the RPI for the 12 months to December 1987 (published on Friday) will be 3.7 per cent, not 3.8 per cent as assumed in the existing scorecard.

ACSA

A C S ALLAN

psl/25A

BUDGET SECRET: TASK FORCE LIST

COPY NO. 12 OF 13. pup

FROM: A C S ALLAN
DATE: 15 January 1988

MISS C EVANS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Culpin
Miss Sinclair
PS/IR

BUDGET: CONSULTATION WITH OTHER MINISTERS

The Chancellor was grateful for your minute of 14 January, and is broadly content with what you propose.

2. He will want to discuss at this afternoon's meeting the need to speak to Mr Baker and Mr Rifkind about covenants (your 3(c)); and he is wary on security grounds of writing to anyone (your 3(d)): those who <u>have</u> to be consulted might be better seen.

ACSA

A C S ALLAN

copy 1 of 32

INLAND REVENUE
STATISTICS DIVISION
SOMERSET HOUSE

FROM: R J EASON

DATE: 15 JANUARY 1988

CHANCELLOR OF THE EXCHEQUER

INCOME TAX OPTIONS - AVERAGE RATES OF TAX AND NIC

1. Following my submission of 14 January on Options 1 and ... 2, I attach two graphs illustrating the reductions in average rates of income tax and NIC for a married man under each option - see paragraph 9 of the submission.

RJE.

R J EASON

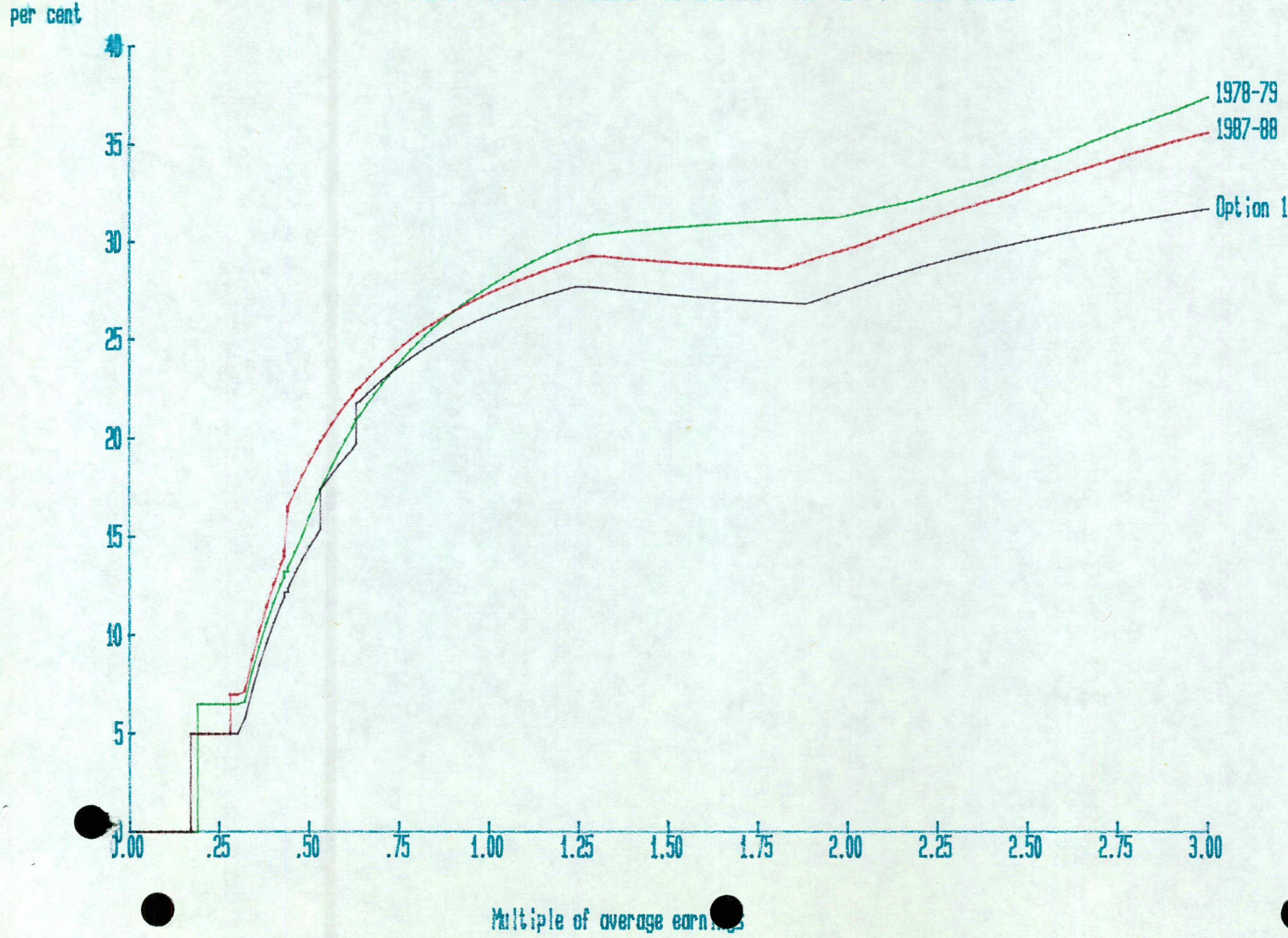
---

cc. PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Evans
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Call
Mr Unwin (Customs & Excise)
Mr Knox (" & ")

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

BUDGET SECRET - TASK FORCE LIST

Average rates of tax and National Insurance Contributions for a married man whose income is all earned



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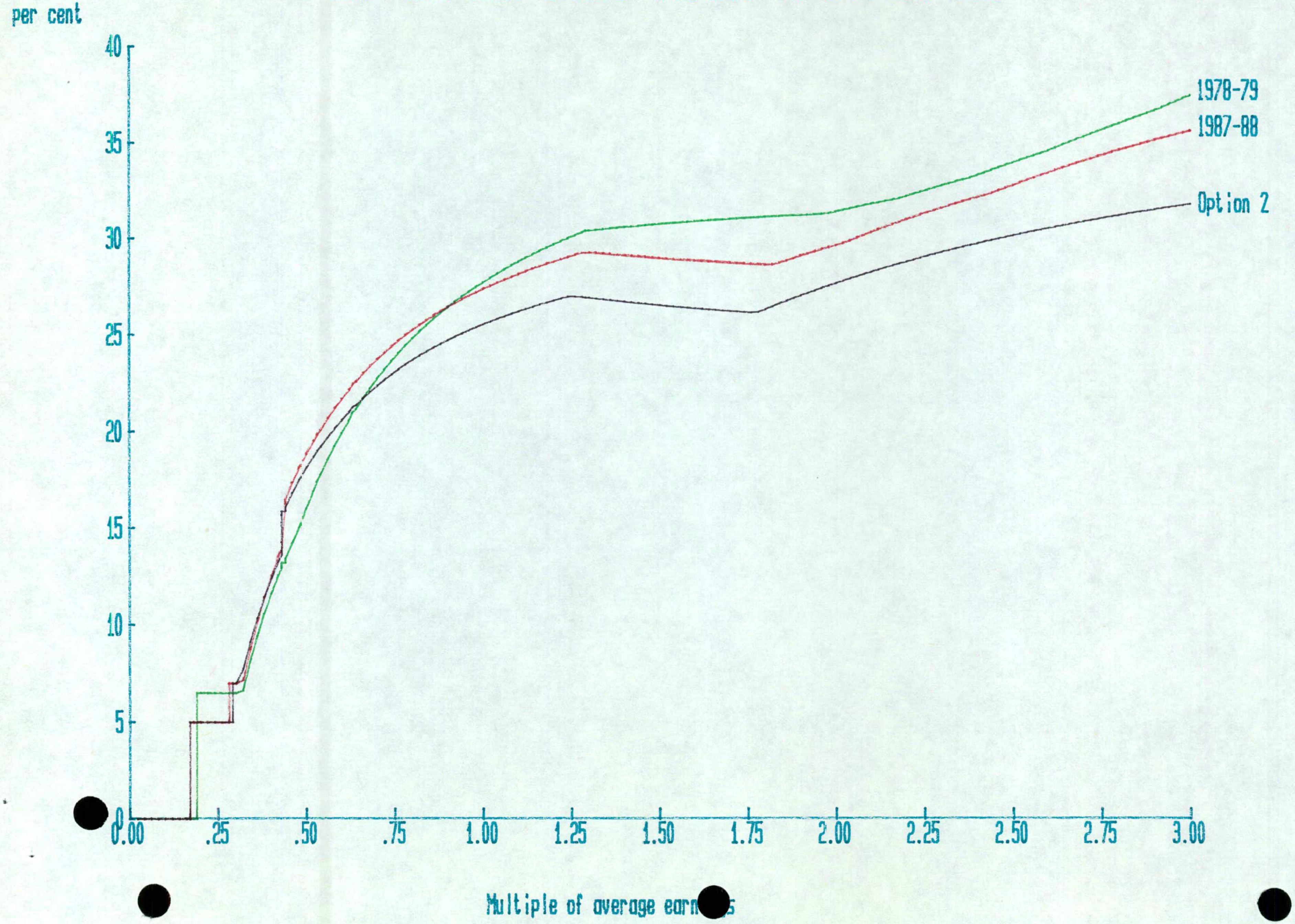

psl/31A

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Mr Prescott - IR (Item 5 only)

Mr Unwin - C&E
Mr Knox - C&E

SECRET

B.L.O.

Papers: (i) Scorecard: Mr Culpin's minute of 14 January.

(ii) Income tax options: Mr Eason's minute of 14 January.

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(ii) The provisional scorecard figures for the effect of assimilating CGT and income tax were very awkward: people would ask what was the point of an increase in the CGT rate if it led to a loss of tax yield. This loss came about because the Inland Revenue model assumed that there was a reduction in realisation immediately after an increase in the CGT rate. The Treasury and the Revenue would look at the figures again.

(iii) It was noted that the car scales for 1988-89 had already been set and would be in the base; Mr Scholar would check whether an increase in 1989-90 was in the base.

(iv) In Note 1, the figures for the double revalorisation of alcohol and tobacco duties showed the additional revenue, but the total RPI effect; this was inconsistent.

(v) In Note 2, the yield from extending the VAT base to non-domestic construction should also show the yield if the option to tax rents was allowed; the judgement on spectacles was expected shortly.

(vi) Among the minor starters, it would be helpful to have a list of the minor personal allowances which were being eliminated (Starter 103).

(vii) The Economic Secretary was considering whether there should be any changes to the North Sea fiscal regime for the Southern Basin; if the proposed package was implemented, it would have a small revenue cost in the early years, offset by additional revenue subsequently.

(viii) The Notes to the scorecard should show the second year costs/yields (ie in 1991-92) from introducing Independent Taxation and a Fringe Benefit Tax. Further consideration should be given to whether the figures for FBT yield should include behavioural effects.

Income tax options

2. No decision on the choice between Option 1 and Option 2 was needed now; discussion would be resumed at the following Overview Meeting, when a further paper would be available on NICs at the lower end. It would be helpful if, before then, further information could be circulated by the Revenue about the numbers of tax units at different income levels affected significantly differently by the two Options; and about taxes and NICs as a percentage of income for those earning various proportions of average earnings.

Excise duties

3. Because of the RPI effects, it was unlikely to be possible to do both a double revalorisation and the proposed extension of the VAT base; of the two, the extension of the VAT base was much to be preferred.

4. Assuming no more than simple revalorisation overall, the following provisional package was agreed:

(i) the duties on pipe tobacco and cigars should remain unchanged. Revenue of £100 million should be raised from cigarettes alone;

(ii) on alcohol duties, the duty on spirits should be left unchanged, with revenue of £110 million raised from increases in beer, cider and wine duties. Cider was relatively under-taxed, and the increase in cider duty should be the same number of pence per pint as the increase in beer duty;

(iii) on motoring taxes, VED should be left unchanged, as should the duty on unleaded petrol. Revenue of £345 million should be raised from increases in the duties on leaded petrol and derv.

VAT base

5. It was agreed that the Treasury Solicitor, currently in Brussels, should be asked to sound out the European Court in a neutral, low-key way, about when judgement was expected. It was perfectly natural for us to do this, given the questions put to the Economic Secretary by the TCSC, and the fact that the Advocate General's Opinion had been recommended for debate in the House of Commons. If it looked as though the judgement was likely to arrive too late for this year's Budget (as seemed likely) Customs would provide a further note on how we should react when the judgement arrived.

6. It would, with hindsight, have been better if the Customs Memorandum to the TCSC in December 1986 had not used the passage about tax on information. But this was not thought to rule out imposing VAT on newspapers. It had been made clear in the Election that while there were pledges on some items, these did not extend to books and newspapers. The fact that the Economic Secretary was due to put a note to the TCSC setting out the Government's pledges were, was quite helpful in this context. Customs would be providing further advice to the Economic Secretary about the proposed exclusion for learned journals.

Fringe benefit tax

(a) **Car benefits**

7. There was extensive discussion about whether the valuation of car benefits should be based on a scale or on the cost to the employer. On the one hand, a move to an employer-based tax was the perfect opportunity to switch the basis of charge to the cost to the employer, and this was likely to provide the only route for increasing car scales to the full value of the benefit. And if companies found the tax onerous, they always had the option of requiring employees to use their own cars for travel to and from work, and to use an employer's car for business purposes only. It might be possible to have scale deductions from the true cost to allow for business mileage. But on the other hand, it was arguable that the tax was aimed at the benefit to the employee of having a car for use at home, and this was independent of the amount of business use; it was reasonably represented by a scale charge.

And charging the full cost would create difficulties over apportioning, for example, maintenance costs; it would also open up the scope for evasion by employees taking company cars home without they (or their employers) reporting it. On balance, a scale charge would be simpler; we would anyway face considerable difficulties from employers in getting the principle of a FBT accepted, and in these circumstances it was more sensible to go for scale charges. The immediate target should be a scale charge of 50 per cent of the standing charges plus running costs, which represented slightly more than a doubling of the existing scales.

8. It would be helpful to have a note on the likely implications for the motor industry. The Chancellor would be seeing Lord Young, but would probably only raise with him the possibility of a major increase in car scales, without at this stage discussing the FBT. The Treasury would provide further advice on consultations with DTI officials, but in the meantime work on a paper on the implications for the motor industry should be started in-house.

9. After a brief discussion, it was confirmed that if an FBT was introduced, then the increase in car scales in 1989-90 should be no more than 10 per cent. The increase planned for 1990-91 should be announced in the Budget, but there was no need to announce a programme for later years. It did not seem likely that it would be attractive to raise to 5,000 miles the present 2,500 mileage limit.

(b) <u>FBT rate</u>

10. For larger firms, a 45 per cent FBT rate would be significantly tougher for benefits paid to basic rate taxpayers than the present system, and marginally tougher for those above the higher rate threshold. The 50 per cent rate had the advantage of being rather tougher on higher rate taxpayers, but at the expense of being very much tougher indeed on basic rate taxpayers, particularly on those in the "kink". It would be possible to increase the rate of FBT subsequently if behavioural changes pointed to that. <u>It was agreed</u> that further work should plan on the assumption of a 45 per cent rate.

11. The proposal was that the tax on fringe benefits should not be deductible in computing profits for corporation tax purposes, but the value of the benefits themselves should be.

(c) Payment arrangements

12. There were administrative arguments for choosing annual payments for FBT, but that would produce a once-for-all revenue loss of £700 million in the year of introduction. That was most unattractive, and the Revenue would consider further how a quarterly system could be introduced as simply as possible. The intention was that the cut in CT should be phased in to match the build-up of FBT payments. The Revenue agreed to provide as much information as was possible on the gainers and losers, both by sector and by size and type of company from the introduction of the FBT and the cut in CT rates.

(d) Coverage

13. The following points were made:

(i) in principle, canteens, luncheon vouchers and directors' lunches should all be included. The only practicable basis of charge seemed to be the variable costs incurred by the employers. The Revenue would provide estimates of the yield, which could be very large indeed, though the figures were very uncertain;

(ii) similarly, sports facilities and workplace nurseries should in principle be within the scope of the tax; but there were some tricky problems about what the basis for tax for sports facilities should be. It would be very odd to have taxed workplace nurseries in the hands of the employee, but then to exempt the employer;

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14. In general, we should use this opportunity to cast the broadest net possible. But there remained some benefits which it would be necessary to exempt. The question was whether too much broadening of the base would exacerbate the difficulties with getting the FBT accepted. The Financial Secretary would consider further, in the light of the points made in discussion, the coverage of the FBT and the basis of valuation. He would report back to the Chancellor, for discussion at a further meeting.

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15. The Revenue would produce a paper as soon as possible on the increases in car scales in 1989-90 and subsequently which we might introduce if we did not proceed with an FBT.

ACSA

A C S ALLAN
19 January 1987

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VAT base

5. It was agreed that the Treasury Solicitor, currently in Brussels, should be asked to sound out the European Court in a neutral, low-key way, about when judgement was expected. It was perfectly natural for us to do this, given the questions put to the Economic Secretary by the TCSC, and the fact that the Advocate General's Opinion had been recommended for debate in the House of Commons. If it looked as though the judgement was likely to arrive too late for this year's Budget (as seemed likely) Customs would provide a further note on how we should react when the judgement arrived.

6. It would, with hindsight, have been better if the Customs Memorandum to the TCSC in December 1986 had not used the passage about tax on information. But this was not thought to rule out imposing VAT on newspapers. It had been made clear in the Election that while there were pledges on some items, these did not extend to books and newspapers. The fact that the Economic Secretary was due to put a note to the TCSC setting out the Government's pledges were, was quite helpful in this context. Customs would be providing further advice to the Economic Secretary about the proposed exclusion for learned journals.

Fringe benefit tax

(a) Car benefits

7. There was extensive discussion about whether the valuation of car benefits should be based on a scale or on the cost to the employer. On the one hand, a move to an employer-based tax was the perfect opportunity to switch the basis of charge to the cost to the employer, and this was likely to provide the only route for increasing car scales to the full value of the benefit. And if companies found the tax onerous, they always had the option of requiring employees to use their own cars for travel to and from work, and to use an employer's car for business purposes only. It might be possible to have scale deductions from the true cost to allow for business mileage. But on the other hand, it was arguable that the tax was aimed at the benefit to the employee of having a car for use at home, and this was independent of the amount of business use; it was reasonably represented by a scale charge.

And charging the full cost would create difficulties over apportioning, for example, maintenance costs; it would also open up the scope for evasion by employees taking company cars home without they (or their employers) reporting it. On balance, a scale charge would be simpler; we would anyway face considerable difficulties from employers in getting the principle of a FBT accepted, and in these circumstances it was more sensible to go for scale charges. The immediate target should be a scale charge of 50 per cent of the standing charges plus running costs, which represented slightly more than a doubling of the existing scales.

8. It would be helpful to have a note on the likely implications for the motor industry. The Chancellor would be seeing Lord Young, but would probably only raise with him the possibility of a major increase in car scales, without at this stage discussing the FBT. The Treasury would provide further advice on consultations with DTI officials, but in the meantime work on a paper on the implications for the motor industry should be started in-house.

9. After a brief discussion, it was confirmed that if an FBT was introduced, then the increase in car scales in 1989-90 should be no more than 10 per cent. The increase planned for 1990-91 should be announced in the Budget, but there was no need to announce a programme for later years. It did not seem likely that it would be attractive to raise to 5,000 miles the present 2,500 mileage limit.

(b) <u>FBT rate</u>

10. For larger firms, a 45 per cent FBT rate would be significantly tougher for benefits paid to basic rate taxpayers than the present system, and marginally tougher for those above the higher rate threshold. The 50 per cent rate had the advantage of being rather tougher on higher rate taxpayers, but at the expense of being very much tougher indeed on basic rate taxpayers, particularly on those in the "kink". It would be possible to increase the rate of FBT subsequently if behavioural changes pointed to that. <u>It was agreed</u> that further work should plan on the assumption of a 45 per cent rate.

11. The proposal was that the tax on fringe benefits should not be deductible in computing profits for corporation tax purposes, but the value of the benefits themselves should be.

(c) Payment arrangements

12. There were administrative arguments for choosing annual payments for FBT, but that would produce a once-for-all revenue loss of £700 million in the year of introduction. That was most unattractive, and the Revenue would consider further how a quarterly system could be introduced as simply as possible. The intention was that the cut in CT should be phased in to match the build-up of FBT payments. The Revenue agreed to provide as much information as was possible on the gainers and losers, both by sector and by size and type of company from the introduction of the FBT and the cut in CT rates.

(d) Coverage

13. The following points were made:

(i) in principle, canteens, luncheon vouchers and directors' lunches should all be included. The only practicable basis of charge seemed to be the variable costs incurred by the employers. The Revenue would provide estimates of the yield, which could be very large indeed, though the figures were very uncertain;

(ii) similarly, sports facilities and workplace nurseries should in principle be within the scope of the tax; but there were some tricky problems about what the basis for tax for sports facilities should be. It would be very odd to have taxed workplace nurseries in the hands of the employee, but then to exempt the employer;

(iii) car parking on an employer's own premises should be exempt from the tax, but the scope for taxing parking off the employer's premises should be examined further;

(iv) we had recently introduced new exemptions for entertainments and gifts, and these should be continued;

(v) the existing exemptions for heating, lighting and other expenses of "lower paid" clergymen, and board and lodging

provided to "lower paid" agricultural workers should be ended. In principle it must be right to tax free accommodation.

(vi) even though there were some arguments that low interest mortgages did not confer a taxable benefit on the employee, it nonetheless would appear very odd if they were exempted from FPT; it was agreed that they should be included. If there were tax relief for private health insurance, logic pointed to it being treated in the same way.

14. In general, we should use this opportunity to cast the broadest net possible. But there remained some benefits which it would be necessary to exempt. The question was whether too much broadening of the base would exacerbate the difficulties with getting the FBT accepted. The Financial Secretary would consider further, in the light of the points made in discussion, the coverage of the FBT and the basis of valuation. He would report back to the Chancellor, for discussion at a further meeting.

(e) Fall-back if FBT not introduced

15. The Revenue would produce a paper as soon as possible on the increases in car scales in 1989-90 and subsequently which we might introduce if we did not proceed with an FBT.

ACSA

A C S ALLAN
19 January 1987

Distribution

Those present
PS/IR
Mr P R H Allen - C&E

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psl/11A

REF NO. J88/6
COPY NO. 1 OF 44.

RECORD OF THE SECOND BUDGET OVERVIEW MEETING:
AT 3.00PM ON MONDAY, 25 JANUARY 1988

Present

Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Byatt
Mr Kemp (Item 5 only)
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr Sedgwick
Mr Burr (Item 3(a) only)
Mr McIntyre (Items 2 and 3 only)
Miss C Evans
Mr Macpherson (Item 2 only)
Mrs Burnhams (Item 6 only)
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Corlett (Items 3 to 5 only)
Mr McGivern - IR (Item 6 only)
Mr Mace - IR (Item 1 to 3only)

Mr Unwin - C&E
Mr Knox - C&E

Papers:

(i) Scorecard: Mr Culpin's minute of 21 January.

(ii) Income tax and NICs:

(a) Mr Eason's minute of 14 January on income tax options.

(b) Mr McIntyre's minute of 21 January on outstanding issues;

(c) Mr Scholar's minute of 21 January on NICs for lower earners.

(iii) Maintenance and Covenants:

(a) Students: Mr Stewart's minute of 21 January and Mr Burr's minute of 22 January on students and covenants.

(b) Maintenance: Mr Corlett's and Mr Stewart's minutes of 21 January.

(c) APA: Mr Isaac's minute of 21 January.

(iv) Fringe Benefits: No papers.

(v) Tax relief for Health Insurance: Mr Kemp's minute of 21 January.

(vi) Ministerial Representations: Mrs Burnhams' minute of 21 January.

Scorecard

The following points were made:

(i) there was no news yet from the European Court on the timing of their judgements on VAT infraction proceedings: the judgement on spectacles was still expected before the Budget, but the other judgements not until afterwards. Mr Knox agreed to produce a note for the following week's Overview Meeting setting out how these issues should be handled;

(ii) Customs agreed to produce a note setting out what public justification Ministers had used last year for the non-revalorisation of excise duties.

(iii) Custons would also provide a further note on the option of a double-revalorisation of excise duties. This remained the alternative to extending the VAT base. It might cover just alcohol and tobacco duties or possibly motoring duties as well. Within such a package, the presumption should be that spirits would be subject to a single revalorisation, as would VED if motoring duties were included; further consideration should be given to what would be appropriate for pipe tobacco and cigars. No decisions would be taken until after the Chancellor had seen the "health" delegation from his Ministerial colleagues on 9 February;

(iv) the revised figures for <u>CGT assimilation</u> reflected discussions between the Treasury and the Revenue. Further work was in hand on the effect of rebasing on company gains. The Treasury in consultation with the Revenue would produce a note on the basis for the new calculations, setting out the assumptions on elasticities and on unlocking/deferral. The Revenue would advise on how the figures would change if rebasing preceded assimilation in the scorecard.

(v) FP would produce their usual note on a <u>"lollipop" trawl</u> (which should not include any VAT options), following suggestions from Ministers, advisers and others.

(vi) it was noted that the line taken by the Chief Secretary and others on <u>health spending</u> had been that the Budget was the place where revenue and borrowing decisions were taken, not spending ones. Two of the items in the present package had expenditure consequences: students and forestry. This would need careful handling.

(vii) the <u>Economic Secretary</u> had agreed with Department of Energy Ministers that there should be no <u>oil package</u>. But there was one new technical starter, on leasing of pipelines after fields had stopped production. This would require a half page of non-controversial Finance Bill legislation. The Economic Secretary would provide more detailed advice to the Chancellor; if the Chancellor was content, the Economic Secretary would announce before the Budget that legislation would be included in the forthcoming Finance Bill.

Income tax and NICs

2. The following points were made on NICs:

(i) no further work was needed on the NICs for the self-employed;

(ii) the sooner the Treasury supplement was abolished the better. We should use the first available opportunity to legislate to do this, but a separate bill was not appropriate;

(iii) the Chancellor would discuss with Mr Moore the question of increasing the NHS allocation. But it would not be appropriate to do this except as part of a general health package. It was unlikely that a suitable vehicle would be available before the next Parliamentary Session.

(iv) it was agreed that, if a package for NICs for lower earners was introduced, Option F was to be preferred to Option 5 (a withdrawable NIC allowance).

3. There was some discussion about which of the income tax and NIC options was to be preferred - Option 1 (a 25p basic rate and an NIC package) or Option 1A (a 24p basic rate and no NIC package). The Chancellor asked for one new option to be considered: a basic rate of 25p; the personal allowances increased by 7.4 per cent (ie a double revalorisation); and a higher rate threshold of £20,000. The Revenue agreed to produce a note costing this option and analysing the distributional consequences.

Maintenance and covenants

4. (a) Students:

It was agreed that setting off part of a student's grant against the tax repayment due on his covenant would be extremely difficult to administer. The preferred scheme was therefore Option 3 in Mr Stewart's note of 7 January (ie two grant/contribution scales). The Chancellor would speak to the Secretaries of State for Education and

Scotland, and ask them to confine knowledge of the proposal, if practicable, to one person in each Department; Mr Burr would provide advice on precisely when these discussions should take place: it seemed that this could wait until mid-February.

(b) Relief for maintenance payments:

On further consideration, the Financial Secretary had concluded that compensation for unmarried "deserted mothers" was impracticable: it would be impossible for the Revenue to police the necessary cohabitation rule. Probably less than 5,000 additional people each year would be significantly affected. Many of them would be compensated by income support, family credit or housing benefit, and some would qualify for the APA. This approach was agreed.

(a) APA:

It was agreed that action should be taken to prevent cohabitees claiming two tranches of APA, but that it was not practicable to go further and restrict the APA to those living alone. It would be possible, though messy, to do some policing to prevent cohabitees claiming two APAs; but it would be almost impossible to police the tighter restriction.

Fringe benefit tax

5. The Chancellor noted that discussions had been going on for some time about whether we should introduce an FBT or whether we should simply increase car scales as much as possible under the existing system. The Revenue were to produce a paper on the scope for increasing car scales without an FBT, and work was in hand on the industrial consequences. The Chancellor's preliminary view was that if that paper seemed to indicate that a reasonable and workable package could be devised within the present system, it would probably be more sensible to do that; but full discussion would await a further meeting.

Tax relief for Private Health Insurance

6. It was agreed that this was not a starter for the Budget. But it could well form an important element of a wider health package, and further early work was needed on:

(i) whether relief should be given just for insurance payments (which would enable a MIRAS-type system to be set up), or for direct expenditure on treatment as well;

(ii) whether the relief should be available to everyone, or restricted in some way (eg to pensioners);

(iii) whether the relief should apply just to individual subscriptions, or whether company schemes should be exempted from any benefits in kind charge.

Mr Kemp would produce a further paper, in consultation with Mr Byatt and Mr Isaac; this should be prepared as soon as possible, but work could await the conclusion on an FBT, and should not interfere with higher priority Budget work.

Ministerial representations

7. Most of the proposals by Lord Young and by Mr Fowler had been considered and rejected before. The following additional points were made:

(i) the Financial Secretary was investigating whether the interaction of ACT and PRT caused particular problems for oil companies buying in their own shares;

(ii) an increase in the Loan Guarantee Scheme ceiling from £75,000 to £100,000 seemed much more promising than Lord Young's ideas on Local Enterprise Companies. The Chancellor would point this out to him, but say that this was not a matter for the Budget, and could be pursued within his existing resources;

(iii) there were some attractions in action to prevent the VAT registration threshold acting as a disincentive for small businesses to expand. But this would require a derogation from the EC Commission and this was not very promising territory to fight on; no other EC country gave any similar relief. Customs would produce a note on this in due course;

(iv) although there were some anomalies on the rules about VAT on gifts to educational establishments, this too would require an EC derogation and was not attractive;

(v) Lord Young's ideas of an exemption from income tax in the most deprived inner city areas for the first two years of a new business ("chance of a lifetime") was not well targetted: small businesses would not necessarily make substantial profits in their first two years, and the Revenue's rules for Schedule D opening accounts were already favourable. The idea of additional BES relief for investment in deprived inner city areas had more attraction. The Revenue would look further at the possibility of extending the "half BES" relief proposed for private renting to full BES relief in appropriate inner city areas;

(vi) although there were occasional complaints about inconsistencies between tax inspectors in giving "dispensations" on the P11D requirements, the Revenue instructions were clear in stating that the dispensations should be given wherever the firm's control mechanisms were adequate;

(vii) there were often complaints that the requirements for sub-contractors' tax certificates were too onerous; the scheme was to be the subject of an Efficiency Scrutiny;

(viii) the Paymaster General was investigating possible changes to the PRP regulations;

(ix) the Economic Secretary was in correspondence with DTp on minor VED starters;

(x) the number of days of letting needed for farmers to qualify for the 1984 Finance Act concession on <u>holiday letting</u> was inevitably arbitrary; a reduction was not attractive;

(xi) the minor change suggested by Mr MacGregor on capital allowances would require legislation, and the case was not strong.

ACSA

A C S ALLAN

26 January 1988

<u>Distribution</u>

Those present
PS/IR
Mr P R H Allen - C&E
Mr P Lewis - IR (paragraph 5 only)
Mr Prescott - IR (paragraph 5 only)

MINUTES OF LAST MEETING

psl/31A

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REF NO. J88/4

COPY NO. 1 OF 38.

BUDGET SECRET

RECORD OF THE FIRST BUDGET OVERVIEW MEETING:
AT 3.00PM ON MONDAY, 18 JANUARY 1988

Present

Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Monck (Item 5 only)
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr Sedgwick
Miss C Evans
Mr Michie (Item 5 only)
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Lewis - IR (Item 5 only)
Mr McGivern - IR (Item 5 only)
Mr Mace - IR (Items 1 and 2 only)
Mr Prescott - IR (Item 5 only)

Mr Unwin - C&E
Mr Knox - C&E

B.L.O.

Papers: (i) Scorecard: Mr Culpin's minute of 14 January.

(ii) Income tax options: Mr Eason's minute of 14 January.

(iii) Excise duties: Mr Knox's minute of 14 January.

(iv) VAT base: Mr Knox's minute of 14 January.

(v) Fringe benefit tax: Mr Lewis's minute of 14 January; and Miss Sinclair's agenda of 15 January.

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Scorecard

The following points were made:

(i) Mr Mace agreed to produce a note on a further option for the APA, under which it would not be paid at all to co-habiting couples; this would extend the number of couples affected from the 5-10,000 who claimed a double APA now, to the 150,000 couples who at present claimed a single APA; but it was arguable that the APA was always intended strictly for one parent families.

(ii) The provisional scorecard figures for the effect of assimilating CGT and income tax were very awkward: people would ask what was the point of an increase in the CGT rate if it led to a loss of tax yield. This loss came about because the Inland Revenue model assumed that there was a reduction in realisation immediately after an increase in the CGT rate. The Treasury and the Revenue would look at the figures again.

(iii) It was noted that the car scales for 1988-89 had already been set and would be in the base; Mr Scholar would check whether an increase in 1989-90 was in the base.

(iv) In Note 1, the figures for the double revalorisation of alcohol and tobacco duties showed the additional revenue, but the total RPI effect; this was inconsistent.

(v) In Note 2, the yield from extending the VAT base to non-domestic construction should also show the yield if the option to tax rents was allowed; the judgement on spectacles was expected shortly.

(vi) Among the minor starters, it would be helpful to have a list of the minor personal allowances which were being eliminated (Starter 103).

(vii) The Economic Secretary was considering whether there should be any changes to the North Sea fiscal regime for the Southern Basin; if the proposed package was implemented, it would have a small revenue cost in the early years, offset by additional revenue subsequently.

(viii) The Notes to the scorecard should show the second year costs/yields (ie in 1991-92) from introducing Independent Taxation and a Fringe Benefit Tax. Further consideration should be given to whether the figures for FBT yield should include behavioural effects.

Income tax options

2. No decision on the choice between Option 1 and Option 2 was needed now; discussion would be resumed at the following Overview Meeting, when a further paper would be available on NICs at the lower end. It would be helpful if, before then, further information could be circulated by the Revenue about the numbers of tax units at different income levels affected significantly differently by the two Options; and about taxes and NICs as a percentage of income for those earning various proportions of average earnings.

Excise duties

3. Because of the RPI effects, it was unlikely to be possible to do both a double revalorisation and the proposed extension of the VAT base; of the two, the extension of the VAT base was much to be preferred.

4. Assuming no more than simple revalorisation overall, the following provisional package was agreed:

(i) the duties on pipe tobacco and cigars should remain unchanged. Revenue of £100 million should be raised from cigarettes alone;

(ii) on alcohol duties, the duty on spirits should be left unchanged, with revenue of £110 million raised from increases in beer, cider and wine duties. Cider was relatively under-taxed, and the increase in cider duty should be the same number of pence per pint as the increase in beer duty;

(iii) on motoring taxes, VED should be left unchanged, as should the duty on unleaded petrol. Revenue of £345 million should be raised from increases in the duties on leaded petrol and derv.

VAT base

5. It was agreed that the Treasury Solicitor, currently in Brussels, should be asked to sound out the European Court in a neutral, low-key way, about when judgement was expected. It was perfectly natural for us to do this, given the questions put to the Economic Secretary by the TCSC, and the fact that the Advocate General's Opinion had been recommended for debate in the House of Commons. If it looked as though the judgement was likely to arrive too late for this year's Budget (as seemed likely) Customs would provide a further note on how we should react when the judgement arrived.

6. It would, with hindsight, have been better if the Customs Memorandum to the TCSC in December 1986 had not used the passage about tax on information. But this was not thought to rule out imposing VAT on newspapers. It had been made clear in the Election that while there were pledges on some items, these did not extend to books and newspapers. The fact that the Economic Secretary was due to put a note to the TCSC setting out the Government's pledges were, was quite helpful in this context. Customs would be providing further advice to the Economic Secretary about the proposed exclusion for learned journals.

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(a) Car benefits

7. There was extensive discussion about whether the valuation of car benefits should be based on a scale or on the cost to the employer. On the one hand, a move to an employer-based tax was the perfect opportunity to switch the basis of charge to the cost to the employer, and this was likely to provide the only route for increasing car scales to the full value of the benefit. And if companies found the tax onerous, they always had the option of requiring employees to use their own cars for travel to and from work, and to use an employer's car for business purposes only. It might be possible to have scale deductions from the true cost to allow for business mileage. But on the other hand, it was arguable that the tax was aimed at the benefit to the employee of having a car for use at home, and this was independent of the amount of business use; it was reasonably represented by a scale charge.

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And charging the full cost would create difficulties over apportioning, for example, maintenance costs; it would also open up the scope for evasion by employees taking company cars home without they (or their employers) reporting it. On balance, a scale charge would be simpler; we would anyway face considerable difficulties from employers in getting the principle of a FBT accepted, and in these circumstances it was more sensible to go for scale charges. The immediate target should be a scale charge of 50 per cent of the standing charges plus running costs, which represented slightly more than a doubling of the existing scales.

8. It would be helpful to have a note on the likely implications for the motor industry. The Chancellor would be seeing Lord Young, but would probably only raise with him the possibility of a major increase in car scales, without at this stage discussing the FBT. The Treasury would provide further advice on consultations with DTI officials, but in the meantime work on a paper on the implications for the motor industry should be started in-house.

9. After a brief discussion, it was confirmed that if an FBT was introduced, then the increase in car scales in 1989-90 should be no more than 10 per cent. The increase planned for 1990-91 should be announced in the Budget, but there was no need to announce a programme for later years. It did not seem likely that it would be attractive to raise to 5,000 miles the present 2,500 mileage limit.

(b) <u>FBT rate</u>

10. For larger firms, a 45 per cent FBT rate would be significantly tougher for benefits paid to basic rate taxpayers than the present system, and marginally tougher for those above the higher rate threshold. The 50 per cent rate had the advantage of being rather tougher on higher rate taxpayers, but at the expense of being very much tougher indeed on basic rate taxpayers, particularly on those in the "kink". It would be possible to increase the rate of FBT subsequently if behavioural changes pointed to that. <u>It was agreed</u> that further work should plan on the assumption of a 45 per cent rate.

11. The proposal was that the tax on fringe benefits should not be deductible in computing profits for corporation tax purposes, but the value of the benefits themselves should be.

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12. There were administrative arguments for choosing annual payments for FBT, but that would produce a once-for-all revenue loss of £700 million in the year of introduction. That was most unattractive, and the Revenue would consider further how a quarterly system could be introduced as simply as possible. The intention was that the cut in CT should be phased in to match the build-up of FBT payments. The Revenue agreed to provide as much information as was possible on the gainers and losers, both by sector and by size and type of company from the introduction of the FBT and the cut in CT rates.

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(iii) car parking on an employer's own premises should be exempt from the tax, but the scope for taxing parking off the employer's premises should be examined further;

(iv) we had recently introduced new exemptions for entertainments and gifts, and these should be continued;

(v) the existing exemptions for heating, lighting and other expenses of "lower paid" clergymen, and board and lodging

provided to "lower paid" agricultural workers should be ended. In principle it must be right to tax free accommodation.

(vi) even though there were some arguments that low interest mortgages did not confer a taxable benefit on the employee, it nonetheless would appear very odd if they were exempted from FPT; it was agreed that they should be included. If there were tax relief for private health insurance, logic pointed to it being treated in the same way.

14. In general, we should use this opportunity to cast the broadest net possible. But there remained some benefits which it would be necessary to exempt. The question was whether too much broadening of the base would exacerbate the difficulties with getting the FBT accepted. The Financial Secretary would consider further, in the light of the points made in discussion, the coverage of the FBT and the basis of valuation. He would report back to the Chancellor, for discussion at a further meeting.

(e) Fall-back if FBT not introduced

15. The Revenue would produce a paper as soon as possible on the increases in car scales in 1989-90 and subsequently which we might introduce if we did not proceed with an FBT.

ACSA

A C S ALLAN
19 January 1987

Distribution

Those present
PS/IR
Mr P R H Allen - C&E

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MINUTES OF FIRST OVERVIEW MEETING

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COPY No 2 OF 33

RECORD OF THE FIRST BUDGET OVERVIEW MEETING:

3.00PM ON 19 JANUARY 1986 7

Present

Chancellor
Chief Secretary (Items 3 + 4 only)
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr Scholar
Mr Sedgwick
Mr Odling-Smee
Miss C Evans
Mr Romanski (Item 2 only)
Mr Cropper
Mr Ross Goobey
Mr Tyrie

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Mace - IR (Item 4 only)

Sir A Fraser - C&E
Mr Knox - C&E
Mr Jefferson Smith - C&E (Items 1, 2 + 3 only)

Papers

(i) Scorecard: Mr Scholar's minute of 15 January.

(ii) Excise duties (including VED): Mr Knox's minute updating his earlier minute of 18 December, and Mr Romanski's minute of 15 January.

(iii) Consumer credit tax: PS/MST's minute of 15 January and note of MST's meeting on 15 January.

(iv) Higher rate tax options: Mr Mace's minute of 15 January.

Scorecard

The following points were made:-

(i) Mr Monck agreed to produce a note explaining the assumptions underlying the figures for PRP (distinguishing take up by existing schemes and by new schemes) and commenting on them; Mr Scholar would reflect them in subsequent issues of the scorecard.

(ii) The Keith measures for charging interest on PAYE tax and tax paid by sub-contractors, and bringing certain payments to directors more clearly within PAYE, should be included in future issues of the scorecard.

(iii) Customs would produce a further note on the date for the start of cash accounting for VAT (there were considerable attractions in bringing its introduction forward to 1 October 1987) and on the turnover limit.

Excise Duties

2. The following provisional decisions were reached:

(i) There should be no increase in cider duty this year.

(ii) Beer, wine and spirits duties should all be increased by 3 per cent, with this under-indexation compensating the brewers for the £25 million extra VAT they would pay via the proposals on partial exemption.

(iii) There should be no increase in the duty on pipe tobacco.

(iv) The duty on cigarettes and on cigars should be increased by 3.75 per cent (ie full revalorisation). The duty on cigars had not been increased in the last two years, but there was a good case for increasing it this year so as to avoid the presumption that cigar and pipe tobacco duty would always move together. A final decision would be made nearer the time. On cigarette duty, there was likely to be some pressure for an over-indexation from the health lobby - and survey evidence suggested that even smokers would not object too strongly. So at a later stage there would need to be a further look at whether the £25 million under-indexation of alcoholic drinks might be recouped from over-indexation of cigarettes.

3. On <u>fuel duties and VED,</u> it was agreed that VED on cars should remain at £100, with the lost revenue being recouped by an over-indexation of petrol duty. It was agreed that there was a strong case for making a switch from lorry VED to derv gradually, so as to prepare the ground and to signal to derv users which way the trend was going. The two most promising options seemed to be either a VED standstill with the lost revenue recouped from derv (ie. an increase of 4.5 per cent) or an increase in derv duty of the same size as petrol (ie. 5.3 per cent) with some reduction in lorry VED. The Chancellor would have an early and informal discussion with the Secretary of State for Transport.

<u>Consumer credit tax</u>

4. The conclusions reached at the Minister of State's meeting were broadly endorsed, subject to the following points.

(i) There was a strong feeling that <u>tax should not be charged on borrowing by charities</u>, though it would be reasonable to tax lending by charities. Loans to groups of individuals or clubs could reasonably be taxed. Customs would prepare a note for the Minister of State setting out how this might be achieved, perhaps by working upwards from individuals to other bodies which should be included rather than downwards from companies to other bodies which should be excluded.

(ii) There should be no special provision to tax loans to businesses to buy cars. It was in any event not practicable to distinguish between loans for cars and loans for other business purposes - company borrowing would not easily be hypothecated to particular assets.

(iii) There were some doubts expressed about the proposal to tax all interest on credit cards, but on balance it was agreed that the need for simplicity and early introduction pointed to doing that. Very few businesses would use this expensive form of credit.

(iv) It was agreed that all the necessary legislation should be included in the 1987 Finance Bill, since any delay to the 1988 Finance Bill would make a 1 April 1988 implementation impossible.

(v) It was agreed that a Keith-type approach to enforcement was appropriate.

(vi) It was agreed that the implementation date for the credit card element of the tax should be 15 August 1987.

(vii) There were severe problems over taxing credit extended to businesses for onward lending. It would be very difficult to distinguish lending to retailers for customer credit from lending for eg stocks. Further work was needed on what de minimis limit might be appropriate, and this would need to be backed up by appropriate anti-avoidance provisions to prevent disaggregation of lending. But the principle of the tax should be that only loans direct to consumers were liable.

(viii) It was noted that there would be compliance cost to lenders over policing the exemption for loans qualifying for MIR (which need not be mortgages). But the evidence required to for this would be the same as the evidence required to validate claims for MIR, so this change might be supportive of action to combat abuse of MIR which was separately under consideration.

5. Summing up, the Chancellor said this tax was still a runner. But the meeting had identified some sensitive areas and some practical problems. The next step would be for the Minister of State to hold a further meeting on the basis of advice from Customs. The subject might then be considered at a future overview meeting.

Income tax higher rates

6. Mr Mace's minute of 15 January identified four options (numbered 2 to 5): option 2 collapsed the five existing rates to two of 45 per cent and 60 per cent; option 3 indexed all thresholds and bands; option 4 increased all the other higher rate thresholds by the same amount in cash terms; and option 5 was a helpful addition giving full indexation of the first threshold, partial indexation of the 45 per cent threshold, and no increases in the other thresholds. In discussion the following points were made:-

(i) Option 2 was a useful simplification in the context of the CGT reform under discussion. But it did have problems in increasing the marginal rates for some taxpayers. If the CGT reform was not pursued, it would be preferable to hold a change of this land until 1988, when there might be scope for cutting the top rates of tax.

(ii) Option 3 had the attraction of being simple and of avoiding narrowing the higher rate bands. But it produced large gains for the highest earners.

(iii) Option 4 was simply a half-way-house between option 3 and option 5, and had few attractions.

(iv) Option 5 was similar to last year's change, which had proved a great success in presentational terms. It compressed the higher rates bands, but this was acceptable pending a future cut in the top rates.

7. It was provisionally agreed that if the CGT reform was carried through, option 2 should be chosen. If not, option 5 was preferable.

Next meeting

8. The second overview meeting will be at 3.00 pm on Monday 26 January. All papers should be circulated on Thursday 22 January.

ACSA

A C S ALLAN
19 January 1987

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Economic Secretary (2)
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr Anson
Sir Anthony Wilson
Mr Scholar
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Mr Odling-Smee
Miss Evans
Mr A Hudson
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Unwin - C&E
Mr Knox - C&E

BUDGET SCORECARD

... I attach the Budget Scorecard for the second Overview Meeting on Monday 25 January. The main changes to Table 1 since last time are these:

- line 7: the cost of independent taxation has gone up because we have discovered that previous estimates omitted the cost of transitional protection for breadwinner wives;
- lines 8 and 9: we have had another look at the likely effects of the CGT changes;
- line 13: we have allowed explicitly for a 10 per cent increase in the car scales in 1989-90, which was not in the figures before;
- Notes: we have added a 1991-92 costing for independent taxation. We have not yet been able to extend the costing of the fringe benefits tax to 1991-92, but we hope to do that next week.

RC

ROBERT CULPIN

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Additional copies for Scorecard work to:

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Miss Hay	)	
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Mr McManus	)	
Mr Boyce	)	
Mr Allen	)	C&E
Miss French	)	

7-1K

SCORECARD OF 21 JANUARY 1988

TABLE 1: DIRECT EFFECTS OF BUDGET MEASURES
assuming a 25p basic rate of income tax

All figures are net of cost or yield of indexation or revalorisation.

Proposal Number	Proposal	Cost(-) or Yield(+) in £ million (rounded to £5 million) 1988-89	1989-90	1990-91
1	Excise Duties	Nil	-20	-55
2	VAT Base	+280	+420	+440
3	Reduce basic rate of IT to 25p	-2550	-3200	-3450
4	Increase higher rate IT threshold to £20,000	-220	-420	-500
5	Abolish higher rates of IT above 40p	-840	-1690	-1920
6	Changes to Class 1 NICs at lower end in October 1988	-380	-800	-850
7	Independent taxation from 1990-91	Nil	Nil	~~-810~~ -560
8	Freeze £6,600 CGT exemption, add remaining gains to income and tax at IT rates (25%/40%)	Nil	+30	+90
9	Rebase CGT to 1982 (cost includes rebasing CT on companies' gains)	Nil	-150	-350
10	Restrict new MIR to residence from 1.8.88 and leave ceiling unchanged at £30,000	+5	+20	+40
11	Abolish tax relief on home improvement loans	+80	+200	+300
12	Abolish tax relief on new covenants between individuals; change rules for maintenance payments	+35	+100	+160
13	Increase car scales by 10 per cent in 1989-90	Nil	+30	+35
14	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91	Nil	Nil	*
15	Reduce corporation tax rate to 33p	Nil	Nil	*
16	Reduce small companies' CT rate to 25p in 1988-89	-Neg	-50	-90
17	Raise IHT threshold to £107,000 and set single rate of 40%	-120	-255	-300
18	Minor starters	+25	+25	+15
	TOTAL TAX MEASURES	-3685	-5760	~~-7245~~ -6995

*See notes

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SCORECARD OF 21 JANUARY 1988

TABLE 1A: DIRECT EFFECTS OF BUDGET MEASURES
assuming a 24p basic rate of income tax

All figures are net of cost or yield of indexation or revalorisation.

Proposal Number	Proposal	Cost(-) or Yield(+) in £ million (rounded to £5 million) 1988-89	1989-90	1990-91
1	Excise Duties	Nil	-20	-55
2	VAT Base	+280	+420	+440
3	Reduce basic rate of IT to 24p	-3830	-4800	-5170
4	Revalorise higher rate IT threshold to £18,600	Nil	Nil	Nil
5	Abolish higher rates of IT above 40p	-900	-1820	-2080
6	No change to NICs	Nil	Nil	Nil
7	Independent taxation from 1990-91	Nil	Nil	~~-850~~ -600
8	Freeze £6,600 CGT exemption, add remaining gains to income and tax at IT rates (24%/40%)	Nil	+30	+90
9	Rebase CGT to 1982 (cost includes rebasing CT on companies' gains)	Nil	-150	-350
10	Restrict new MIR to residence from 1.8.88 and leave ceiling unchanged at £30,000	+5	+20	+40
11	Abolish tax relief on home improvement loans	+80	+200	+300
12	Abolish tax relief on new covenants between individuals; change rules for maintenance payments	+35	+95	+150
13	Increase car scales by 10 per cent in 1989-90	Nil	+30	+35
14	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91	Nil	Nil	*
15	Reduce corporation tax rate to 33p	Nil	Nil	*
16	Reduce small companies' CT rate to 24p in 1988-89	-Neg	-75	-135
17	Raise IHT threshold to £107,000 and set single rate of 40%	-120	-255	-300
18	Minor starters	+25	+25	+15
	TOTAL TAX MEASURES	-4425	-6300	~~-7870~~ -7620

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*See notes

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Notes to Tables 1 and 1A

All figures show cost (-) or yield (+) in £ million unless otherwise indicated.

Excise Duties

1. The base forecast assumes excise duties revalorised by 3.7 per cent (the inflation rate for the twelve months to December 1987). If the duties were not revalorised, RPI inflation would be 0.28 percentage points lower than in the base forecast.

It has already been agreed not to increase duties on betting and gaming, and on matches and mechanical lighters. At the Overview Meeting on 18 January, a further package was agreed which assumed revalorisation in overall terms with the following departures for individual duties:

Alcoholic Drinks

Spirits: No change

Beer, cider and wines: increased to recoup revenue lost by not revalorising spirits, cider being increased by the same pence per pint as beer.

Tobacco

Pipe tobacco and cigars: no change
Cigarettes and hand rolled tobacco: increased to recoup revenue lost by not revalorising pipe tobacco and cigars.

Oils and VED

VED, unleaded petrol, fuel oil and gas oil: no change
Leaded petrol: increased to recoup revenue lost by not revalorising VED on cars and light vans, unleaded petrol, fuel oil and gas oil
Derv: increased to recoup revenue lost by not revalorising VED on other vehicles

The cost of this package is shown in Tables 1 and 1A. The package has been designed to have the same cost as revalorisation in 1988-89; the additional cost in subsequent years occurs because the cost of the standstill in duty on unleaded petrol rises faster than the yield from higher duties on leaded petrol and derv. It would have a very similar RPI effect to straight revalorisation and would imply the following percentage duty increases and price increases:

Product	Unit	Duty increase (per cent)	Price increase (pence) Proposed	Diff. from Reval.
Beer	Pint	4.8	1.0	+0.2
Cider	Pint	9.6	1.0	+0.6
Table wine	75cl	4.8	4.1	+1.0
Sherry	70cl	4.8	6.5	+1.5
Spirits	75cl	nil	nil	-20.1
Cigarettes	20KS	3.8	3.5	+0.1
Cigars	5 whiffs	nil	nil	-1.9
Pipe tobacco	25 grams	nil	nil	-2.7
Petrol (leaded)	Gallon	5.7	5.8	+2.1
Petrol (unleaded)	Gallon	nil	nil	-3.6
Derv	Gallon	5.3	4.5	+1.3
VED (cars)	-	nil	nil	-£3.70
VED (other)	-	nil	nil	-(various)
Gas oil	Litre	nil	nil	-0.2
Fuel oil	Litre	nil	nil	-0.1

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If instead of the above package, all alcohol and tobacco duties were double revalorised, and remaining duties revalorised, the yield would be:

	1988-89	1989-90	1990-91
Alcohol	+105	+115	+125
Tobacco	+100	+110	+110

This would add an additional 0.08 percentage points to RPI inflation (alcohol) and an additional 0.08 percentage points (tobacco).

VAT

2. The base forecast assumes no change in the standard rate and assumes revalorisation by 3.7 per cent of the VAT registration threshold to £22,100 (from £21,300).

The yield shown in Tables 1 and 1A arises from the changes to the VAT base discussed at Chevening and assumes the changes take effect from 1 May 1988. This would add an estimated 0.19 percentage points to RPI inflation.

The yield from and RPI effect of extending the VAT base to non-domestic construction (from 1 August 1988) and spectacles (from 1 May 1988) would be:

	1988-89	1989-90	1990-91	RPI effect
Construction	+100	+250	+400	Nil
with option to tax rents etc	+25	+75	+125	Nil
Spectacles	+15	+25	+25	+0.01

Income Tax Rates and Personal Allowances

3. The base forecast assumes statutory indexation by 3.7 per cent of the main personal allowances.

Mr Eason's paper of 14 January discussed the option shown in Table 1A, ie a 24p basic rate of income tax, revalorisation of the higher rate threshold to £18,600 and no changes to NICs at the lower end.

A 2p cut in the basic rate would add 0.12 percentage points to RPI inflation; a 3p cut would add 0.18 percentage points.

National Insurance Contributions

6. Assumes Option F selected at the meeting on 19 November:

	NIC rates			
Earnings Bands	Employees		Employers	
	now	Oct 1988	now	Oct 1988
Under £41	Nil	Nil	Nil	Nil
£41- £70	5	5	5	5
£70-£105	7	5	7	7
£105-£130	9	5	9	9
£130-£155	9	7	9	9
£155-£305	9	9	10.45	10.45

Costings assume LEL uprated in April 1989 but no uprating of reduced rate bands. Benefit savings would be

1988-89	1989-90	1990-91
+15	+50	less than +50

Mr Scholar's paper of 21 January discusses further options on NICs at the lower end.

Independent Taxation

7. Costs are provisional. Assumes implementation from 1990-91 and:

- Disaggregation of all husband and wife's income
- Introduce Married Couples' Allowance equal to difference between MMA and single allowance with MCA transferable to wife if husband cannot use it fully
- MCA withdrawn gradually when husband's total income exceeds £40,000 (assumes clawback will operate in-year; full year yield of £100 million included in Tables 1 and 1A)
- Disaggregate husband and wife's capital gains with separate exemption of £6,600 each
- Only one CGT residence exemption per couple
- Review APA entitlement rules to remove tax penalty on marriage (yield not yet included in Tables 1 and 1A)
- Transitional protection for breadwinner wives
- Give age allowance only on basis of taxpayer's own age

The fourth year (1991-92) cost is estimated at £~~1190~~ 860 million with a 25p basic rate and £~~1250~~ 910 million with a 24p basic rate.

Capital Gains Tax

8. & 9. These costings are provisional and have been revised to reflect new behavioural and forecast assumptions. Aggregration of capital gains with income produces a small yield because of the higher effective tax rate; this is not entirely offset by a fall in the volume of disposals. The cost of rebasing will be reviewed in the next Scorecard when further work has been done on companies' gains.

Mortgage Interest Relief

10. All costings ignore behavioural effects and assume change to residence basis on 1 August 1988.

If the MIR ceiling was increased to £35,000 on the residence basis the cost would be:

	1988-89	1989-90	1990-91
25p Basic Rate:	-180	-230	-270
24p Basic Rate:	-170	-220	-260

Covenants and maintenance

12. Assumes abolition of relief on all new covenants between individuals on basis of option 3 in Mr Stewart's paper of 7 January. Assumes relief on maintenance payments to divorced/separated spouses and unmarried mothers limited to £2425, and no tax on payee.

Fringe Benefits Tax

14. Assumes non-deductible FBT on employers at rate of 45 per cent introduced in 1990-91. Car scales would be increased in 1990-91 to 50 per cent of standing charges plus running costs (ie slightly more than double the 1987-88 scales). Receipts of FBT depend on coverage. The Revenue will be producing a paper and costings next week.

Car scales are set one year in advance; the base forecast incorporates the 10 per cent increase already announced for 1988-89 but assumes unchanged scales in 1989-90. It was decided at the Overview Meeting on 18 January to increase car scales by a further 10 per cent in 1989-90; the additional yield is shown under proposal 13 in Tables 1 and 1A.

The Revenue are also preparing a paper on car scales in the event that an FBT is not introduced.

Corporation Tax

15. It is assumed that the CT rate is cut by 2p to 33p in the year before employers start paying the FBT so that the effects of each are felt at the same time. The provisional decision to make FBT payable quarterly points to a cut in the CT rate in 1989.The cost of a 2p cut in the CT rate would be -neg in the first year, -£800 million in the second year (ie the year when receipts of FBT start) and -£1,200 million in a full year.

Minor Starters

18. See Table 4. Not included in Tables 1 and 1A are starters which protect existing revenue and are thus already assumed in the base forecast.

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SCORECARD OF 21 JANUARY 1988

TABLE 2: PSBR EFFECTS[a]
assuming a 25p basic rate of income tax

Proposal Number	Proposal	Reduction (-) or increase (+) in £ millio (rounded to £5 million) 1988-89	1989-90	1990-91
1	Excise Duties	Nil	Nil	-30
2	VAT Base	-280	-220	-15
3	Reduce basic rate of IT to 25p	+2600	+3360	+3970
4	Increase higher rate IT threshold to £20,000	+230	+425	+540
5	Abolish higher rates of IT above 40p	+880	+1720	+2065
6	Changes to Class 1 NICs at lower end in October 1988	+390	+810	+880
7	Independent taxation from 1990-91	Nil	Nil	~~+850~~ +570
8	Freeze £6,600 CGT exemption, add remaining gains to income and tax at IT rates (25%/40%)	Nil	-30	-90
9	Rebase CGT to 1982 (cost includes rebasing CT on companies' gains)	Nil	+150	+350
10	Restrict new MIR to residence from 1.8.88 and leave ceiling unchanged at £30,000	-5	-20	-40
11	Abolish tax relief on home improvement loans	-65	-205	-370
12	Abolish tax relief on new covenants between individuals; change rules for maintenance payments	-35	-105	-185
13	Increase car scales by 10 per cent in 1989-90	Nil	-30	-35
14	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91	Nil	Nil	*
15	Reduce corporation tax rate to 33p	Nil	Nil	*
16	Reduce small companies' CT rate to 25p in 1988-89	Neg	+50	+90
17	Raise IHT threshold to £107,000 and set single rate of 40%	+120	+255	+300
18	Minor starters	-25	-25	-15
	TOTAL	+3810	+6135	~~+8265~~ +7985

(a) The figures for PSBR cost given in this table are calculated in terms of the change in the fiscal adjustment implied by each measure listed. They show how much of any fiscal adjustment indicated by the forecasts, assuming a given PSBR, would be used up.

*See notes to Tables 1 and 1A

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SCORECARD OF 21 JANUARY 1988

TABLE 2A: PSBR EFFECTS[(a)]

assuming a 24p basic rate of income tax

Proposal Number	Proposal	Reduction (-) or increase (+) in £ million (rounded to £5 million) 1988-89	1989-90	1990-91
1	Excise Duties	Nil	Nil	-30
2	VAT Base	-280	-220	-15
3	Reduce basic rate of IT to 24p	+3905	+5040	+5950
4	Revalorise higher rate IT threshold to £18,600	Nil	Nil	Nil
5	Abolish higher rates of IT above 40p	+945	+1850	+2240
6	No change in NICs	Nil	Nil	Nil
7	Independent taxation from 1990-91	Nil	Nil	~~-870~~ +615
8	Freeze £6,600 CGT exemption, add remaining gains to income and tax at IT rates (24%/40%)	Nil	-30	-90
9	Rebase CGT to 1982 (cost includes rebasing CT on companies' gains)	Nil	+150	+350
10	Restrict new MIR to residence from 1.8.88 and leave ceiling unchanged at £30,000	-5	-20	-40
11	Abolish tax relief on home improvement loans	-65	-205	-370
12	Abolish tax relief on new covenants between individuals; change rules for maintenance payments	-35	-105	-185
13	Increase car scales by 10 per cent in 1990-91	Nil	-30	-35
14	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91	Nil	Nil	*
15	Reduce corporation tax rate to 33p	Nil	Nil	*
16	Reduce small companies' CT rate to 24p in 1988-89	Neg	+75	+135
17	Raise IHT threshold to £107,000 and set single rate of 40%	+120	+255	+300
18	Minor starters	-25	-25	-15
	TOTAL	+4560	+6735	~~+7325~~ +8810

(a) The figures for PSBR cost given in this table are calculated in terms of the change in the fiscal adjustment implied by each measure listed. They show how much of any fiscal adjustment indicated by the forecasts, assuming a given PSBR, would be used up.

* See notes to Tables 1 and 1A

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SCORECARD OF 21 JANUARY 1988

TABLE 3: STAFFING EFFECTS[a]

Proposal Number	Proposal	Effect on manpower numbers at April 1989	April 1990	April 1991
1	Excise Duties	Nil	Nil	Nil
2	VAT Base[b]	+10	+10	+10
3	Reduce basic rate of IT to 24p or 25p	Neg	Neg	Neg
	Indexation of personal allowances and first higher rate threshold	+10	+80	+80
4 & 5	Increase higher rate IT threshold to £20,000 Abolish higher rates of IT above 40p	Nil	-90	-90
6	Changes to Class 1 NICs at lower end in October 1988[c]	Nil	Nil	Nil
7	Independent taxation from 1990-91 - independent taxation of husband and wife[d]	+420	+770	+1425 to +1475
	- changes to APA rules[e]		not yet known	
8	Freeze CGT exempt amount	Nil	+10	+10
	Add remaining gains to income and tax at IT rates	Nil	+Neg	+Neg
9	Rebase CGT to 1982	Nil	+5	+5
10	Restrict new MIR to residence from 1.8.88 and leave ceiling unchanged at £30,000[f]	+25	+25	+25
11	Abolish tax relief on home improvement loans[g]	-150	-200	-250
12	Abolish tax relief on new covenants; change rules for maintenance payments[h]	-140	-320	-400
13	Increase car scales by 10 per cent in 1989-90	Nil	Nil	Nil
14	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91[i]	Nil	+150 to +250	Nil to +150
15	Reduce corporation tax rate to 33p	Nil	Nil	Nil
16	Reduce small companies' CT rate to 25p	Nil	Nil	Nil
17	Raise IHT threshold to £107,000 and set single rate of 40%	-5	-10	-15
18	Minor starters[j]	-75	-100	-100
	No change in stamp duty threshold	+10	+10	+10
	TOTAL[k]	+105	+440	+910

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Notes to Table 3

(a) Health Warning. The conventional assumption used in costing Budget changes is that nothing else is changing at the same time. But there are, of course, other factors which will affect the Revenue's and Customs' manpower over the same period. The correct approach in principle is to take all the changes into account in the order in which they should happen but, among other things, the need to maintain Budget security makes this difficult. So there is a risk of some double counting of both savings and costs. Pluses or minuses could turn out larger or smaller and some figures could change sign. The total is (like the PSBR) the difference between large plus and minus components.

(b) The effect on manpower numbers of extending VAT to non-domestic construction would be an additional 60 units in each of the three years.

(c) Staff effects at DHSS are not known.

(d) Setting up costs - some of the staffing need may be covered by use of overtime and casual staff.

(e) Changing the qualifying rules for APA will involve a staff cost (yet to be determined) for the Revenue.

(f) If the ceiling is increased to £35,000, there would be a transitional effect on manpower of +65 units in April 1989, falling to +15 in April 1990 and April 1991.

(g) Further staff savings in later years.

(h) Figures under review.

(i) These are setting up costs. Will produce staff savings in later years.

(j) The staff savings shown are entirely accounted for by abolition of minor personal allowances.

(k) Total uses maximum staff additions possible under proposals 7 and 14.

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SCORECARD OF 21 JANUARY 1988

TABLE 4: MINOR STARTERS

(Items in Starters list which Ministers have agreed are now serious contenders, including all those with revenue effects of £5 million or more)

FB Starter Number	Proposal	Cost(-) or Yield(+) in £ million 1988-89	1989-90	1990-91
30	Keith package (Customs & Excise)	Neg	Neg	Neg
34	Tax on supply to be liability of person completing VAT invoice	+5	+5	+5
60	Disclosure of importers' details	Neg	Neg	Neg
61	Search of persons	Nil	Nil	Nil
62	Penalty for customs fraud	Nil	Nil	Nil
63	Prosecution time limits	Neg	Neg	Neg
103	Abolition of three minor personal allowances (housekeeper, son's or daughters's services and dependent relative allowances)	+10	+10	+10
111	Review of S79 unapproved employee share schemes	Neg	Neg	Neg
117	Redundancy payments: top-slicing	Neg	Neg	Neg
118	Premiums for leases: top-slicing	Neg	Neg	Neg
151	Personal pensions: delay in commencement	+10	+10	+Neg
203	Business Expansion Scheme changes/limit		not yet known	
214	Lloyd's: RIC leavers	Neg	Neg	Neg
216	Lloyd's: reform of assessment system	Neg	Neg	Neg
354	North Sea Fiscal Regime		not yet known	
452	Keith package (Inland Revenue)		not yet known	
453	Forestry	Nil	Neg	Neg
-	BES: Privated rented sector		not yet known	
	TOTAL	+25	+25	+15

Note

Not included above are the following minor starters which protect existing revenue and are thus already assumed in the base forecast

213 In-year assessment of Schedule D income

400 S482: company residence and migration

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Mr Anson
Sir Anthony Wilson
Mr Scholar
Mr Sedgwick
Mr Odling-Smee
Miss Evans
Mr A Hudson
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Unwin - C&E
Mr Knox - C&E

Ch
Note below records errors, ~~but~~ - amendment made in manuscript
AA

BUDGET SCORECARD

... I attach the Budget Scorecard for the second Overview Meeting on Monday 25 January. The main changes to Table 1 since last time are these:

- line 7: the cost of independent taxation has gone up because we have discovered that previous estimates omitted the cost of transitional protection for breadwinner wives;
- lines 8 and 9: we have had another look at the likely effects of the CGT changes;
- line 13: we have allowed explicitly for a 10 per cent increase in the car scales in 1989-90, which was not in the figures before;
- Notes: we have added a 1991-92 costing for independent taxation. We have not yet been able to extend the costing of the fringe benefits tax to 1991-92, but we hope to do that next week.

RC

ROBERT CULPIN

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Additional copies for Scorecard work to:

Miss Sinclair	FP
Mr Riley	
Miss Hay	
Mr Michie	
Mr Sparkes	
Mr Sedgwick	
Mr Davies	MP
Mr Bredenkamp	
Mr Beighton	IR
Mr Calder	
Mr Marshall	
Mr Ko	
Mr McManus	
Mr Boyce	
Mr Allen	C&E
Miss French	

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SCORECARD OF 21 JANUARY 1988

TABLE 1: DIRECT EFFECTS OF BUDGET MEASURES
assuming a 25p basic rate of income tax

All figures are net of cost or yield of indexation or revalorisation.

Proposal Number	Proposal	Cost(-) or Yield(+) in £ million (rounded to £5 million) 1988-89	1989-90	1990-91
1	Excise Duties	Nil	-20	-55
2	VAT Base	+280	+420	+440
3	Reduce basic rate of IT to 25p	-2550	-3200	-3450
4	Increase higher rate IT threshold to £20,000	-220	-420	-500
5	Abolish higher rates of IT above 40p	-840	-1690	-1920
6	Changes to Class 1 NICs at lower end in October 1988	-380	-800	-850
7	Independent taxation from 1990-91	Nil	Nil	~~-810~~ -560
8	Freeze £6,600 CGT exemption, add remaining gains to income and tax at IT rates (25%/40%)	Nil	+30	+90
9	Rebase CGT to 1982 (cost includes rebasing CT on companies' gains)	Nil	-150	-350
10	Restrict new MIR to residence from 1.8.88 and leave ceiling unchanged at £30,000	+5	+20	+40
11	Abolish tax relief on home improvement loans	+80	+200	+300
12	Abolish tax relief on new covenants between individuals; change rules for maintenance payments	+35	+100	+160
13	Increase car scales by 10 per cent in 1989-90	Nil	+30	+35
14	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91	Nil	Nil	*
15	Reduce corporation tax rate to 33p	Nil	Nil	*
16	Reduce small companies' CT rate to 25p in 1988-89	-Neg	-50	-90
17	Raise IHT threshold to £107,000 and set single rate of 40%	-120	-255	-300
18	Minor starters	+25	+25	+15
	TOTAL TAX MEASURES	-3685	-5760	~~-7245~~ -6995

*See notes

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SCORECARD OF 21 JANUARY 1988

TABLE 1A: DIRECT EFFECTS OF BUDGET MEASURES

assuming a 24p basic rate of income tax

All figures are net of cost or yield of indexation or revalorisation.

Proposal Number	Proposal	Cost(-) or Yield(+) in £ million (rounded to £5 million) 1988-89	1989-90	1990-91
1	Excise Duties	Nil	-20	-55
2	VAT Base	+280	+420	+440
3	Reduce basic rate of IT to 24p	-3830	-4800	-5170
4	Revalorise higher rate IT threshold to £18,600	Nil	Nil	Nil
5	Abolish higher rates of IT above 40p	-900	-1820	-2080
6	No change to NICs	Nil	Nil	Nil
7	Independent taxation from 1990-91	Nil	Nil	~~-850~~ -600
8	Freeze £6,600 CGT exemption, add remaining gains to income and tax at IT rates (24%/40%)	Nil	+30	+90
9	Rebase CGT to 1982 (cost includes rebasing CT on companies' gains)	Nil	-150	-350
10	Restrict new MIR to residence from 1.8.88 and leave ceiling unchanged at £30,000	+5	+20	+40
11	Abolish tax relief on home improvement loans	+80	+200	+300
12	Abolish tax relief on new covenants between individuals; change rules for maintenance payments	+35	+95	+150
13	Increase car scales by 10 per cent in 1989-90	Nil	+30	+35
14	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91	Nil	Nil	*
15	Reduce corporation tax rate to 33p	Nil	Nil	*
16	Reduce small companies' CT rate to 24p in 1988-89	-Neg	-75	-135
17	Raise IHT threshold to £107,000 and set single rate of 40%	-120	-255	-300
18	Minor starters	+25	+25	+15
	TOTAL TAX MEASURES	-4425	-6300	~~-7870~~ -7620

*See notes

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Notes to Tables 1 and 1A

All figures show cost (-) or yield (+) in £ million unless otherwise indicated.

Excise Duties

1. The base forecast assumes excise duties revalorised by 3.7 per cent (the inflation rate for the twelve months to December 1987). If the duties were not revalorised, RPI inflation would be 0.28 percentage points lower than in the base forecast.

It has already been agreed not to increase duties on betting and gaming, and on matches and mechanical lighters. At the Overview Meeting on 18 January, a further package was agreed which assumed revalorisation in overall terms with the following departures for individual duties:

Alcoholic Drinks

Spirits: No change

Beer, cider and wines: increased to recoup revenue lost by not revalorising spirits, cider being increased by the same pence per pint as beer.

Tobacco

Pipe tobacco and cigars: no change
Cigarettes and hand rolled tobacco: increased to recoup revenue lost by not revalorising pipe tobacco and cigars.

Oils and VED

VED, unleaded petrol, fuel oil and gas oil: no change
Leaded petrol: increased to recoup revenue lost by not revalorising VED on cars and light vans, unleaded petrol, fuel oil and gas oil
Derv: increased to recoup revenue lost by not revalorising VED on other vehicles

The cost of this package is shown in Tables 1 and 1A. The package has been designed to have the same cost as revalorisation in 1988-89; the additional cost in subsequent years occurs because the cost of the standstill in duty on unleaded petrol rises faster than the yield from higher duties on leaded petrol and derv. It would have a very similar RPI effect to straight revalorisation and would imply the following percentage duty increases and price increases:

Product	Unit	Duty increase (per cent)	Price increase (pence) Proposed	Diff. from Reval.
Beer	Pint	4.8	1.0	+0.2
Cider	Pint	9.6	1.0	+0.6
Table wine	75cl	4.8	4.1	+1.0
Sherry	70cl	4.8	6.5	+1.5
Spirits	75cl	nil	nil	-20.1
Cigarettes	20KS	3.8	3.5	+0.1
Cigars	5 whiffs	nil	nil	-1.9
Pipe tobacco	25 grams	nil	nil	-2.7
Petrol (leaded)	Gallon	5.7	5.8	+2.1
Petrol (unleaded)	Gallon	nil	nil	-3.6
Derv	Gallon	5.3	4.5	+1.3
VED (cars)	-	nil	nil	-£3.70
VED (other)	-	nil	nil	-(various)
Gas oil	Litre	nil	nil	-0.2
Fuel oil	Litre	nil	nil	-0.1

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If instead of the above package, all alcohol and tobacco duties were double revalorised, and remaining duties revalorised, the yield would be:

	1988-89	1989-90	1990-91
Alcohol	+105	+115	+125
Tobacco	+100	+110	+110

This would add an additional 0.08 percentage points to RPI inflation (alcohol) and an additional 0.08 percentage points (tobacco).

0·16

VAT

2. The base forecast assumes no change in the standard rate and assumes revalorisation by 3.7 per cent of the VAT registration threshold to £22,100 (from £21,300).

The yield shown in Tables 1 and 1A arises from the changes to the VAT base discussed at Chevening and assumes the changes take effect from 1 May 1988. This would add an estimated 0.19 percentage points to RPI inflation.

The yield from and RPI effect of extending the VAT base to non-domestic construction (from 1 August 1988) and spectacles (from 1 May 1988) would be:

	1988-89	1989-90	1990-91	RPI effect
Construction	+100	+250	+400	Nil
with option to tax rents etc	+25	+75	+125	Nil
Spectacles	+15	+25	+25	+0.01

Income Tax Rates and Personal Allowances

3. The base forecast assumes statutory indexation by 3.7 per cent of the main personal allowances.

Mr Eason's paper of 14 January discussed the option shown in Table 1A, ie a 24p basic rate of income tax, revalorisation of the higher rate threshold to £18,600 and no changes to NICs at the lower end.

A 2p cut in the basic rate would add 0.12 percentage points to RPI inflation; a 3p cut would add 0.18 percentage points.

National Insurance Contributions

6. Assumes Option F selected at the meeting on 19 November:

	NIC rates			
Earnings Bands	Employees		Employers	
	now	Oct 1988	now	Oct 1988
Under £41	Nil	Nil	Nil	Nil
£41- £70	5	5	5	5
£70-£105	7	5	7	7
£105-£130	9	5	9	9
£130-£155	9	7	9	9
£155-£305	9	9	10.45	10.45

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Costings assume LEL uprated in April 1989 but no uprating of reduced rate bands. Benefit savings would be

1988-89	1989-90	1990-91
+15	+50	less than +50

Mr Scholar's paper of 21 January discusses further options on NICs at the lower end.

Independent Taxation

7. Costs are provisional. Assumes implementation from 1990-91 and:

- Disaggregation of all husband and wife's income
- Introduce Married Couples' Allowance equal to difference between MMA and single allowance with MCA transferable to wife if husband cannot use it fully
- MCA withdrawn gradually when husband's total income exceeds £40,000 (assumes clawback will operate in-year; full year yield of £100 million included in Tables 1 and 1A)
- Disaggregate husband and wife's capital gains with separate exemption of £6,600 each
- Only one CGT residence exemption per couple
- Review APA entitlement rules to remove tax penalty on marriage (yield not yet included in Tables 1 and 1A)
- Transitional protection for breadwinner wives
- Give age allowance only on basis of taxpayer's own age

The fourth year (1991-92) cost is estimated at £~~1190~~ 860 million with a 25p basic rate and £~~1250~~ 910 million with a 24p basic rate. (Figures do not yet include the effect of separate CGT exemption for husband & wife which would begin to feed through in 1991-92)

Capital Gains Tax

8. & 9. These costings are provisional and have been revised to reflect new behavioural and forecast assumptions. Aggregration of capital gains with income produces a small yield because of the higher effective tax rate; this is not entirely offset by a fall in the volume of disposals. The cost of rebasing will be reviewed in the next Scorecard when further work has been done on companies' gains.

Mortgage Interest Relief

10. All costings ignore behavioural effects and assume change to residence basis on 1 August 1988.

If the MIR ceiling was increased to £35,000 on the residence basis the cost would be:

	1988-89	1989-90	1990-91
25p Basic Rate:	-180	-230	-270
24p Basic Rate:	-170	-220	-260

Covenants and maintenance

12. Assumes abolition of relief on all new covenants between individuals on basis of option 3 in Mr Stewart's paper of 7 January. Assumes relief on maintenance payments to divorced/separated spouses and unmarried mothers limited to £2425, and no tax on payee.

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Fringe Benefits Tax

14. Assumes non-deductible FBT on employers at rate of 45 per cent introduced in 1990-91. Car scales would be increased in 1990-91 to 50 per cent of standing charges plus running costs (ie slightly more than double the 1987-88 scales). Receipts of FBT depend on coverage. The Revenue will be producing a paper and costings next week.

Car scales are set one year in advance; the base forecast incorporates the 10 per cent increase already announced for 1988-89 but assumes unchanged scales in 1989-90. It was decided at the Overview Meeting on 18 January to increase car scales by a further 10 per cent in 1989-90; the additional yield is shown under proposal 13 in Tables 1 and 1A.

The Revenue are also preparing a paper on car scales in the event that an FBT is not introduced.

Corporation Tax

15. It is assumed that the CT rate is cut by 2p to 33p in the year before employers start paying the FBT so that the effects of each are felt at the same time. The provisional decision to make FBT payable quarterly points to a cut in the CT rate in 1989.The cost of a 2p cut in the CT rate would be -neg in the first year, -£800 million in the second year (ie the year when receipts of FBT start) and -£1,200 million in a full year.

Minor Starters

18. See Table 4. Not included in Tables 1 and 1A are starters which protect existing revenue and are thus already assumed in the base forecast.

SCORECARD OF 21 JANUARY 1988

TABLE 2: PSBR EFFECTS[(a)]
assuming a 25p basic rate of income tax

Proposal Number	Proposal	Reduction (-) or increase (+) in £ millio (rounded to £5 million) 1988-89	1989-90	1990-91
1	Excise Duties	Nil	Nil	-30
2	VAT Base	-280	-220	-15
3	Reduce basic rate of IT to 25p	+2600	+3360	+3970
4	Increase higher rate IT threshold to £20,000	+230	+425	+540
5	Abolish higher rates of IT above 40p	+880	+1720	+2065
6	Changes to Class 1 NICs at lower end in October 1988	+390	+810	+880
7	Independent taxation from 1990-91	Nil	Nil	~~+850~~ +570
8	Freeze £6,600 CGT exemption, add remaining gains to income and tax at IT rates (25%/40%)	Nil	-30	-90
9	Rebase CGT to 1982 (cost includes rebasing CT on companies' gains)	Nil	+150	+350
10	Restrict new MIR to residence from 1.8.88 and leave ceiling unchanged at £30,000	-5	-20	-40
11	Abolish tax relief on home improvement loans	-65	-205	-370
12	Abolish tax relief on new covenants between individuals; change rules for maintenance payments	-35	-105	-185
13	Increase car scales by 10 per cent in 1989-90	Nil	-30	-35
14	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91	Nil	Nil	*
15	Reduce corporation tax rate to 33p	Nil	Nil	*
16	Reduce small companies' CT rate to 25p in 1988-89	Neg	+50	+90
17	Raise IHT threshold to £107,000 and set single rate of 40%	+120	+255	+300
18	Minor starters	-25	-25	-15
	TOTAL	+3810	+6135	~~+8265~~ +7985

(a) The figures for PSBR cost given in this table are calculated in terms of the change in the fiscal adjustment implied by each measure listed. They show how much of any fiscal adjustment indicated by the forecasts, assuming a given PSBR, would be used up.

*See notes to Tables 1 and 1A

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SCORECARD OF 21 JANUARY 1988

TABLE 2A: PSBR EFFECTS[(a)]
assuming a 24p basic rate of income tax

Proposal Number	Proposal	Reduction (-) or increase (+) in £ million (rounded to £5 million) 1988-89	1989-90	1990-91
1	Excise Duties	Nil	Nil	-30
2	VAT Base	-280	-220	-15
3	Reduce basic rate of IT to 24p	+3905	+5040	+5950
4	Revalorise higher rate IT threshold to £18,600	Nil	Nil	Nil
5	Abolish higher rates of IT above 40p	+945	+1850	+2240
6	No change in NICs	Nil	Nil	Nil
7	Independent taxation from 1990-91	Nil	Nil	~~+870~~ +615
8	Freeze £6,600 CGT exemption, add remaining gains to income and tax at IT rates (24%/40%)	Nil	-30	-90
9	Rebase CGT to 1982 (cost includes rebasing CT on companies' gains)	Nil	+150	+350
10	Restrict new MIR to residence from 1.8.88 and leave ceiling unchanged at £30,000	-5	-20	-40
11	Abolish tax relief on home improvement loans	-65	-205	-370
12	Abolish tax relief on new covenants between individuals; change rules for maintenance payments	-35	-105	-185
13	Increase car scales by 10 per cent in 1990-91	Nil	-30	-35
14	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91	Nil	Nil	*
15	Reduce corporation tax rate to 33p	Nil	Nil	*
16	Reduce small companies' CT rate to 24p in 1988-89	Neg	+75	+135
17	Raise IHT threshold to £107,000 and set single rate of 40%	+120	+255	+300
18	Minor starters	-25	-25	-15
	TOTAL	+4560	+6735	~~+7325~~ ~~+9065~~ +8810

(a) The figures for PSBR cost given in this table are calculated in terms of the change in the fiscal adjustment implied by each measure listed. They show how much of any fiscal adjustment indicated by the forecasts, assuming a given PSBR, would be used up.

* See notes to Tables 1 and 1A

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TABLE 3: STAFFING EFFECTS[a]

Proposal Number	Proposal	Effect on manpower numbers at April 1989	April 1990	April 1991
1	Excise Duties	Nil	Nil	Nil
2	VAT Base[b]	+10	+10	+10
3	Reduce basic rate of IT to 24p or 25p	Neg	Neg	Neg
	Indexation of personal allowances and first higher rate threshold	+10	+80	+80
4 & 5	Increase higher rate IT threshold to £20,000 Abolish higher rates of IT above 40p	Nil	-90	-90
6	Changes to Class 1 NICs at lower end in October 1988[c]	Nil	Nil	Nil
7	Independent taxation from 1990-91 - independent taxation of husband and wife[d]	+420	+770	+1425 to +1475
	- changes to APA rules[e]		not yet known	
8	Freeze CGT exempt amount	Nil	+10	+10
	Add remaining gains to income and tax at IT rates	Nil	+Neg	+Neg
9	Rebase CGT to 1982	Nil	+5	+5
10	Restrict new MIR to residence from 1.8.88 and leave ceiling unchanged at £30,000[f]	+25	+25	+25
11	Abolish tax relief on home improvement loans[g]	-150	-200	-250
12	Abolish tax relief on new covenants; change rules for maintenance payments[h]	-140	-320	-400
13	Increase car scales by 10 per cent in 1989-90	Nil	Nil	Nil
14	Abolish tax on employees' benefits in kind, introduce fringe benefits tax on employers and increase car scales in 1990-91[i]	Nil	+150 to +250	Nil to +150
15	Reduce corporation tax rate to 33p	Nil	Nil	Nil
16	Reduce small companies' CT rate to 25p	Nil	Nil	Nil
17	Raise IHT threshold to £107,000 and set single rate of 40%	-5	-10	-15
18	Minor starters[j]	-75	-100	-100
	No change in stamp duty threshold	+10	+10	+10
	TOTAL[k]	+105	+440	+910

Notes to Table 3

(a) Health Warning. The conventional assumption used in costing Budget changes is that nothing else is changing at the same time. But there are, of course, other factors which will affect the Revenue's and Customs' manpower over the same period. The correct approach in principle is to take all the changes into account in the order in which they should happen but, among other things, the need to maintain Budget security makes this difficult. So there is a risk of some double counting of both savings and costs. Pluses or minuses could turn out larger or smaller and some figures could change sign. The total is (like the PSBR) the difference between large plus and minus components.

(b) The effect on manpower numbers of extending VAT to non-domestic construction would be an additional 60 units in each of the three years.

(c) Staff effects at DHSS are not known.

(d) Setting up costs - some of the staffing need may be covered by use of overtime and casual staff.

(e) Changing the qualifying rules for APA will involve a staff cost (yet to be determined) for the Revenue.

(f) If the ceiling is increased to £35,000, there would be a transitional effect on manpower of +65 units in April 1989, falling to +15 in April 1990 and April 1991.

(g) Further staff savings in later years.

(h) Figures under review.

(i) These are setting up costs. Will produce staff savings in later years.

(j) The staff savings shown are entirely accounted for by abolition of minor personal allowances.

(k) Total uses maximum staff additions possible under proposals 7 and 14.

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SCORECARD OF 21 JANUARY 1988

TABLE 4: MINOR STARTERS

(Items in Starters list which Ministers have agreed are now serious contenders, including all those with revenue effects of £5 million or more)

FB Starter Number	Proposal	Cost(-) or Yield(+) in £ million 1988-89	1989-90	1990-91
30	Keith package (Customs & Excise)	Neg	Neg	Neg
34	Tax on supply to be liability of person completing VAT invoice	+5	+5	+5
60	Disclosure of importers' details	Neg	Neg	Neg
61	Search of persons	Nil	Nil	Nil
62	Penalty for customs fraud	Nil	Nil	Nil
63	Prosecution time limits	Neg	Neg	Neg
103	Abolition of three minor personal allowances (housekeeper, son's or daughters's services and dependent relative allowances)	+10	+10	+10
111	Review of S79 unapproved employee share schemes	Neg	Neg	Neg
117	Redundancy payments: top-slicing	Neg	Neg	Neg
118	Premiums for leases: top-slicing	Neg	Neg	Neg
151	Personal pensions: delay in commencement	+10	+10	+Neg
203	Business Expansion Scheme changes/limit		not yet known	
214	Lloyd's: RIC leavers	Neg	Neg	Neg
216	Lloyd's: reform of assessment system	Neg	Neg	Neg
354	North Sea Fiscal Regime		not yet known	
452	Keith package (Inland Revenue)		not yet known	
453	Forestry	Nil	Neg	Neg
-	BES: Privated rented sector		not yet known	
	TOTAL	+25	+25	+15

Note

Not included above are the following minor starters which protect existing revenue and are thus already assumed in the base forecast

213 In-year assessment of Schedule D income

400 S482: company residence and migration

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