

PO-CH/NL/0124

PART A

Part A.

CONFIDENTIAL

(Circulate under cover and notify REGISTRY of movement)

Begins: 11/6/85.
Ends: 26/11/87.



PO -CH /NL/0124



PART A

Chancellor's (Lawson) Papers:

POSSIBLE AREAS IN WHICH
TO INTRODUCE NEW TAXES

PO -CH /NL/0124

PART A

Disposal Directions: 25 Year

J. Anderson

21/8/95.



H.M. CUSTOMS AND EXCISE
 KING'S BEAM HOUSE, MARK LANE
 LONDON EC3R 7HE

Please Dial my Extension Direct:
 Use Code (01)-382 followed by
 Extension Number 5.02.3...

Contd. from work book 2 avail. with Mr. P. H. M. M.

From: P G Wilmott
 Date: 11 June 1985

PS/Chancellor of the Exchequer

cc PS/Minister of State
 Mr Monger
 Mr Cropper

*As requested.
 Note para 4. See also
 two flags. Ruo 11/6*

AIRPORT TAX

1. Your note of 4 June asked for a list of Western countries which operate an airport tax.
2. This is an area of taxation where our information on international practice is limited and open to considerable misinterpretation. Many countries collect from departing air passengers taxes or fees designed to help pay for aviation facilities. The United Kingdom operated a "tax" of this kind in the early post-war years before the establishment of the British Airports Authority, the proceeds going to the former Ministry of Civil Aviation (who were at that time responsible for the major airports). Nowadays the BAA, in common with its counterparts in most other industrialised countries, collects all airport charges direct from the airlines.
3. We have assumed that the Chancellor is interested not in these "airport taxes" but rather in "departure taxes" of a type levied on international passenger travel and designed to raise revenue for the national exchequer. As far as we can establish, only a few Western countries operate such departure taxes : in the European Community, Belgium, Denmark and Ireland; of other OECD countries, Australia, New Zealand, Canada, Japan and Sweden. I attach a note which sets out in a little more detail our understanding of the position in those countries, but I should stress that it is only as reliable as our not very comprehensive sources in this area.

Internal circulation: CPS, Mr Knox, Mr Bone

4. We have received a number of letters this year about departure taxes as revenue raisers and have just started a quick review of such taxes and their possible application here. We shall be reporting to the Minister of State when we have completed our study.

X



P G WILMOTT

DEPARTURE TAXES IN WESTERN COUNTRIES

The following countries are understood to operate departure taxes:

Belgium

Belgium has recently introduced a travel tax on all flights to or from Belgium. The tax is levied on all passengers over 2 years of age. Tax rates vary depending on the airport used and whether the ticket is purchased in Belgium or overseas.

Denmark

In 1977 Denmark introduced a "charter flight" tax of about £4.00 payable by all passengers of 2 years and over, on charter flights leaving the country from Danish airports. The rate was increased to about £12.75 per passenger in June 1980. In 1982 tax receipts were about £9 million.

Ireland

On 1 September 1982 Ireland introduced a new tax on all passenger tickets purchased in Ireland for travel from Ireland to any destination outside the country (other than Northern Ireland). The tax, known as a Foreign Travel Tax, is payable on travel by sea or air. The rate was increased on 1 April 1983 to about £4.00.

Australia

A departure tax of about £11.00 per person is payable by all passengers over 12 years of age, leaving the country from an Australian airport or seaport. It is not payable by transit or short stay passengers.

New Zealand

New Zealand has a departure tax payable on air tickets purchased in New Zealand. The current rate is about £14.10 per passenger, but there are reduced rates for children under 12. The tax is collected by central government and in the year ending 31 March 1984 raised about £4.4 million. In addition there is a tax of about £0.70 per passenger on all departures from an airport. This is payable by passengers who purchased their tickets overseas as well as by passengers who purchased their tickets in New Zealand (in which case it is additional to the departure tax mentioned above). This is a regional authority tax and appears to be hypothecated directly to the support of aviation. It is therefore, more akin to an airport tax than a departure tax.

Canada

Canada introduced a departure tax in 1974. It covers all international flights leaving Canada and is not dependent on the place of issue of the ticket. If the ticket is purchased in Canada and is for any destination other than the USA the rate is about £8.80 per passenger. For flights to the USA the tax is levied at a rate of 8% of the ticket price up to a maximum of about £4.00. If the ticket is purchased in Britain a charge of £10.00 is made. In 1982 tax receipts were about £116 million. The airlines are responsible for collecting the tax.

Japan

Japan has had a "travel tax" for many years. The tax is an ad valorem charge of 10% of the fare and is payable on travel by train, ship or aircraft. This is not a departure tax as such since it is levied on domestic as well as international travel, but because of various exemptions the great bulk of the tax (well over 90%) is collected from air travel.

Sweden

Sweden introduced a "travel tax" in 1978 on air passengers leaving the country. The tax is levied on all people over 12 years of age and the present rate is about £18.00 per person. For people who buy return tickets abroad, there are apparently international agreements on how much should be included in the ticket price to allow for the departure tax. The airlines are responsible for paying the tax to the fiscal authorities. In 1982 tax receipts were about £15 million.

CONFIDENTIAL

*PS of Mr. & Mrs. Vines
Adv. 1/2*



FROM: M W NORGROVE

DATE: 22 July 1985

C. Mr Wilmott's minute below, as requested.

PS/CHANCELLOR I think the potential revenue is attractive - even a charge of only £5 would still reap £175m - and I don't see the arguments against as overwhelming by any means.

- cc PS/Chief Secretary
- PS/Financial Secretary
- PS/Economic Secretary
- Mr Monger
- Mr Griffiths
- Mr Cropper
- PS/Customs & Excise
- Mr B H Knox C & E
- Mr Wilmott C & E

If you wished to pursue as a possible Budget starter, a short letter to Mr Tebbit, copied to Messrs Ridley, Young and N/O would be one way,

A POSSIBLE DEPARTURE TAX

but that could provoke very negative responses. A better way might be to float it to Mr Tebbit first in discussion.

The Minister of State has seen Mr Wilmott's minute of 19 July. *(but still negative) line*
In view of the Chancellor's commissioning of this review, the *at Flag X.*
Minister would be grateful if you could please check with the
Chancellor that he is happy with this general line. *Riv 29/7*

M W NORGROVE

Private Secretary

CONFIDENTIAL



6/8 14/8pl

FROM: VIVIEN LIFE
DATE: 31 July 1985

APS/CHANCELLOR

cc: PS/Chief Secretary
PS/Minister of State
PS/Economic Secretary
Mr Monger
Mr Griffiths
Mr Cropper
Mr Davies
Mr Lord

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

A POSSIBLE DEPARTURE TAX

The Financial Secretary has seen the papers on this issue including your minute of 30 July. He has commented that, although he can always see attraction in the revenue raised from such a tax he thought that the Government's aim was to lower, broaden and abolish taxes where possible. He does not see the fact that we have an attractive tourist industry as a sufficient reason to try milk it and add an impediment to movement.

VIVIEN LIFE

Handwritten notes:
P
...
news (on 5/10)

PS/CHANCELLOR

FROM: P J CROPPER
DATE: 31 July 1985cc PS/Minister of State
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Monger
Mr Griffiths
Mr Davies
Mr Lord
PS/C&E
Mr Knox - C&E
Mr Wilmott - C&EA POSSIBLE DEPARTURE TAX

The Chancellor has asked for views on a possible departure tax.

2. In the run up to this year's budget, when the sterling exchange rate was very low, I thought seriously that we might introduce a tax on tourists - an arrival rather than a departure tax. Congestion on the streets of London makes one think there might still be a good case.

3. Mr Willmott's calculations are based on a departure tax of £10 a head. I do not think we could possibly charge that much to people using the short sea crossings. Which means, really, that it would be simpler and easier to justify confining the tax to airborne departures. Once one had limited the tax to people flying out of the country, it might be decided that yet higher airport charges would be a more logical step to take.

4. From an EEC point of view, I cannot imagine Lord Cockfield would be very happy if we put a swingeing departure tax on those travelling within his "internal market".

5. On balance, I doubt whether this would be a very happy method of raising an extra £¼ billion or so in taxation.

P J CROPPER

FROM: H J DAVIES
DATE: 1 AUGUST 1985

CHANCELLOR 12/2

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Mr Monger
Mr Griffiths
Mr Cropper
Mr Lord
PS/C&E
Mr Knox, C&E
Mr Wilmott, C&E

A POSSIBLE DEPARTURE TAX

I am in principle prejudiced in favour of small, discreet and discrete taxes as long as they are relatively cheap to administer. At first sight this appears to fall into that category.

2. But there are three problems:

- novelty
- collected with the price of a ticket it would look like a travel surcharge, and
- £10 is rather high.

3. The novelty of the tax is a problem since we often make a virtue of your success in abolishing three taxes in two years. We would need to drop that line and might have it thrown back at us.

4. Collected by travel agents it would look very obviously like a ticket surcharge. I suppose Customs and Excise are right that it would be impossible to collect at airports though I note that in Australia there is a very simple procedure at airports whereby a traveller purchases a kind of postage stamp which is attached to one's boarding card. This did not look to me to be a very complex process, though I recognise that the numbers here are greater and that one is so happy to leave Australia that 10 dollars seems a small price to pay.

5. £10 is a rather large sum in relation to the cost of many package holidays or, indeed, to the cost of a cross channel short

term trip. Many packages to Spain, for example, are in the £150-£200 area with flights still often below £100. This would therefore be a surcharge of between 5% and 10% on the cost of holidays for many working class and lower middle class people. Since this would hit very directly at the kind of voters we need to attract again in the next election the electoral arithmetic of the tax looks unappealing.

6. I am therefore left with the conclusion that unless a lower, say £5, tax could be cheaply collected at the point of departure, I find the proposal unattractive. And obviously a smaller than £10 ^{proposal} the/ would not generate much revenue.

HJ9

H J DAVIES

FROM: R A L LORD
 DATE: 2 AUGUST 1985
 cc. Chief Secretary
 Financial Secretary
 Minister of State
 Economic Secretary
 Mr Monger
 Mr Griffiths
 Mr Cropper
 Mr Davies
 PS/C&E
 Mr Knox C&E
 Mr Wilmott C&E

CHANCELLOR

A POSSIBLE DEPARTURE TAX

I suspect that the letters which Treasury ministers receive recommending a departure tax are mostly prompted by little-England patriotism. Those to whom a departure tax appeals probably see any holiday taken abroad as a loss of jobs to this country and a blow to the balance of payments, just as they see investment abroad as investment lost to this country.

2. Although this feeling is quite strong it is surely not an argument we can use to justify such a tax. Given our generally anti-protectionist stance and our abolition of exchange controls it would be odd (and in the long run economically damaging) to introduce what would amount to a customs duty on trade in tourists.

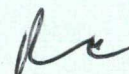
3. Nor do I see that we could justify it on grounds of fiscal neutrality. There may be a case for putting VAT on public transport, but surely not for putting a tax only on foreign travel.

4. These arguments of principle should not be underestimated when it comes to persuading people of the merits of a new tax. There will also be other more sectional arguments against it, such as that it will penalise exporters (this from the same people who see holidays abroad as unpatriotic), that a flat rate tax would be regressive and that it would damage tourist interests. It would certainly look somewhat

inconsistent with the tourism review which Lord Young has just published. And of course the large number of holidaymakers going abroad would resent it.

5. The main argument in favour might be that foreign travel was a luxury like whisky or cigarettes and different in kind from domestic travel. There is undoubtedly a degree of disapproval/envy of foreign holidays expressing itself along the lines "if my milkman can afford a holiday in Spain then he can afford to pay proper rent/rates/tax etc...

6. On balance, I would be against introducing a departure tax. But having said that, it might be fairly invisible. Travellers are already used to paying surcharges of various kinds for fuel price increases or security checks. Indeed when my secretary, Mrs Bateman, asked the inquiry office at Gatwick today why she needed to pay additional charges on her air ticket she was told: "it's a kind of departure tax"



R A L LORD

CONFIDENTIAL



FROM: A M ELLIS
DATE: 2 August 1985

PS/CHANCELLOR

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Mr Monger
Mr Griffiths
Mr Cropper
Mr Davies
Mr Lord
PS/C&E Mr Knox - C&E
Mr Wilmott - C&E

A POSSIBLE DEPARTURE OF TAX

The Economic Secretary has seen the papers on this issue. Like the Financial Secretary (Ms Life's minute of 31 July) he is not enthusiastic about what is in effect a tax on the movement of people. He has also commented that the figure of £10 per head seems very high and its projected effect on demand (paragraph 5 of Mr Wilmott's paper) suggests that it could have a traumatic effect on the tourist industry.

A handwritten signature in black ink, appearing to be "A M Ellis".

A M ELLIS

FROM: M C FELSTEAD

DATE: 24 October 1986



PS/CHANCELLOR

)
)

Copied to each

PS/MINISTER OF STATE

)

cc

Miss Sinclair

SURCHARGE ON TOURISTS

You may be interested to see a copy of the
... attached correspondence between Lord Young
and the Chief Secretary.

*Copy with
present*

M C Felstead

M C FELSTEAD

Assistant Private Secretary



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Lord Young of Graffham
Secretary of State for Employment
Department of Employment
Caxton House
Tothill Street
London
SW1H 9NF

24 October 1986

Dear David,

SURCHARGE ON TOURISTS

Many thanks for sending me Mr Leigh's letter about the new arrangements in the USA for surcharging international passengers.

I certainly take your point about the surcharge being a possible way to cover additional expenditure - I promise to think about the idea!

Yours ever,
JM

JOHN MacGREGOR



Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213 6460.....

Switchboard 01-213 3000 GTN Code 213

Facsimile 01-213 5465 Telex 915564

22 October, 1986

The Rt. Hon. John MacGregor O.B.E., M.P.,
Chief Secretary,
H M Treasury,
Parliament Street,
London, S.W.1.

John MacGregor

Even though I have the responsibility for tourism, I am enclosing a copy of a letter I have received from a friend of mine which I suspect could be quite a useful way to cover any additional expenditures.

John MacGregor

26 MANCHESTER SQUARE
LONDON W1M 6EU

TEL: 01-486 6080

FAX: 01-486 5428

TELEX: 894915

2/MG/7121

29th September 1986

Rt Hon Lord Young of Graffham
28 York Terrace West
London NW1 4QA

Dear David,

I happened to see the enclosed note at the bottom of my Pan American World Pass statement.

It would appear that the United States are covering their increased costs of services provided by imposing an additional surcharge on all passengers.

I must tell you that the service has greatly improved at ports of entry and departure.

Is this one worthwhile considering?


G N LEIGH

PAN AM WORLDPASS. STATEMENT

1986 Prior Balance at Statement	+ Total Miles Posted This Statement	= 1986 Miles Available For Award Claim	Activity Processed Through
0	5,000	5,000	13 Jun 86
WorldPass Number	Total Miles Available in Prior Year Programs		Lifetime WorldPass Mileage
75011075Z	1984 0	1985 0	5,000

Including all miles previously redeemed. Amount shown is not applicable to current award claims.

Mr. Geoffrey N. Leigh
3 Manchester Square
London, Great Britain

If you have changed your address, please make the appropriate changes next to your current address printed at left. Please indicate whether change of address is for:
 WorldPass only or Home address or
 WorldPass and Clipper Club Business address
 Signature: (All changes of address must be signed and dated).

PAN AM. Pan American World Airways, Inc. P.O. Box 4200 Woburn, MA 01888

X _____ Date: _____

MILEAGE SUMMARY

June 1986 Page 1 of 1
016699 75011075Z 913 S1XXXA

Date	Activity	Travel Itinerary	Miles	Partner Miles	Comments	Bonus Miles	Total Miles
	Current Balance						5,000

FAST FACTS

Effective July 7, 1986, Pan Am must comply with a new U.S. Customs Service requirement that a U.S. \$5.00 surcharge be collected from every international departing passenger to cover the U.S. Custom Service's increased costs. This surcharge must be collected on all tickets including free WorldPass awards.



14/3/67.

Wholly wrong, unusable
& unacceptable.

Let us see to say
praise of Family

Credit - ~~the~~ general
has specific targets
What need of

greater - & as to
tax, wait for RTHF's
Budget.

v

TAX CUTS 'NO GAIN' TO LOW-PAID 12 MILLION (Guardian, 14 March)

(behind)

Mr Gordon Brown asserts that:

- 12 million married couples and single people will gain little or nothing from the Budget;
- for each £1 they receive in tax cuts,
 - 215,000 people on housing benefit (HB) will lose 65p,
 - 350,000 families on family credit (FC) will lose 70p
 - 100,000 families on FC and HB will lose 96p.

Line to take

- (i) [Vast majority of 12 million do not pay income tax, and so by definition cannot benefit from income tax cuts.] Since 1979, Government has (before today's Budget) taken 1½ million out of tax.
- (ii) Mr Brown's last number is wrong. Fewer than 10,000 families will lose 96p for each £1 they receive in tax cuts. New regime will result in fewer people with marginal tax rates over 90 per cent than now (around 70,000 versus 115,000).
- (iii) Under new social security regime, tax cuts can take people off benefits altogether (or reduce their benefits by increasing net incomes). Better for people to keep more of their own earnings than depend on benefits.
- (iv) Income related benefits based on net income more rational. Means marginal tax rates cannot go above 100 per cent. Would Opposition want to keep old system, which allows marginal tax rates of over 100 per cent?
- (v) 88 per cent of those on income-related benefits will gain in cash terms from transition to new system or see no change.
- (vi) Is Government to be criticised for spending so much more on Family Credit, from which 450,000 will benefit compared to some 200,000 on Family Income Supplement?

Background

Under new system of social security, which comes into operation on 6 April 1988,

- withdrawal of benefits calculated with reference to net income (after income tax and NIC) rather than gross income as previously. Means marginal tax rates cannot go above 100 per cent. So except in very limited circumstances (NIC steps), cannot be made worse off by earning more;
- net earnings basis of benefit withdrawal means that those receiving income related benefits will lose much of their tax cut through reduction in benefit (although with a lag until they become subject to reassessment). Mr Brown's estimates of the withdrawal rates are correct.

Labour says benefit losses will cancel out Chancellor's largesse

Tax cuts 'no gain' to low-paid 12m

John Carvel
Political Correspondent

THE Chancellor's expected tax cuts package tomorrow will provide little or no benefit to about 12 million married couples and single people on low incomes, according to calculations published yesterday by the shadow Chief Secretary to the Treasury, Mr Gordon Brown.

"This is the first time so many taxpayers have been unable to secure any real cash benefit from a tax reduction," he said.

"The reason is that they will lose in rent and rates rebates and family credit almost all they gain from a tax cut. Under the new social security changes benefits for low-income families and pensioners are taken away immediately there is a tax cut."

Mr Brown said that 215,000 people on housing benefit will lose 65p from each pound they gain in tax cuts; 350,000 families on family credit will lose 70p; and 100,000 families on housing benefit and family credit up to 96p.

In addition, a million people, many of them pensioners, receiving housing benefit for rates only would lose a substantial part of any money gained from tax cuts.

Mr Brown went on: "For a family on £100 a week in receipt of family credit and housing benefit a 2p cut in the basic rate will be worth exactly 2p a week.

"For someone on £50,000 a 2p cut in the basic rate and a cut in the top rate of tax to 40 per cent would mean a cash boost of over £67 a week, or £3,513 a year; for those at the bottom of the earnings ladder it will mean 2p a week or £1 a year."

Mr Robin Cook, Labour's

social services spokesman, said that tonight the Government would run into fierce Opposition protests when it tries to impose the guillotine on the Social Services Bill to push it through the Commons on the eve of the budget.

"This is the bill which stops unemployed teenagers and people over 55 with retirement pensions from getting benefit," he said.

"No previous government has tried to guillotine discussions on amendments before the debate on them even begins. Now, this government is applying to the procedures of Parliament its security policy of shoot first and talks afterwards."

CONFIDENTIAL

*This is a look at it
I have a paper on it
with an open mind
ch
Now attached
19/3*

From: N MONCK
Date: 17 March 1987

MR SCHOLAR

cc Mr A C S Allan
Sir P Middleton
Mr Burgner
Mrs Lomax
Mr Culpin

THE INDEPENDENT STORY ON "TAX REVIEW OF TAKEOVER FINANCING"

The Independent reports that

"The Government is considering introducing legislation to remove some of the tax offsets available to companies which borrow heavily to launch takeovers, it emerged yesterday."

Mr Farrow tells me that the Governor was taken aback to find that his supposedly informal remarks to an Industrial Society seminar were being recorded and that he was then questioned.

2. Mr Farrow said we should not regard this incident as implying that the Governor was trying to win support for this tax proposal. He did not know whether the Governor had seen my letter (to Mr Farrow) of 3 February. It said that the Bank's ideas had been looked at both in the Treasury and in the Inland Revenue; and that we were agreed that the proposal did not seem at all promising to us, either in a general form or if it were confined to takeovers. The letter concluded by saying:

"In short we think that a modest reduction in the allowability of interest to bring about parity of tax treatment between interest and dividend would be difficult to operate, hard to defend and probably ineffective in restraining leveraged takeovers."

3. The Independent quotes a DTI spokesman as saying that the proposal is being considered "because it has been raised by a very substantial contributor to the review". Hans Liesner has not yet come back to me on this. But this is not necessarily a reference to the Bank and is in a sense perfectly fair since the Review is formally still considering everything put to it. The idea was included in a paper submitted by Adrian Cadbury through MAFF as a possibility worth considering for limiting the problems raised by heavily geared bids: the suggestion was

"that the ability to offset interest charges against tax should be gradually tapered off and removed beyond a certain point".

However he is on the Court at the Bank of England. Mr Farrow is finding out whether the Court has discussed this subject.

*not copied to us

4. Kit Farrow agreed to make sure that the Governor is now told about the contents of my letter of 3 February.

5. If IDT needs a line, they could say that this is for the DTI but they understand it is one of (many) ideas included in representations to the DTI.



N MONCK

THE INDEPENDENT

Tax review of takeover financing

??

||

THE Government is considering introducing legislation to remove some of the tax offsets available to companies which borrow heavily to launch takeovers, it emerged yesterday.

The idea, which was initially disclosed by the Governor of the Bank of England, Robin Leigh-Pemberton, was later confirmed by the Department of Trade and Industry.

The plan that appears to be under consideration would effectively make it difficult or impossible for companies to offset against tax the interest payments they incur in financing takeovers.

The idea was revealed by Mr Leigh-Pemberton when he answered questions after a speech at an Industrial Society seminar, in which he had again criticised the "irresponsible" behaviour of some takeover practitioners. He particularly singled out "predators" who take minority

By Michael Harrison and
Jonathan Davis

shareholdings and use the threat of a takeover bid to unsettle well-managed companies.

Confirming that the tax change was one of the options being considered by the Government's competition policy review team, Mr Leigh-Pemberton said the purpose of the change would be to deter "highly-leveraged bids".

These are bids in which the bidder borrows heavily against the assets of the company which it is bidding for. They are the device by which relatively small companies are often able to bid for companies many times their size.

According to sources on the review panel, the proposals to deter highly-leveraged bids are likely to attract a fair degree of support, though it is by no means certain that the Government will eventu-



Robin Leigh-Pemberton: attacking "irresponsible" takeover practitioners.

ally implement them. The panel is understood to be considering a range of tax measures and amendments to accounting legislation designed to make certain takeover activity less attractive.

Typical of the kind of takeovers which could be affected by the

ending of tax allowances is last year's Elders IXL bid for Allied-Lyons, which was heavily financed through loans. The Monopolies Commission eventually ruled that the bid was not against the "public interest", despite the Bank's warning that the financing meth-

ods raised serious dangers.

Asked about the tax change idea last night, a DTI spokesman said: "The proposal is being given full consideration because it has been raised by a very substantial contributor to the review."

Outlook page 19

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3971/42

VAT

PS/CHANCELLOR

Noted
Nigel

FROM: P J CROPPER
DATE: 30 April 1987

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Scholar
Mr A Edwards
PS/Customs

VAT - EUROPEAN PARLIAMENT

Received by this morning's post. Perhaps Customs and Mr Edwards' team will be able to evaluate.

Imyable

PJ

P J CROPPER

GRP TORY
GRP RADO
GRP TVEE
GRP POPS
GRP EVEN
GRP SCOT
GRP WALE
GRP NOWT
GRP NEST
GRP SWET
GRP SAST
GRP MIDS
GRP MANN
GRP ANGL
GRP BRUS
GRP TCOM
PAPA

PRESS RELEASE FROM THE CONSERVATIVES IN THE EUROPEAN
PARLIAMENT: THE EUROPEAN DEMOCRATIC GROUP.

BRUSSELS: THURSDAY APRIL 23 1987.

ZERO RATING DEFENDED.

Conservatives in the European Parliament today won a significant battle in defence of Britain's VAT zero rating system.

By an overwhelming majority the European Parliament's Economic and Monetary Committee backed Tory Euro MP Ben Patterson's view that abolition of zero rating is politically unacceptable.

"This shows that the Labour Party's scare stories that the European Community are about to impose VAT on children's clothes, food and transport are groundless.

"There never has been any evidence that zero rating is to be abolished. I welcome the support that Labour colleagues in the European Parliament gave to my amendment.

"As far as this committee is concerned there is no threat of abolition of zero rating as the Labour Party has been claiming.

"Let there be no mistake, Parliament will listen to the committee and the Commission will have to take account of Parliament's view."

The committee also backed moves tabled by the MEP for Kent West to simplify taxation on alcohol and tobacco.

He said afterwards: "In the case of alcohol it means tax would be charged according to alcoholic content ending the ability of countries such as France to exempt their own wine while laying heavy duty on British whisky."

ENDS

More information: Contact Chris White Brussels (010 322) 234 3024. Home 771 81 28.

GRS 400

UNCLASSIFIED
FM UKREP BRUSSELS
TO IMMEDIATE FCO
TELNO 1578
OF 111905Z MAY 87

*Don't draw X
with LS of
P. Croppin. (all mm?)*

FRAME ECONOMIC

EUROPEAN PARLIAMENT PLENARY, STRASBOURG 11 MAY : VAT ZERO RATES AND
FOOD DISTRIBUTION

SUMMARY

1. BRITISH LABOUR GROUP FAIL TO SECURE AGREEMENT TO A DEBATE/
COMMISSION STATEMENT ON VAT ZERO RATES, BUT MANAGE TO ARRANGE A
DEBATE ON THE EC PROGRAMME TO DISTRIBUTE MEAT AND BUTTER TO THE OLD
AND POOR.

DETAIL

2. THE EP PLENARY DECIDED BY A STRONG MAJORITY NOT TO TAKE A
MOTION FOR A DEBATE PRESENTED BY MCMAHON (UK LABOUR) AND 21 OTHERS
ON VAT ZERO RATES. THE DRAFT MOTION WAS COINED IN TERMS OF SEEKING
A COMMISSION STATEMENT ON THE 11 MAY ECOFIN AND 12 MAY INTERNAL
MARKET COUNCIL. LORD PLUMB (EP PRESIDENT) POINTED OUT THAT THE IM
COUNCIL HAD BEEN CANCELLED. COMMISSIONER SUTHERLAND, ON BEHALF OF
LORD COCKFIELD, CONFIRMED THAT NO PROPOSALS ON VAT APPROXIMATION HAD
YET BEEN DISCUSSED OR AGREED BY THE COMMISSION. WORK WAS CONTINUING
AT THE LEVEL OF THE COMMISSION SERVICES. KLEPSCH (GERMAN CD), LEADER
OF THE EPP) ASKED THE LABOUR GROUP NOT TO DRAG DOMESTIC ELECTORAL
POINTS INTO THE EP. IN THE VOTE, ONLY LABOUR MEMBERS VOTED IN FAVOUR
OF ALLOCATING DISCUSSION TIME TO THE MOTION.

3. THE BRITISH LABOUR GROUP DID SUCCEED BY ONE VOTE IN SECURING A
DEBATE ON THE OPERATION OF THE EC PROGRAMME TO DISTRIBUTE FOOD TO
THE OLD AND POOR. A SHORT DEBATE TOOK PLACE AT WHICH NEWMAN (UK,
SOC) ARGUED THAT PERHAPS A HEATING ALLOWANCE WOULD HAVE BEEN MORE
APPROPRIATE THAN THE FREE DISTRIBUTION OF FOOD. IN HIS VIEW, MOST OF
THE PROBLEMS EXPERIENCED WITH THE EXERCISE HAD OCCURRED IN THE UK.
ONLY 13,624 TONNES OF BUTTER AND 1041 TONNES OF BEEF HAD BEEN
DISTRIBUTED THERE. NO FLOUR, SUGAR OR VEGETABLE OIL HAD BEEN
DISTRIBUTED AT ALL IN THE UK DESPITE THESE BEING IN SURPLUS. THE
CHARITIES WHICH WERE FORCED TO PLAY A PRINCIPAL ROLE SHOULD BE
REIMBURSED BY THE COMMISSION FOR ALL EXPENSES INCURRED. PROUT (UK,
EDG) WAS CONVINCED THAT IT WAS TOO EARLY TO HOLD A DEBATE, THE EP
WAS NOT IN FULL POSSESSION OF THE FACTS AND COMMISSIONER ANDRIESEN
HAD NOT YET COME FORWARD WITH HIS PROMISED DETAILED REPORT. UK
CHARITIES WANTED THE EXPERIMENT TO BE REPEATED PROVIDED THEY WERE
GIVEN MORE ADVANCED WARNING, AND STRICTER RULES ON ELIGIBILITY. HE
ADMITTED THERE HAD BEEN A PARTICULAR PROBLEM WITH THE DISTRIBUTION

OF BEEF, WHICH NEEDED TO BE COOKED. TAYLOR (UK, EURO RIGHT) WELCOMED THE SCHEME AND PRAISED THE COMMISSION AND CHARITIES FOR ACTING PROMPTLY. BUT THE UK GOVERNMENT HAD MADE NO PROPER ARRANGEMENTS FOR THE DISTRIBUTION AND ITS FINANCING. HE WAS SHOCKED AT THE LACK OF HMG'S SUPPORT. COMMISSION SUTHERLAND, WHO WAS PRESENT, CHOSE NOT TO RESPOND.

HANNAY

YYYY

ADVANCE

KERR FCO

WALL FCO

WEBB FCO

HOLROYD CAB

BUDD CAB

HADLEY MAFF

MELVILLE MAFF

MORTIMER TSY

CRABBIE TSY

ANDREWS TSY

FRAME ECONOMIC

EC0 (1)

UCLNAN 8188

(ADVANCED AS REQUESTED)

NNNN



Minister of State, Treasury

PPS

Draft reply prepared
by Mr Tynie -
with possible extra
paragraph to rebut
what MST calls
Mr Lomas' "literary".

DR
3/6

MST From Mr. Tynie,
Comments please. PS refers
to your earlier comment.

SPS 3/6

DRAFT REPLY FOR THE PRIME MINISTER TO SEND TO ALF LOMAS

This is also going in Chancellor's
box tonight.

Thank you for your letter of 15 May.

2. As an MEP you should know that it is quite absurd
to talk of vetoing Commission proposals before they
have even been made. The Commission's proposals may
or may not contain suggestions affecting the zero
rate. The Government cannot ^{do as you suggest and} form a view on proposals
it has not seen, and neither can you. [but that is what
your letter suggests the Government should do].

3. Finally, the alteration in VAT rates occurred soon
after the 1979 election. You seem to forget
that the Conservatives also won a General
election in 1983.

Ch
This is too felle, give PM's
own line at Press Conference etc. &
I attach alternative

P.E.

MA

Use etc. as
amend.



FROM: S P JUDGE

DATE: 4 June 1987

PRINCIPAL PRIVATE SECRETARY

cc Mr Tyrie

Mr Wilmott - C&E

LETTER FROM ALF LOMAS MEP TO THE PRIME MINISTER

The Minister of State has seen the draft reply prepared by Mr Tyrie.

He has commented that the Prime Minister has now said publicly that we would veto a Commission proposal to change our zero rate - on the grounds that this should be a decision for us, not for them. I attach relevant press cuttings.

I attach an alternative reply, which acknowledges the Prime Minister's statement last Friday but tries to limit the damage. Mr Tyrie is content with it: I suggest we show it to our respective Ministers overnight.

S P JUDGE
Private Secretary

MS-T
49/2

THE INDEPENDENT

Thatcher hedges on VAT extension

By Anthony Bevins
Political Editor

THE PRIME Minister and Norman Tebbit yesterday added fuel to the Labour charge that the Conservatives planned to extend value added tax to fuel and power, children's footwear and clothing, books, newspapers, new buildings and water.

Margaret Thatcher and Mr Tebbit yesterday refused to give a direct answer to questions about the imposition of VAT on water, gas and electricity — although they have repeatedly pledged that it would not be extended to food.

Nigel Lawson, the Chancellor of the Exchequer, said on Wednesday that he had "no present intentions" to add the tax to gas, electricity and coal bills, but he added: "I have to look at the situation in the light of events at the time."

When *The Independent* asked Mrs Thatcher yesterday to describe the level of crisis which might force an extension of VAT, she said three times: "We don't have crises in finance under the Conservative government." But she refused to say whether that meant the tax would not be extended.

She did say, however, that a Conservative government would veto any VAT base changes proposed by the European Commission, adding: "I want our value added tax to be decided by us."

Roy Hattersley, Labour's Treasury spokesman, later challenged the Conservatives: "Will they rule out any increases in VAT? If they can promise not to extend VAT to food, why can't they promise not to extend it to these other items?"

Neil Kinnock, the Labour leader, said in Norwich that the Government's planned increase in VAT and the proposal to make even the poorest people pay the poll tax community charge would add further to the "injustice and insecurity" pensioners faced.

When asked about VAT extension on the BBC *Election Call* programme, Mr Tebbit said: "We will certainly resist any ideas of putting VAT on food. Now, because we are a responsible government, we could never promise with an absolute promise that VAT would not be extended at all in any direction. That wouldn't make sense."

"But the key one I think that we've talked about is food and we don't see any reason why we should do that and we would certainly resist the European Community trying to impose on us a requirement to put VAT on things where we didn't think it should be."

Mr Hattersley said in a statement: "The Government is now wriggling over VAT. Mrs Thatcher's defensive statement this morning was a smokescreen designed to obscure rather than enlighten. She said her government, if re-elected, would make

THE TIMES

Veto on move to end VAT choice

By Our Chief Political Correspondent

The Prime Minister announced yesterday that Britain would veto European Commission proposals to end the right of individual countries to decide which products to exempt from VAT.

Officials in Brussels have been drawing up proposals to harmonize VAT rates throughout the European Community, a plan which would inevitably mean the end of the "zero-rating" which currently applies in Britain to items like food, fuel, children's clothing, newspapers and books.

The proposal has already become an election issue, with the Labour Party alleging that the EEC will be forcing the United Kingdom into increasing VAT. The proposals have been drawn up by civil servants working for Lord Cockfield, the former Cabinet minister sent by Mrs Margaret Thatcher to Brussels as a British commissioner.

At her daily election press conference yesterday, Mrs Thatcher again declined to give an undertaking that the Government would not impose VAT on water, gas and electricity. The Government's line has constantly been that it cannot rule out tax changes for all time, although the Prime Minister has said VAT will not be applied to food.

But she then said for the first time that she would stand in the way of plans to end zero-rating. She stated: "If the Community comes in with a Community law to change our capacity to zero-rate what we want to zero-rate we should use our veto against that."

While that did not rule out the ending of zero-rating on certain goods, Mrs Thatcher was making clear that she wanted to retain the right for Britain to decide which goods should be zero-rated.

Morning Star Tory VAT veto

MRS. THATCHER desperately tried to head off Labour criticism of her tax policy yesterday by saying she might veto Common Market VAT changes.

the decision about EEC proposals to increase VAT, not the EEC itself. She again did not rule out increases and extensions of VAT.

"Throughout this campaign the Conservatives have persistently refused to rule out higher VAT rates. Will they rule out the end of zero-rating of fuel and power, children's footwear and clothing, books and newspapers, new buildings and water?"

It is a long-standing aim of the Government to switch the balance of taxation from direct to indirect taxes. Although the Conservatives had said during the 1979 election campaign that this pledge did not mean a doubling of VAT, Sir Geoffrey Howe "unified" the two VAT rates of 8 per cent and 12.5 per cent into the current rate of 15 per cent in his first 1979 Budget.

S FINANCIAL TIMES

Tories resist European VAT rates

By Lisa Wood

A CONSERVATIVE Government would veto proposals for value-added tax rates in Britain to be decided by the European Community, the Prime Minister said yesterday.

Mrs Margaret Thatcher, responding to questions at a press conference about Community proposals to harmonise the imposition of VAT in Europe, said: "We would veto plans to come under a Community-based system."

She said that for Labour to accuse the Conservatives over intentions to increase VAT was "absolutely absurd."

Mr Roy Hattersley, Labour's deputy leader and shadow Chancellor of the Exchequer, commenting on Mrs Thatcher's statement on VAT said she had not ruled out increases and extensions in VAT.

Mr Hattersley said: "Throughout this campaign the Conservatives have persistently refused to rule out higher VAT rates and they have persistently refused to rule out the end of zero-rating on fuel and power, children's footwear and clothing, books and newspapers, new buildings and water."

DAILY EXPRESS

Maggie's veto vow over VAT

MRS THATCHER will force Eurocrats to a showdown if they try to impose huge VAT rises on Britain.

The Prime Minister also dismissed as "absolutely absurd" Labour claims that a third-term Tory Government would massively increase VAT.

She pledged that if the Eurocrats go ahead with plans to bring all Common Market countries into line on VAT—which would mean taxing food, gas and electricity—then Britain would veto the move.

Mrs Thatcher told a Press conference: "Our VAT will be decided by us."

A12



DRAFT LETTER FROM PRIME MINISTER TO ALFRED LOMAS MEP

Thank you for your further letter of 15 May. As an MEP you must be aware that it would be ridiculous for us to veto the Commission's proposals as a whole before we have even seen them.

Their proposals may or may not affect our zero rate. If they propose ending any zero rates that we wish to retain, then - as I made clear on 29 May - we would veto these aspects.

MT

purp



FROM: A C S ALLAN
DATE: 15 June 1987

CHANCELLOR

VAT

... I attach the main transcripts on this. VAT on food, gas and electricity seem completely ruled out. Children's clothes and shoes are covered by the "never, never, never get it through the House". Books do not seem pledged by the Prime Minister, but were by the Chief Secretary. Water and newspapers seem to have escaped any pledges.

*Thanks.
CST's quasi-politics
on gas & water decisions;
food/gas/electricity
children's clothes + shoes
ruled out by this,
but not clear.*

AA

A C S ALLAN



FROM: S P JUDGE
DATE: 23 June 1987

mp

PAYMASTER GENERAL

APS/CHANCELLOR OF THE EXCHEQUER

cc Mr Scholar
Miss Sinclair
Miss O'Mara
Mr Romanski
Parliamentary Clerk
Mr Wilmott - C&E

VAT ZERO RATES: BRIEFING FOR No 10

The Paymaster General has seen the revised briefing attached to Mr Romanski's submission of 19 June. He thinks that the Lord Privy Seal's attention should be drawn to the fact that Mr MacGregor's statement on Breakfast Time extended the VAT veto to books.

*Nigel
Task Party
ref pass + in
point on
Richard Savage
is dealing.
MPT 23/6*

SJS

S P JUDGE
Private Secretary

Ch
I never saw this; I shall make it
dev to PS/LPS that he must not
derrate from line.

AA



H.M. CUSTOMS AND EXCISE
KING'S BEAM HOUSE, MARK LANE
LONDON, EC3R 7HE

Please Dial my Extension Direct:
Use Code (01)-382 followed by
Extension Number 5...023....

From: P G WILMOTT
Date: 25 JUNE 1987

PS/PAYMASTER GENERAL

cc PS/Chancellor
Mr Scholar
Ms Sinclair
Mr Cropper

OFFICE OF ARTS AND LIBRARIES: VAT ON BOOKS

1. The office of Arts and Libraries has asked for guidance on a reply to George Bayntun-Coward, bookseller, who is seeking an assurance that the Prime Minister's commitment to retain certain zero rates extends to books. I attach copies of the correspondence.

2. Much depends on the interpretation of the former Chief Secretary's interview on BBC's Breakfast Time, reported in Mr Romanski's note of 19 June and alluded to in your note of 23 June. Although it is possible that Mr McGregor did not consciously wish to extend the scope of earlier commitments, it would be difficult to argue that no commitment to protect the zero rate on books was made. We suggest that an attempt now to qualify Mr McGregor's statement has little to recommend it, since it would clearly unleash a further high-profile campaign on "Don't Tax Reading" lines. Our inclination therefore is to accept the commitment as given, and to reply accordingly to the OAL. Given the sensitivity of the subject, you may prefer to send a reply direct from your office to Mr Luce's. I attach a draft.

P G WILMOTT

25 June 1987

Ch
No (to X). No question of us drawing attention to former CST reply, line should be PM made positive clear: we have no plans at present to extend to VAT base, but the Chancellor has to form his own Budget judgement
AA

Internal circulation: CPS, Mr Knox, Mr Jefferson Smith, Ms Barrett, Ms French, Mr Geddes.

D R A F T Letter to PS to Mr Luce

Mr Fallon of the OAL wrote to Customs and Excise on 23 June about the terms of a reply to Mr Bayntun-Coward's request for clarification of the Government's position on VAT and books.

During the Election campaign the Prime Minister touched on VAT on a number of occasions. On ITV's "This Week" on 4 June, for example, she said

if anyone tried to put VAT on children's clothes and shoes they would never, never, never get it through the House.

She went on to say

I have undertaken not to do it [apply VAT] on food - that was in right from the beginning, and on gas and electricity. No we haven't got any particular plans to do it on other things, but I'm not going to constrain a Chancellor of the Exchequer. I don't know what the circumstances will be of any particular Budget.

The then Chief Secretary was asked the following day, on BBC's "Breakfast Time",

can you confirm that an incoming Conservative Government would not impose VAT on electricity bills, gas bills, children's clothing, shoes and books?

Mr McGregor replied

Yes, indeed.

The Paymaster General takes this as a clear commitment to retain the zero rate on books.

S P JUDGE

Our reference

Your reference



Date 23 June 1987

Miss Alison French
HM Customs & Excise
Kings' Beam House r 41
Mark Lane, EC3R 7HE

Office of
Arts and
Libraries

Great George Street, London SW1P 3AL
Telephone 01-270 5873

Dear Alison

VAT ON BOOKS

We spoke today about Mr Bayntun-Coward's letter to the Minister on 18 June seeking confirmation that the Government will not change the existing zero rating arrangements for books.

You will see that the Minister is anxious to provide a prompt reply: I should welcome your guidance on the form that this might take. Many thanks for your cooperation.

If I can discover what undertaking Mr Luce made on the wireless in the run up to the Election I shall let you know.

Yours ever

Patrick Fallon

P J Fallon

enc

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BOOKSELLER TO THE LATE QUEEN MARY

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ENGLAND

Telephone: BATH (0225) 66000



HBC/CMG

18th June 1987

Richard Luce, Esq., M.P.,
The House of Commons,
London, S.W.1.

PL
Pl. ensure 103 & v
in value + format reply

Dear Mr. Luce,

The members of my Association have fought for years to keep books zero rated for V.A.T., so I was delighted to hear you say categorically on the wireless a few weeks ago, that this would not be changed.

However, I have had difficulty persuading my colleagues that this is the case as it was not confirmed during the Election by the Prime Minister, although she mentioned food, gas and electricity. Can you please put our minds at rest.

You may be interested in the enclosed copy of the report of the Venice Congress where I put the British case.

Yours sincerely,

H. Baynton Coward

MINISTER OF STATE PRIVY COUNCIL OF GREAT BRITAIN
C. 3989
22 JUN 1987
FILING INSTRUCTIONS FILE No.

Encl.

OFFICE OF ARTS AND LIBRARIES	
ACTION	MS. Parry
BY	26/6/87
FOR INFORMATION:	
Mr Stone	
draft reply pls - for we box (at latest)	
OAL (JW)	



Inland Revenue

Policy Division
Somerset House

FROM: E. MCGIVERN

DATE: 25 JUNE 1987

Subject of PS's views, I am asked to agree with X. However, other measures cannot be made help by a side-wind.

Ch
You have not seen this before, as we were waiting for FST's conclusions (now expected next week).

FINANCIAL SECRETARY

TAX REVIEW OF TAKEOVER FINANCING

in the paper on Prof. King's proposals

Your private secretary's minute of 27 March asked me, together with Treasury officials, to produce a note setting out the basic issues here.

1. This note has been agreed with Treasury FP division. I am sorry it has been delayed because of work on the Finance Bill and related matters - we assumed you would not have time to look at this during the Election campaign. We have kept it fairly short as we are not convinced that there is a great deal of merit in the Bank's ideas (which it is only fair to say they put forward for consideration rather than as firm proposals) but we shall be happy to develop any of the points in more detail.

2. By way of background, I attach a copy of the Bank's letter of 12 December (Annex 1) together with a short note in Annex 2 extracted from a DTI paper setting out concerns about leveraged takeovers.

3. The Bank's ideas raise two separate, although related, issues. First whether action should be taken to remove a perceived tax bias towards debt financing for firms generally (illustrated in Annex 3), with a view to improving the quality of capital and removing a distortion in the demand for credit.

- cc PS/Chancellor
- Sir P Middleton
- Mr Monck
- Mr Burgner
- Mrs Lomax
- Mr Scholar
- Mr Cropper
- Mr Tyrie

- Mr Painter
- Mr McGivern
- Mr Beighton
- Mr Taylor Thompson
- Mr Pitts
- Mr Hunter
- Mr Weeden
- Mr Bryce
- Mr Reed
- PS/IR

This approach would imply a relatively mild restriction to the deductibility of interest (see para 7), but one which would apply to all firms. It would aim to provide tax neutrality, but would do nothing to counteract non-tax incentives to debt financing.

4. The second issue is whether the tax system should be used to discourage particular instances of (what might be perceived to be) excessively high gearing. This action might apply to all highly-g geared companies, or apply only when the gearing arose from leveraged takeovers (ie those financed to a large extent by debt which is effectively secured on the target company's assets). The idea would be to discourage a trend which is not stopped by the existing mechanisms for overseeing takeovers, but which might be seen as undesirable partly on prudential grounds and partly on industrial policy grounds - as a manifestation of "short-termism" in an extreme form. This approach would imply a closely targeted restriction, but possibly a much more severe one. The aim would not be neutrality but active discouragement, and perhaps at the extreme an effective veto on very highly geared transactions.

Restrict tax relief to a proportion of interest

5. The following paragraphs (6 to 10) deal just with the issue of a general change in the tax treatment of debt financing.

6. The Bank's first idea was for a limitation on the proportion of all interest which is tax deductible. They suggested that this might be justified on the grounds that only real interest should be deductible. One problem with this argument is that it would follow that only real interest should be taxable. More generally, the 1984 CT changes moved away from taking account of inflation in the tax system (with the abolition of stock relief and of general 100 per cent capital allowances).

7. The Bank suggested an alternative justification, which would be to remove the present bias in favour of debt finance rather than equity (this bias was reduced, but not eliminated, by the 1984 corporation tax reforms which narrowed the gap between the main rate of CT and the basic rate of income tax). This could be done by allowing relief only on that proportion of the interest which corresponds to the ratio of the basic rate of income tax to the main rate of corporation tax, ie at present rates of tax about 77 per cent would be allowable (if the basic rate came down to 25 per cent, and the main rate of corporation tax remained at 35 per cent, the proportion of the interest which would be allowable would drop to about 71 per cent). And to keep in step with the treatment of dividends, there would need to be a corresponding reduction in the taxable amount of interest when this was received by a company (this is because a company is not normally taxable when it receives a dividend but is taxable when it receives interest). The position of companies liable at the small companies rate of corporation tax would need to be considered.

8. In principle there is much to be said for taxing interest and dividends on effectively the same basis. It is also desirable that retentions should be seen as another source of funds with debt and equity, with similar tax consequences. The question however is whether the extent of the present distortions in the system would justify the considerable structural tax changes and complex administration which would be required to eliminate or at least reduce the misallocation of resources - perhaps fairly modest in scale since the completion of the 1984 corporation tax reforms - which is likely to arise.

9. Reducing the amount of allowable interest would represent a major upheaval in the corporation tax system and would have implications for the tax treatment of interest flowing overseas, and hence for inward investment. Depending upon what was done for companies liable at the small companies rate, the change might also have to apply to interest paid for business purposes by unincorporated businesses, in order to

maintain parity of treatment with companies. And if it did apply to such interest you might then need to consider mortgage interest relief and the taxation of interest received by the personal sector. If you wished to pursue this course we should need to do a fair amount of work before we could let you have another note.

10. This is not to say that we regard the present regime as wholly satisfactory. The fact that interest is deductible while dividends are not (although some relief is given through the imputation system) gives rise to abuse and distortion, in particular through thinly capitalised companies controlled from overseas. In these cases the interest is deductible by the payer, but not assessable in the UK on the overseas lender, thus creating a substantial bias in favour of debt financing of inward investment. But the problem of thin capitalisation goes far wider than this submission. We have drawn it to Ministers' attention before, while recognising the difficulty of finding a solution, and if you would like to look at it again we can provide a separate paper on it.

Special treatment of highly-gearred companies

11. The general change discussed in the previous paragraphs would probably be ineffective in restraining leveraged takeovers. The following paragraphs consider a specific tax measure which might apply to all highly-gearred companies, or only when the gearing arose from a leveraged takeover.

12. The Bank's suggestion was that all (or a proportion of) interest payments above, say, £1 million would not be allowable unless the gearing of the corporate taxpayer was less than 75 per cent (debt/equity ratio of 3). But as the Bank recognised, there would be problems with the measurement of gearing and there would be a big incentive for window-dressing and off-balance sheet finance. Consideration would also need to be given to the effect on existing highly-gearred companies and what transitional arrangements would be appropriate.

13. If the target is high-gearing generally, our conclusion would be that we see great difficulty in defining and justifying "acceptable" and "unacceptable" levels of gearing as the basis of an effective tax measure. Some jurisdictions have introduced legislation directed against thin capitalisation but again this raises problems of definition and we understand that the measures have not proved entirely successful.

14. If the target is leveraged takeovers, the problems of definition and enforcement could be even more acute. There is no evidence that any feasible tax measure would be sufficient to influence takeover behaviour. And there is some risk that the effect could be counter-productive: we do not scare people off, but we do give them a strong incentive to break up their target (and so run down their gearing) even more quickly and brutally than at present. It is worth pointing out that the USA has enacted tax legislation directed specifically against highly-leveraged takeover bids but we understand that the measure is not too difficult to avoid.

15. It might also be necessary to have a let-out for small takeovers by large, highly-g geared companies or for uncontested takeovers or for other takeovers generally thought to be in the "public interest". And some thought would have to be given to the practical consequences of this sort of rule - for example, a company which did not wish to be taken over might gear itself up so that if it were taken over, the new group would be highly-g geared and so there would be a tax penalty. Would this sort of poison pill be desirable?

16. So even this more limited proposal for leveraged takeovers is fraught with difficulties and we would need to carry out much further work before we could hope to identify a workable scheme.

Narrower measures

17. It might be possible to devise a more targeted measure (possibly even denying any deduction for interest) to affect only particular types of takeover. Although of course if they could be identified sufficiently precisely to be the basis of a special tax provision it might be that some non-tax way of discouraging or preventing them could be devised. Indeed the question must be asked whether it makes sense to try to use the tax system in this way - at the cost of even more complexity - in an attempt to influence company behaviour in takeovers.

18. But more generally, if highly-g geared takeovers are regarded as an unsatisfactory method of financing, the question arises whether the Government ought not to use its mergers policy to tackle the problem. If bids were not referred to the Monopolies Commission or if the Commission did not recommend against them, the case for using the tax system as an indirect means of attempting to discourage them is not at all clear. As we understand it, DTI and Treasury officials do not consider that either policy on referring takeovers or the decisions of the MMC could sensibly be based on some mechanical quantified rule about the level of gearing (and the same difficulties would arise with any special tax provision).

Link with use of preference shares to minimise company tax liability

19. You asked whether there was any link between this and the question addressed in our minute of 26 February (somewhat misleadingly entitled "Ring-fence ACT") on the scope for using share capital to minimise company tax liability. There is not a strong link. The connection is that while in general the tax system favours debt finance over equity finance, the bias is reversed if the borrower is tax-exhausted and wishes to raise money from another company (eg, a bank) which would prefer to receive dividends which are not liable to corporation tax rather than interest which is liable. But we do not think that in general there is any particular

significance in this for highly-gearred takeovers. The exception to this would be if the financing requirement for the takeover was so great that there would be insufficient profits in the group after the takeover against which to offset all the interest. In that case the bidding company might wish to limit its debt finance so that it could offset all the interest and raise the balance in the form of equity (eg preference shares).

Conclusion

X | 20. This minute has considered the various targets suggested by the Bank and found that the case for trying to hit them through the tax system is weak. There is in principle a case for neutrality in the treatment of debt, equity and retained profits. But the remaining bias is relatively small and removing it through the tax system would certainly be complex. Subject to what follows on thinly capitalised companies, the case in principle for discouraging any particular numerically defined level of gearing, whether or not tied to takeover situations, through the tax system looks at best exceedingly weak. Again any benefits would be very small in absolute terms and in relation to the complexity of the tax rules that would be needed. We recommend that these ideas should be taken no further.

21. However, we remain concerned about the use of thinly capitalised companies controlled from abroad to erode the UK tax base (para 10) and if you wish we can provide a separate paper on this.


E McGIVERN

19/50

ANNEX 1

CONFIDENTIAL

C J Farrow
Assistant Director
01-601 4657

BANK OF ENGLAND
Threadneedle Street
London
EC2R 8AH

12 December 1986

N J Monck Esq
H M Treasury
Parliament Street
London SW1P 3AG

Dear Nick,

CORPORATE GEARING, TAKEOVERS AND TAX

At our meeting last week we discussed the general proposition that if there is a general policy concern about the growth of highly geared takeovers a reduction of the amount of interest which is allowed as a cost for corporation tax would provide a mechanism by which a disincentive could be introduced. Particular advantages of action by way of the tax system would be:-

- (a) it could be introduced rapidly;
- (b) since the tax system still contains some bias in favour of debt finance a reduction in interest allowability could be constructed so as to be a move to a more neutral structure;
- (c) it would be automatic, not discretionary;
- (d) it would still leave the level of gearing to decision by companies;
- (e) it would contribute revenue rather than adding to expenditure.

I am enclosing with this letter the note by Andrew Threadgold to which we referred. As you will see it is not designed to promote a particular solution, but only to canvas possible approaches, and to indicate some of the issues involved. Clearly a change to reduce the allowability of interest would, if introduced across the board, have an impact going far beyond the leveraged bids it was designed to catch. To reduce the risk of unintended effects it would seem desirable to limit its scope where practicable. The major area would be to limit it to plc's [and their subsidiaries].

I should point out that there would be some problems with the measurement of gearing. Treatment of good will is one area. Another is the big incentive it would offer for window-dressing and off-balance sheet finance. Before spending time on addressing those issues in substance, however, it would be helpful to know whether the concept is one which is likely to be given serious consideration.

I am sending a copy of this letter to Hans Liesner (DTI).

Yours

Vit

5

AIDE MEMOIRE

CORPORATE GEARING, WITH PARTICULAR REFERENCE TO TAKEOVERS

The tax deductibility of interest, gives some incentive to borrow rather than raise equity capital to finance takeovers, even with imputation of tax on dividends and the low rate of CT (35%).

These tax advantages of debt are weighed against the "costs" of additional debt in terms of raising the probability of bankruptcy[†]. It should be noted that the recent cut in MCT has reduced the incentive to high gearing.

If it is felt that capital gearing of the corporate sector as a whole is being raised, or may be raised "excessively" for prudence by highly geared takeovers there are two broad approaches:-

- (i) limit the proportion of all interest which is tax deductible; or
- (ii) put a threshold on the amount of interest which is deductible. A proposal such as all interest payments above, say, £1million would not be allowable unless the gearing of the corporate taxpayer was less than 75% (debt/equity ratio of 3).

In addition there would be a question of whether the restriction would apply to take-over bids or generally.

1 The simplest proposal would be to reduce the tax deductibility of interest across the board from 100% to, say 60%.

This might be justified on the grounds that only real interest should be deductible. At base rate +1%, borrowing costs 12% and

[†] The tax treatment of income and capital gains in the hands of investors also bears on the optimal gearing ratio.

underlying inflation of, say, 5% only 7/12th of nominal interest would be deductible.

2 Limiting the reduction to takeover bids would raise questions of equity and timing.

- (i) would it apply only to contested bids?
- (ii) for how long would the reduction apply?
- (iii) would it apply to pre-existing debt? of both the offeror and offeree companies?

3 Applying a threshold would overcome some of the drawbacks of 1, in that it could exempt all small companies, and companies which were less highly geared from the reduced deductibility of interest. The deductibility above the threshold need not, of course, fall to zero.

The threshold would create problems, no doubt. It might encourage degrouping in certain cases, and other creative accounting. This might be handled by a low threshold and a fairly high level of deductibility (say 50% or 60%) above the threshold.

4 Limiting the threshold to takeover bid situations, raises the questions in 2. A key question would be whether the restriction applied only to the debt issued in the takeover, or all debt of the merged company. Subsequently fungibility of debt and equity capital would make it very difficult to limit the restriction to just the debt issued in the takeover. Complicated rules would be required. Applying the restriction to all debt of the merged company would put it at a competitive disadvantage.

This brief note has not considered the wider ramifications of, say 3 (the reduced tax deductibility of interest above a certain threshold defined in terms of an absolute amount and gearing). These would include the impact on:-

- (i) international competitiveness, and
- (ii) distressed borrowers (but these are probably tax exhausted anyway, so the question would be whether reduced tax losses would hinder recovery, or 'white knight' takeovers).

A R Threadgold (4042)

4 December 1986

General concerns about takeover activity

On the industrial side, concerns about leveraged takeovers to some extent reflect more general concerns about takeover activity as a whole;

- (i) In particular, for those who believe that there is in some sense "too much" takeover activity, and that the threat of takeover can be damaging in diverting attention to short term profit and share price performance at the expense of longer term consideration, leveraging intensifies the problem;
- (ii) More specifically related to leveraged takeovers is concern over "asset stripping". The loans to finance leveraged bids typically have to be repaid within a short period, and often this can only be done if some of the assets of the target company are sold following the takeover;
- (iii) A different ground for concern is that following a leveraged bid, the management of the new company will be forced to take short term measures to reduce financial pressures created by high gearing even where these are to the detriment of the long term interests of the company, and were not part of the original plan.

ANNEX 3

Example showing the extent to which debt finance is treated more favourably than equity

This shows the advantage where dividends or interest are paid to non-corporate investors.

	<u>Equity</u>	<u>Debt</u>
a. Pre-tax profits of borrower	100	100
b. Corporation tax at 35% of a.	(35)	-
c. Dividends or interest paid to investor	65	100
d. Plus tax credit at 27/73rds of dividend at c.	24.04	-
e. Taxable income of investor (c. + d.)	<u>89.04</u>	<u>100</u>
f. Personal income tax liability of investor liable at (say) 50% of e. (after set off of tax credit at d.)	(20.48)	(50)
g. Net income of investor (c. - f.)	<u>44.52</u>	<u>50</u>

The advantage of debt finance over equity finance is present whatever the marginal tax rate of the investor (including if it is exempt from tax), provided that the company pays corporation tax at a rate above the small companies rate (27%). If it pays corporation tax at the small companies rate the system is neutral as between debt and equity finance.

However, the present system is in principle neutral as between equity and debt finance within the corporate sector. Thus:

	<u>Equity</u>	<u>Debt</u>
a. Pre-tax profits of borrower	100	100
b. Corporation tax at 35% of a.	(35)	-
c. Income received by investor	65	100
d. Corporation tax on investor at 35% of a.	-	(35)
e. Post-tax return on capital	<u>65</u>	<u>65</u>



H.M. CUSTOMS AND EXCISE
KING'S BEAM HOUSE, MARK LANE
LONDON, EC3R 7HE

pmg

Please Dial my Extension Direct:
Use Code (01)-382 followed by
Extension Number 5.....023.

Draft as agreed with PMG.

PS/PAYMASTER GENERAL

*Ch (could discuss with PMG @ Prayers).
First change marked below
is designed to avoid nuance
that we'd quite like to be forced
to end zero-rates. (PM's
actual words flagged)*

From: P G WILMOTT

Date: 2 JULY 1987

cc PS/Chancellor
Sir G Littler
Mr Lavelle
Mr Scholar
Mr Edwards
Miss Sinclair
Mr Mortimer
Mr Cropper

AA

VAT ON BOOKS: TELEX FROM MR CLIVE BRADLEY

I attach a draft reply to Mr Bradley's telex, which could, I suggest, go as a letter. Mr Bradley's 'cri de coeur' is presumably the first shot in a new campaign. The only real comfort we can offer him is the Prime Minister's commitment to veto unacceptable Commission proposals.

P G WILMOTT

Internal circulation: CPS, Mr Knox, Mr Jefferson Smith, Ms Barrett,
Ms French.

DRAFT Letter

Mr C Bradley
Publishers Association
19 Bedford Square
London
WC1B 3HJ

July 1987

Thank you for your telex of 1 July.

My understanding of the position in Brussels is that the Commission is unlikely to make provision in its harmonisation proposals for the continuation of zero rates of VAT. In my view, this is attributable solely to deeply-held doctrinal beliefs in the Berlaymont and not to any lack of persuasive powers on the part of your Committee, or to anything that was or was not said in the election campaign. The Prime Minister has given a clear commitment to ~~reject unacceptable proposals for ending~~ zero rates. This reflects our strong belief that decisions on reliefs from VAT must be made here and not in Brussels.

Such decisions are of course a matter for the Chancellor's annual Budget judgment. The Prime Minister has indicated some areas of expenditure where we think the case for continuing relief is overwhelming. The fact that these assurances ~~were not all-embracing~~ *did not extend to all items which are currently zero-rated* does not mean that we plan to extend VAT into other areas. But, equally, we cannot say now in exactly what circumstances the Chancellor will be framing his Budget judgment in future years.

veto any proposals which would restrict our ability to apply

PETER BROOKE

Alex - 1 thing
Prayers ^{on} for Wednesday ~~are~~
for this. I know No 10 want
urgent reply, but doesn't seem
worth setting up special
meeting tomorrow OK?
OK,

D R A F T

Mr J E Tomlinson MEP

Thank you for your letter of 1 July about European Commission proposals on VAT.

The Government's position on VAT is perfectly clear. The Lord Privy Seal's assurance in the House on 30 June represents a full and authoritative statement of Government policy, and I am frankly surprised that you should seek to suggest otherwise. As far as Lord Cockfield's proposals are concerned, I have made it plain that we could not accept proposals that threatened to change our capacity to zero rate what we want to zero rate. This reflects our strong belief that decisions affecting reliefs from VAT must be made here and not in Brussels.

MARGARET THATCHER

FROM: S P JUDGE
DATE: 16 July 1987



PAYMASTER GENERAL

PS/CHANCELLOR

cc: Mr Lavelle
Mr Scholar
Mr Culpin
Mr Cropper
Mr Tyrie
PS/C+E (*)
Mr Wilmott - C+E
(* advanced copy by fax)

VAT: LETTER FROM JOHN TOMLINSON MEP

Further to Mr Wilmott's minute of 9 July to me, the Paymaster General has approved the attached redraft.

2. Is the Chancellor content for this to be forwarded to No. 10?

*I have
redrafted
Mr.*

S P JUDGE
Private Secretary

DRAFT LETTER FROM PRIME MINISTER TO JOHN TOMLINSON MEP

Thank you for your letter of 1 July. As you know, the Commission has now published its proposals.

They cannot be adopted unless there is unanimous agreement. I have made it perfectly clear that we will not accept proposals to abolish zero rates that we wish to retain. I have also made it clear that the Government have no plans to end the zero rates for food, gas, electricity and young children's clothes and shoes.

I am frankly surprised that you should suggest that the Lord Privy Seal's replies in the House were not a full and authoritative statement of Government policy.

MARGARET THATCHER

And there is no question of
our accepting anything that
will be in conflict with
our pledges I have given
our capacity to zero rate
what we wish to zero rate.

John Tomlinson

And there is no question of our accepting anything that either conflicts with the pledges I have given on our zero rates or would remove our capacity to zero rate what we wish to zero rate.



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

16 July 1987

Dear Mr. Kuczys,

I enclose a copy of a letter which the Prime Minister has received from Gordon Brown MP.

I should be grateful if you would let me have a draft reply for the Prime Minister's signature, to reach me by close of play, tomorrow, **Friday 17 July.**

*Yours sincerely,
Deborah Greer*

p.p. Mark Addison

A. W. Kuczys, Esq.,
H.M. Treasury.



HOUSE OF COMMONS
LONDON SW1A 0AA

16/7/87

Rt Hon Margaret Thatcher
The Prime Minister
10 Downing Street
London

Dear Prime Minister

This morning on the TODAY programme on Radio Four, your Paymaster General, Mr Peter Brooke, confirmed, on behalf of the Government, that "we would in fact veto" Commission proposals for an extension of VAT to food, fuel, and children's shoes and clothes.

The precise exchange with Mr Brian Redhead was as follows

MR REDHEAD: Mr Brown is very clear. He wants it vetoed. Will you veto it?

MR BROOKE: Well the Prime Minister made it perfectly clear during the election on the subject of food, on the subject of fuel, on the subject of children's clothing and shoes that those would not be acceptable propositions if they emerged from Lord Cockfield as they now have or from the Commission as they now have. That we would in fact veto those so that the position has been made totally clear in the past

Your own refusal to confirm, after a direct question on this matter this afternoon, that you will use your veto against these EEC plans will cause confusion in Europe and consternation amongst the British public, who were led to believe during the election campaign that VAT would not be imposed on these items. This was certainly the view of Mr Brooke when he spoke on radio this morning.

I would be grateful if you would now confirm that the use of the veto - as announced by Mr Brooke - is what the Government propose to do, and that this will be the policy pursued at the next meeting of the Council of Finance Ministers on September 12 and 13th. I would be grateful also if you would confirm that your Government will, under no circumstances, introduce VAT on food, fuel, children's clothes and shoes and on newspapers, periodicals or books.

Yours sincerely

Gordon Brown

Gordon Brown
Dunfermline East

BROWN
TO
PM
16/7

DRAFT MINUTE FROM THE PRIME MINISTER TO GORDON BROWN MP

Thank you for your letter of 16 July.

The EC Commission's proposals cannot be adopted unless there is unanimous agreement. I have already made the Government's policy on this subject perfectly clear: we will not accept any proposal which either conflicts with the pledges I have given on our zero rates or would remove our capacity to zero rate the things which we wish to zero rate.

Despite the assertion you make in your letter, I made quite plain in the House yesterday my endorsement of the Paymaster General's words as the following extract from Hansard confirms:

"My hon. Friend the Paymaster General specifically confirmed what I said during the general election campaign, and that was his precise purpose. I am well aware of the words that he used".

MARGARET THATCHER

Ch
Content with draft
reply for PM's sig
(supplied by PS/PMG)?
DWK
17/7
OK ✓

FROM: S P JUDGE
DATE: 17 July 1987



MR COCKERELL - C&E

cc: PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Lavelle
Mr Scholar
Miss Sinclair
Mr Culpin
Mr Holroyd (Cab Off)
Mrs Hay (Trsy Sols)
Parliamentary Clerk
PS/C&E
Mr Knox - C&E

Ch
See Minute from
Cockerell below
SPJ

ZERO RATE INFRACTION CASE: CONFIDENTIALITY OF PLEADINGS

The Paymaster General has seen your note of 16 July to me. I have now written on the lines of the attached draft.

2. Please let me have urgent advice on the lines set out in the penultimate paragraph of the letter, and a draft Press line (by close Monday).

3. I would be grateful if Parliamentary Section could check with me on Monday before putting this Question down.

*much **
Give the
info re
of Mr Cockerell's note
I am pleased to see
but to say the UK
plans should be
made before the
time as in note

S P JUDGE
Private Secretary

SUGGESTED PARLIAMENTARY QUESTION

To ask Mr Chancellor of the Exchequer whether he will now cause to be placed in the Library a copy of the report for the hearing of case 416/85 before the European Court of Justice brought by the Commission of the European Communities against the United Kingdom concerning the zero-rating of certain goods and services.

ANSWER

A copy of the report for the hearing of case 416/85 before the European Court of Justice on 15 September 1987 has today been placed in the Library of the House. This is a document prepared by the Court on the basis of the submissions put to it and gives only a brief outline of the main issues. It cannot be expected to reflect the full force of the Government's arguments, which will be reiterated by Counsel at the Hearing itself. In addition Appendices 2 and 3 of the Fourth Report from the Treasury and Civil Service Committee (Session 1986-87) "The defence of VAT zero-rating" contain, respectively, an account of the Government's position on the specific areas under challenge and an outline of the rules on disclosure of pleadings.



Treasury Chambers, Parliament Street, SW1P 3AG

Jeremy Godfrey Esq
 Private Secretary to the Secretary of State
 for Trade and Industry
 Department of Trade and Industry
 1-19 Victoria Street
 London SW1H 0EJ

17 July 1987

Dear Jeremy

ZERO RATES INFRACTION CASE: CONFIDENTIALITY OF PLEADINGS

In the debate in the House of Lords on 1 July, which followed the Question by Lord Bruce of Donington, the Secretary of State for Trade and Industry gave two undertakings with regard to material which might be placed in the Library of the House. The Official Report may, however, be misleading.

In reply to Lord Wedderburn of Charlton, Lord Young undertook to see if he could obtain a communication which the confidentiality argument rested on. (OR 1 July 1987, Col 249).

In addition the Secretary of State appears to have undertaken to see if he could obtain an authenticated copy of the convention (of confidentiality) referred to during the debate. (OR 1 July 1987, Col 250). Lord Young's reply appears to refer back to the previous undertaking and it is possible that he had thought that Lord Bruce of Donington had asked for a copy of a "communication" rather than a "convention".

I enclose (at A) a copy of a submission from Customs which deals with these issues. It concludes that there is no written communication from the Commission which fits the terms of Lord Wedderburn's request - the communication having been in the form of a telephone conversation. The convention to which Lord Bruce made reference is present only in the abstract, being a recognised "code of conduct" governing the confidentiality of pleadings in such cases.

There is thus nothing which can be placed in the Library in response to either question.

However Customs have just received the attached (at B) Report for Hearing of the case before the European Court. This is a public document freely available on application to the Court.

'Although there appear to be hazards in placing this in the Library, there appear to be greater hazards in not doing so. The point is argued at paragraphs 7-10 of Customs' submission. The Paymaster will answer the attached arranged PQ (at C) next Tuesday.

The Paymaster suggests that the Secretary of State should write to Lords Bruce and Wedderburn on the lines of the draft at D:

- i. indicating that the communication was oral and from the Commission's Agent;
- ii. that there is no written convention which might be placed in the Library; but
- iii. it is now possible to place there a copy of the Report for Hearing;
- iv. drawing attention to Appendices 2 and 3 of the Fourth Report from the Treasury and Civil Service Committee which demonstrate, respectively, the Government's position on specific areas of zero-rating under challenge and the general rules of disclosure of pleadings in cases before the European Court of Justice.

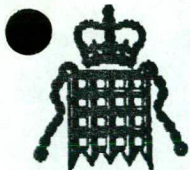
The Paymaster General has asked Customs to pursue urgently whether, since the Court has published its summary two months early, the Commission will now release us from the obligation to keep our pleadings confidential. He does not propose to take any immediate action until will have heard from the Commission, noting that since they can communicate with us by telephone we can presumably do the same.

I am copying this to John Sawers in Mrs Chalker's office, and to Mike Eland in the Lord President's office. I am separately sending him a draft letter for the Lord President, referring to the letter Lord Young is sending. Could we liaise on Monday before despatching these letters?

Yours ever
Simon Inge.

S P JUDGE
Private Secretary

28



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

*W/ghd pass Re
Commission hard (2 grounds)
for ruling against or position*

FROM: P JEFFERSON SMITH
DATE: 21 July 1987

PAYMASTER GENERAL

*Pass the
1 suspect
Lawyer
Dun (as a rule)
New work
agree it
push*

cc: Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Mr Lavelle
Mr Scholar
Miss Sinclair
Mr Culpin
Mr Dyer
Mr Holroyd (Cab Off)
Mrs Hay (Tsy Sols)

ZERO RATES INFRACTION CASE : CONFIDENTIALITY OF PLEADINGS

1. Further to my report to your PS yesterday the meeting of the Law Officers was duly held, with the personal representation of the Attorney General, The Lord Advocate, and The Solicitor General; and the purpose of this submission is to advise the next steps to be taken on the issue, and to bring recipients up to date taking account of the Law Officers' a suggested reply for Lord Young to send to Lord Bruce of Donington.

2. The Law Officers' unanimous view was that significant damage would be done both to the convention that pleadings are regarded as confidential to parties in dispute, and to the Government's legal policy in relation to other and future infraction cases, - particularly in the area of public interest immunity - if disclosure were carried out by the UK in the zero rates case without the formal agreement of the Commission. In summary, the medium and long term UK legal and political interests would be jeopardised for this short

Internal distribution:

CPS
Mr Knox
Mr Howard

VA Asst Secs
Mr Cockerell
Mr Wilmott

Mr Craske
Mr Toll

term advantage. This view was given in the full knowledge of the early publication of the Commission's Report for the Hearing at the ECJ. In the Law Officers' opinion, there is insufficient distinction to be made in the instant case to warrant departure from normal practice.

3. The Law Officers suggest, as an alternative to unilateral disclosure, that political pressure may be alleviated by formally asking the Commission to review its position on this particular case. This will see us through to the Recess after which the Court case itself will become the focus of attention. In that the written pleadings may never fully be revealed, this is a helpful suggestion and arrangements are accordingly being made. Although the informal approach to the Commission yesterday resulted in a refusal, we have now set in train a further more formal approach through UKREP.

4. The Law Officers recognise, however, that, at the end of the day, the decision whether the UK pleadings are published or not is a political one. Our advice is that the Law Officers' strong opinion is persuasive and, in the absence of overwhelming considerations to the contrary, should be accepted.

5. There remain several strands of correspondence to complete. Lord Young requires urgently to respond to Lord Bruce of Donington; and it would still be helpful if a copy of the Commission's report for the Hearing is deposited in the Libraries of both Houses.

Accordingly, I attach:

- (a) Suggested revised letter for Lord Young to send to Lord Bruce of Donington (this has been cleared with Cabinet Office). It incorporates a paragraph in response to Lord Bruce's letter to the Lord President.
- (b) Suggested Parliamentary Question (Commons) to lead to deposit of the Report for Hearing in the House of Commons Library.

The reply to the Parliamentary Question contains a passage in square brackets which reflects the latest developments, and which goes beyond the otherwise purely factual reply. We recommend the somewhat longer response which contains information otherwise only contained in Lord Young's letter to Lord Bruce.



P JEFFERSON SMITH

Lord Bruce of Donington
House of Lords
London
SW1A 0PW

July 1987

In past months there has been a number of exchanges in the House about the confidentiality of the pleadings in the zero-rates infraction case before the European Court of Justice. I understand that you consider that some of the statements I have made were misleading.

On 16 October I said (Col 913):

"Under the rules of the Court the pleadings remain confidential to the parties."

This is incorrect and I apologise. As I said on 1 July, there is nothing in the rules of the Court regulating the disclosure by the parties either of their own pleadings or the pleadings of others. There is however a convention, recognized equally by the Commission and by Member States that the confidentiality of the other parties' pleadings should be respected.

I said on 1 July that I would endeavour to obtain an authenticated copy of the convention to place in the Library. I am afraid that in answering you there was a slight misunderstanding: I was referring to the communication from the Commission which records its objections to disclosure. The convention itself is not a document. It is an accepted position which the Commission and Member States observe in litigation before the European Court of Justice. With regard to the objection to disclosure from the Commission, I am informed that in this case it was made in a telephone call from the Commission's legal agents to the Treasury Solicitor. Unofficial contact yesterday [20 July] with the Commission's Legal Service confirms that it remains its view that it would object to disclosure. However, the Government has formally asked the Commission to review its position in the circumstances of this particular case.

However I can now place in the Library a copy of the European Court's report for the hearing of the case. I said that this would be made available about a week before the oral hearing but it has in fact been issued much earlier, probably because the Court rose on 10 July for its Summer Recess and will reconvene on 15 September, the date set for the hearing. Although the report gives only a brief synopsis of the case and does not show the full detail of the UK's vigorous defence, it does reveal more of the arguments than has previously been disclosed. I should add that the Judges of the European Court will base their judgment on the full written and oral submissions presented to it and not on the report itself. In addition we shall have the opportunity at the oral hearing to stress the most significant features of our defence.

May I also draw your attention to Appendices 2 and 3 of the Fourth Report from the Treasury and Civil Service Committee, Session 1986-1987, entitled "The Defence of VAT Zero-rating"? These Appendices, copies of which I attach, outline respectively the Government's position on the specific areas under challenge and general position on the disclosure of pleadings before the European Court of Justice.

You have also drawn the Lord President's attention to an article in Accountancy Age which in your view reveals that I made misleading statements in the House of Lords about the confidentiality of pleadings before the European Court of Justice. Notwithstanding the comments alleged in the article to have been made by an unnamed senior EEC legal official, I am advised that in this case the Commission Agent stated categorically that the Commission did not wish its pleadings to be made public. He has not withdrawn this statement. As the UK pleadings are made in direct response to the Commission's observations to the European Court, the Government is precluded from disclosing its own pleadings as this would reveal the Commission's arguments. However we are asking the Commission to change their mind. If they do so then we will publish the Government's case.

I am copying this letter to Lord Wedderburn.

LORD YOUNG OF GRAFFHAM

SUGGESTED PARLIAMENTARY QUESTION

To ask Mr Chancellor of the Exchequer whether he will cause to be placed in the Library a copy of the report for the hearing of case 416/85 before the European Court of Justice brought by the Commission of the European Communities against the United Kingdom concerning the zero-rating of certain goods and services.

ANSWER

A copy of the report for the hearing of case 416/85 before the European Court of Justice on 15 September 1987 has today been placed in the Library of the House. This is a document prepared by the Court on the basis of the submissions put to it and summarises the main issues. [It cannot be expected to reflect the full force of the Government's arguments, which will be vigorously pursued by Counsel at the Hearing itself. It is not the practice to disclose written pleadings before the ECJ without the agreement of the other party to the case, in this case the Commission. We have approached the Commission to see if in the particular circumstances they would be prepared to agree to publication.] But a summary of the Government's position and the general rules on confidentiality of pleadings are set out in Appendices 2 and 3 respectively of the Fourth Report from the Treasury and Civil Service Committee (Session 1986-87) "The defence of VAT zero-rating".



PS / Chancellor

cc Mr. Lavelle
Mr. Schuler
Miss Sinclair
Mr. Culpin

ZERO RATES INFRACTION CASE : CONFIDENTIALITY OF PLEADINGS

I attach a copy of the Law Officers' advice
on 'unilateral' and 'agreed' disclosure.

21/7

S. P. JUDGE

01 07 21 15:40 X 01 242 9286 ATTORNEY GENERAL 02

DISCLOSURE OF ECJ PLEADINGS

SUMMARY OF ADVICE GIVEN BY THE ATTORNEY GENERAL AND THE LORD ADVOCATE
AT A CONSULTATION HELD IN THE ATTORNEY GENERAL'S CHAMBERS
ON 21 JULY 1987

1. The Attorney General and the Lord Advocate (hereafter "the Law Officers") noted that the rule under which parties to ECJ litigation did not disclose the written pleadings without the agreement of the other parties to the case is a rule of practice, not a rule of law. Nevertheless, it was complied with by all the Member States and the institutions of the Community, so far as the Government was aware. EQO (Guidance) (87)(3) sets out cogent reasons for the practice. The rule allows for the possibility of waiver of confidentiality by the parties. In Case 416/85 (VAT zero rating) this meant that the agreement of the Commission to disclosure of the pleadings was necessary.

2. If the UK breached the rule in Case 416/85 this could lead to a breakdown of the rule. In that event, the damage to UK interests would outweigh the short-term gain in terms of avoiding political embarrassment in the particular case. UK interests would be likely to be particularly damaged if it became the practice for the Commission to publish its pleadings in Article 169 cases without the consent of the Member State involved.

3. In relation to Case 416/85, they would advise Ministerial colleagues that the rule of practice is important; there is no means to isolate this case from the generality of proceedings before the European Court. Although ultimately the question whether disclosure of pleadings should be made in this case was a matter for political decision, they would counsel strongly against disclosure. The Government is entitled, however, to stress how strongly the case is being defended before the European Court.

4. The Law Officers advised that a formal approach should be made to the Commission to seek their agreement to disclosure in this case. They noted that the Commission Legal Service had indicated that it would advise the Commission against disclosure. The attention of Members of both Houses of Parliament should be drawn to the memorandum outlining the Government's position which had been submitted to the Treasury and Civil Service Select Committee by Customs and Excise, and published in the Committee's Report of 16 February 1987. Copies of the Report for the Hearing should be deposited in the Libraries of both Houses. Ministers might wish to make it clear that the Report contained only a summary of the submissions contained in the written pleadings.

m f 3

21 July 1987

INFRACTION
CASE



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

FROM: P JEFFERSON SMITH
DATE: 23 July 1987

CHANCELLOR

Handwritten notes in red ink:
PMS
The
Kuczyk was
@ Paymaster

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Lavelle
Mr Scholar
Miss Sinclair
Mr Culpin
Mr Dyer

ZERO RATES INFRACTION CASE : CONFIDENTIALITY OF PLEADINGS

1. Mr Kuczys's note of yesterday to PS/Paymaster General indicated that, following our meeting with the Law Officers, the Commission should be pressed hard to lift its objection to the UK publishing its pleadings in this case.

2. In a minute to me of the same date (copied to PS/Chancellor), PS/Paymaster General reported that the Treasury Solicitor thought that application of such pressure would be inconsistent with the Law Officers' advice that any approach to the Commission "should be done in a deadpan way and without applying pressure". UKREP has already written to Ehlermann, Director General of the Commission Legal Services asking (in moderate terms) for the Commission formally to reconsider its position. Mr Judge's note also records the Treasury Solicitor's view that the Law Officers would not wish to disclose the pleadings even if the Commission now gives assent.

Internal distribution:

CPS
Mr Knox
Mr Howard

VA Asst Secs
Mr Cockerell
Mr Wilmott
Mr Fotherby

Mr Craske
Mr Toll

328/2/87

THE PROBLEM

3. There remain significant differences of view between Treasury Ministers' wishes and the Law Officers' advice. In defending the Government's refusal to publish the UK pleadings in the case, Ministers have on many occasions argued that the only impediment to disclosure is the Commission's refusal to permit its own pleadings to be revealed. UK is thus constrained by the general convention to observe confidentiality.

4. There seems little point in having asked the Commission before, and in formally asking the Commission once again, to review its position unless we intend to publish our own pleadings if the objection is withdrawn. Indeed this has been the overriding philosophy all along. And, of course, the Commission might give a favourable decision even on the low-key approach. In his letter to Lord Bruce of Donington (also of yesterday's date), Lord Young undertook unequivocally to publish the Government's case if the Commission changes its mind.

5. We understand that the Commission will discuss the UK request at its pre-vacation meeting on 28/29 July. If we are to seek further to influence its decision we could ask UKREP to approach Ehlermann again and also provide briefing for the UK Cabinets in Brussels - but we shall need to do so quickly.

CONCLUSION

6. Treasury Solicitor was asked to obtain a view from the Attorney General on the conflicting interpretations being placed on the Law Officers' advice. This has just been received and is as follows:


"The consensus view of the Attorney General and the Lord Advocate is that it would be unwise to go further than we have already gone. We should certainly be seen to be making a genuine request but that should be in neutral terms. It would be inconsistent with the overall tenor of their advice given last Tuesday to press keenly for disclosure in this particular case, as it would breach the more general interest of the UK as referred to in that advice. Even if the rule against disclosure

could be said still to exist in the event of disclosure taking place in this case, it might lead to an expectation in the future. The (two) Law Officers added that the proviso is, if there is an overwhelming political interest in this case to press for disclosure, that is not really a matter for the Law Officers."

7. Thus, there is essentially a difference between the Law Officers and Treasury Ministers, and it will have to be resolved very quickly if pressure is to be put on the Commission early next week. There is scarcely time for the matter to be resolved by correspondence or discussion on the OD(E) network. We suggest that the best course would be for you or the Paymaster General to speak directly with the Attorney-General. If he will modify his view, and the Foreign and Commonwealth Office see no objection, the way would be clear to lobby the Cabinets in Brussels. If you would wish alternatively or additionally to write to colleagues in OD(E), a draft letter is attached.

ch
Best for you (or PMG) to
speak to Attorney-General
(after discussion at Rogers)?

AWK


P JEFFERSON SMITH

Draft letter to Foreign and Commonwealth Secretary
Copies to other members of OD(E)

EC INFRACTION CASES : CONFIDENTIALITY OF PLEADINGS

It is established policy, underpinned by Cabinet Office guidelines, that the written pleadings of parties to infraction cases are regarded as confidential to those parties. This convention is respected throughout the Community, and we know of no case where confidentiality has not been respected. Colleagues will however be aware of the infraction proceedings against some of the UK's VAT zero rates. In this case, I am persuaded that the convention will not operate to the advantage of the United Kingdom, and I believe that, for this case alone, the UK should publish its written pleadings.

The zero rates case has attracted a great deal of public and Parliamentary attention. The Government is publicly committed to a vigorous defence; though because of the confidentiality rule, it is difficult to persuade those not directly involved that such a defence is being mounted. Questions have been asked in both Houses, and the response has always rested on the knowledge that the Commission will not release the UK from respecting the convention.

There are aspects of the zero rates case which distinguish it from those normally bound by confidentiality. There has been, naturally, a great deal of public exposure to the issue, often being presented as an attempt by the Commission to dominate fiscal policy - though the case is, of course, quite separate from Lord Cockfield's recent harmonisation proposals. In addition, the Juge Rapporteur's Report for the Hearing at the ECJ has been released some two months before the Hearing itself. Normally the Report is issued only a week before a Hearing. The early release of the Report, plus the fact that it is, inevitably, only a very brief summary of the arguments

and thus does not reflect the full vigour of our defence, exposes us to a politically difficult situation, best met by disclosing the full UK pleadings in the case.

The Law Officers have advised that, notwithstanding the political pressures in this particular case, it remains in the wider political and legal interests to continue to respect confidentiality. However, they agreed to a fresh approach to the Commission to determine whether they will reconsider their position. The Commission will be discussing the approach on Tuesday or Wednesday of next week.

Although the approach has been in neutral terms, it would be possible for us to put on pressure to allow publication, by lobbying the two UK Commissioners' Cabinets. The Law Officers are opposed to going further than we have already gone. However, I think the case is wholly exceptional, and that we cannot afford to be other than open. I seek colleagues urgent agreement to mounting a lobbying of the Commission; if their agreement is forthcoming, publication of the UK's pleadings would follow.

Colleagues in OD(E) are invited to indicate whether they can accept this line by midday on Monday 27 July. I am copying this letter to members of OD(E), to the Law Officers and to Sir Robert Armstrong.



PS/ Secretary of State for Trade and Industry

CH/EXCHEQUER	
REC.	24 JUL 1987 ✓ 24/7
ACTION	PMG
COPIES TO	

DEPARTMENT OF TRADE AND INDUSTRY
 1-19 VICTORIA STREET
 LONDON SW1H 0ET
 TELEPHONE DIRECT LINE 01-215 5422
 SWITCHBOARD 01-215 7877

*BF withalmed 5/8
(for 4/8) pl p)*

BF 5/8

23 July 1987

Tony Kuczys Esq
 Private Secretary to the Chancellor of the Exchequer
 HM Treasury
 Parliament Street
 LONDON
 SW1P 3AG

*ch
I think Lord Young
has a point
DWN
24/7*

*I agree. Who was @ fault?
C&B or HM? or
both?*

Dear Tony

I am enclosing a copy of a letter my Secretary of State has written to Lord Bruce of Donington concerning the confidentiality of the pleadings in the zero-rates infraction case before the European Court of Justice. He has asked me to write to express his irritation at having to write such a letter and to ask you to ensure that he is adequately briefed before answering for the Treasury in future.

Last October he omitted to draw a distinction between the rules of the European Court and the conventions relating to proceedings before the Court. He believes that Customs officials ought to have advised him to write to Lord Bruce to put the records straight within a few days of the debate. Had they done so, Lord Bruce would not have been able to claim that the Government's position conflicted with what he had been told by the Court Registrar.

He was briefed for the 1 July debate that the Government's position depended upon a categorical statement by the Commission legal agent that the Commission was not prepared to consent to disclosure. He relied on this point heavily during the debate. He was not however briefed that this categorical statement was made in a telephone call. It is embarrassing to have undertaken to look into the possibility of placing a copy of a communication in the Library only to find that the communication was oral and not written. It would also have been helpful if the briefing had made clear that the convention on which our arguments depended was similarly unwritten.



My Secretary of State feels that these points ought to have been anticipated by your officials and hopes that this is the last time he will be placed in this position after answering for the Treasury.

Yours ever

Jeremy Godfrey

JEREMY GODFREY
Private Secretary

JF6ANH



DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET 5422
TELEPHONE DIRECT LINE 01-215
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

22 July 1987

Lord Bruce of Donington
House of Lords
LONDON
SW1A 0PW

Per Young.

In past months there have been a number of exchanges in the House about the confidentiality of the pleadings in the zero-rates infraction case before the European Court of Justice. I understand that you consider that some of the statements I have made were misleading.

On 16 October I said (col 913):

"Under the rules of the Court the pleadings remain confidential to the parties."

As I explained on 1 July this is incorrect: there is nothing in the rules of the Court regulating the disclosure by the parties either of their own pleadings or the pleadings of others. What there is is a convention, recognized equally by the Commission and by Member States that the confidentiality of the other parties' pleadings should be respected.

I said on 1 July that I would endeavour to obtain an authenticated copy of the convention to place in the Library. However the convention itself is not a document. It is an accepted position which the Commission and Member States observe in litigation for the European Court of Justice. I also said I would endeavour to place in the Library a copy of the communication from the Commission which records its objections to disclosure. However I am informed that in this case it was made in a telephone call from the Commission's legal agents to the Treasury Solicitor.

JF6AND



You have also drawn the Lord President's attention to an article in Accountancy Age which attribute comments to an unnamed senior EEC legal official to the effect that the Commission would not object to disclosure. Officials have informally rechecked the position with the Commission Legal Service whose view remains that the pleadings ought not to be made public. We shall therefore formally ask the Commission to change their mind. If they do so then we will publish the Government's case.

However I can now place in the Library a copy of the European Court's report for the hearing of the case. I said that this would be made available about a week before the oral hearing but it has in fact been issued much earlier, probably because the Court rose on 10 July for its Summer Recess and will reconvene on 15 September, the date set for the hearing. Although the report gives only a brief synopsis of the case and does not show the full detail of the UK's vigorous defence, it does reveal more of the arguments than has previously been disclosed. I should add that the Judges of the European Court will base their judgement on the full written and oral submissions presented to it and not on the report itself. In addition we shall have the opportunity at the oral hearing to stress the most significant features of our defence.

Can I also draw your attention to Appendices 2 and 3 of the Force Report from the Treasury and Civil Service Committee, Session 1986-1987, entitled "The Defence of VAT Zero-rating"? These Appendices outline the Government's position on the specific areas under challenge and general position on the disclosure of pleadings before the European Court of Justice.

I am copying this letter to Lord Wedderburn.

Yours
Y

LORD YOUNG OF GRAFFHAM

~~b.f. Hudson~~
US

FROM: J COLENUTT

DATE: 2 September 1987

MR HUDSON

✓
12.9.

cc PS/Paymaster General
Mr Lavelle
Mr Culpin
Mr S Matthews
Miss Sinclair
Ms French C+E
Mr Savage

SALES TAX RATES IN THE US

You asked me to look into the Chancellor's argument that the removal of barriers to inter-state trade in the US has tended to equalise sales tax rates.

2. The ideal test would, presumably, involve looking at sales tax rates after the removal of a restriction on inter-state trade. There have not been any formal restrictions on inter-state trade this century (ie. since sales taxes were first introduced) and one of the original clauses of the Constitution forbids any action by a state that would "impair inter-state commerce". A state is, however, entitled to levy a sales tax on goods that a resident purchases outside the state if the goods are to be used within the state. The responsibility for paying tax at the appropriate rate rests with the consumer.

3. The changes to sales tax rates during the course of this century are better explained by changing revenue needs rather than through any liberalisation of inter-state commerce.

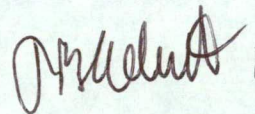
4. There remain large differences between sales tax rates across the fifty states (from 0 to 7½ per cent). The rates tend to be closer for adjoining states. Boroughs are also able to levy their own sales taxes. There will, therefore, be variations in the rates of sales tax levied within, as well as between, states.

5. Mail-order firms do not charge sales tax. It is the sole responsibility of the consumer to declare such purchases and pay tax. There is, therefore, a disparity in sales tax rates facing the consumer not only between the resident's own state and neighbouring states, but between the resident's own state and the zero-rate charged by mail-order firms.

6. Given the authorities' reliance upon the consumer's own declaration of out-of-state purchases a large amount of consumer spending is conducted across the border and not declared. One would expect that a consumer would only make purchases in the state of residence (assuming sales tax rates greater than zero) if transport costs were high, the item was perishable or if the good needed to be inspected before purchase.

7. States need to consider not only their own revenue needs when levying sales tax but the rates in adjoining states and the zero-rate charged by mail-order firms. In practice the state authorities may realise that sales taxes are only recouped on a fraction of goods (the rest being purchased by mail order or by cross-border traffic and not declared). The rump of goods where tax is collected will respond little to changes in sales tax rates. The differing revenue demands facing each state and the reliance the authorities place upon other forms of tax (on income, property or mineral extraction for example) may lead to a continuation of widely divergent sales tax rates.

8. There remain wide differences in sales tax rates across states. There is no evidence that differences have been reduced since sales taxes were first introduced (in the 1920s). There have not been any major changes to the structure of inter-state trade that would allow an analysis of the effects of the removal of frontier controls upon sales tax rates. The rate of sales tax charged in adjoining states (or by mail-order firms) will clearly be a consideration facing the state authorities when determining their own sale tax rates but differing revenue demands and the fact that much of consumers' spending can not be conducted out of state will ensure the persistence of substantial differences in sales tax rates.



J COLENUTT



PAYMASTER GENERAL

~~XXXX~~

*100s like
from the AH's
opinion as son
a 12 is
available*

FROM: B H KNOX
DATE: 16 SEPTEMBER 1987

JT

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

pp. p! (if any)

- cc PS/Chancellor
- PS/Chief Secretary
- PS/Financial Secretary
- PS/Economic Secretary
- Mr Lavelle
- Mr Scholar
- Miss Sinclair
- Mr Michie
- Mr Culpin
- Mr Holroyd
(Cab Office)
- Mrs Hay (Trsy Sols)

VAT ZERO RATES: INFRACTION PROCEEDINGS: ORAL HEARING 15 SEPTEMBER 1987.

1. The oral hearing of the Commission's challenge on some UK zero rates was heard by the European Court in Luxembourg yesterday. I attended with Mr Cockerell and our lawyers in support of David Vaughan of Counsel.
2. The UK & Irish cases were heard together. The Commission's case was summarised by David Gilmour the Commission's legal agent but ineffectually presented. He focussed on the two criteria for zero-rating derived from Article 28.2 of the Sixth Directive/Article 17 of the Second Directive that they should be:
 - (a) for clearly defined social reasons; and
 - (b) for the benefit of the final consumer.

He stressed that the benefit should be direct and that the items under challenge were considered by the Commission to be too remote to qualify under (b). Gilmour was not helped by interventions by the President and the juge rapporteur (Judge Bosco) questioning aspects of the Commissions' claim and giving the feeling of antagonism towards it.

Internal distribution:-

- | | |
|--------------------------|-------------|
| CPS | Mr Fotherby |
| Mr Jefferson Smith | Mr Craske |
| Mr Finlinson | Mr Toll |
| Mr Cockerell | |
| VA Assistant Secretaries | |
| Mr P R H Allen | |

3. The main thrust of UK Counsel's speech was towards the invalidity of the Commission attempting to use the judicial procedure of instituting proceedings under Article 169 of the Treaty to solve a problem which should be addressed by political means in the Council of Ministers. The legal right of the UK to rely upon Article 28.2 of the Sixth Directive to have its zero-rating under the transitional provisions was emphasised. Mention was also made of the very recent (Cockfield) proposals which represented the correct approach by the Commission to making progress on harmonisation rather than the incorrect judicial approach it had adopted. Counsel then analysed the UK's detailed defence to each item under challenge, with particular emphasis in relation to construction and housing.

*Procedurally
correct, but no more.*

4. The judge rapporteur questioned the Commission forcibly on how it reconciled its challenge on UK & Ireland on "benefit to the final consumer" when in a separate report to the Council on the transitional provisions on zero-rates, it had accepted that there was such a benefit to the population at large. Gilmour relied upon the argument that such a benefit was too remote which drew the response from the judge rapporteur that to say that was to criticise the entire zero-rating system because in all cases there must be remoteness.

5. The Court noted that the Commission had now formulated tax harmonisation proposals for presentation to the Council and asked for a copy when they were published in the Official Journal. This should help us; the presentation of the proposals (whether adopted in due course or not) will be seen as giving effect to Article 28.2 and will support our contention that the political route is the correct one.

The Press

6. Members of the Press were present at the Court and there has been fairly extensive coverage in the dailies. Most of the reporting is helpful particularly if it does not fuel the fire of those who are urging disclosure of our proceedings. The Daily Mail leader refers to the ".....Government lawyers trenchantly arguing Britain's case" and the Financial Times remarks the "noticeably sceptical reception....." from the Court.

Building Trade

7. Representatives of the Building Trade attended the hearing and the Builders Employers Confederation phoned me this morning to express their appreciation of the UK's presentation. They are likely to write to express this to Ministers.

Next steps

8. We expect the Advocate Generals' Opinion on 12 November and shall make arrangements for representation at the Court. It is usual (but not invariable) for the Court's judgment to follow the Opinion and we can expect the judgment in the early part of next year. Clearly the full implications of the judgment cannot be considered until we have studied it in detail.

9. Summary

We can be satisfied that our oral presentation has assisted our case, indeed we can afford to be guardedly optimistic internally. But we should avoid raising expectations externally - we should maintain the line that we have used to date that the Government has vigorously and robustly defended UK interests and that we should have to study the terms of the Court's judgments before any decisions which may be necessary could be taken.

10. I shall keep you informed of developments.

Bryce Knox

B H KNOX



H M CUSTOMS AND EXCISE
 KNOLLYS HOUSE BYWARD STREET
 LONDON EC3R 5AY
 01-382 - 5319

Ch
 Content for PMG to
 write as suggested? (I think it
 might be best to remove the last
 few lines on the first page, which
 - despite the "if any" do still imply
 that we would change our
 VAT rates).

FROM: B J COCKERELL
 DATE: 18 SEPTEMBER 1987

PS/PAYMASTER GENERAL

cc PS/Chancellor
 Mr Lavelle
 Mr Scholar
 Miss Sinclair

** per 8/8 25 18/9 Greggs Ann... (6/21/1 attach response) M.*

ZERO RATES INFRACTION CASE: CONFIDENTIALITY OF PLEADINGS.

LORD BRUCE OF DONINGTON'S LETTER TO THE TIMES: 16 SEPTEMBER 1987.

1. You told me that the Paymaster thought that he should send a quick response to the letter by Lord Bruce of Donington which was published in The Times on 16 September. You asked for a draft soon after noon on Friday (18 September) in the hope that the letter might be published on Monday (21 September).
2. Lord Bruce focusses on two issues:-
 - (i) disclosure of pleadings
 - and
 - (ii) the possibility of veto of the European Court judgment.

Internal distribution:-

CPS
 Mr Knox
 Mr Jefferson Smith

VA Assistant Secretaries
 Mr Allen
 Mr Fotherby

Mr Rogers PRIO
 Mr Craske
 Mr Toll

3. Disclosure of pleadings

Lord Bruce is continuing his campaign even though he has been told categorically what is the situation and what is the distinction between the rules of the European Court and the constraints of the (unwritten) convention between parties to the proceedings. His letter correctly quotes the House of Lords reports although it is a little misleading to quote the Court thus:-

"the British Government can publish pleadings. It is our policy only to give particulars to the parties. But the parties are at complete liberty to make pleadings public. There is no sub judice rule".

In isolation, this gives the impression that, while the Court will not publish the pleadings, the British Government is free to do so.

It has been explained to Lord Bruce (Lord Young's letter of 22 July 1987 - copy attached) that it is the (unwritten) convention which effectively precludes publication of our defence and Lord Young has sent him (14 August) a copy of the letter from the Commissioner's legal service which refuses to agree to disclosure. We think that this aspect should be put right and the distinction between the two possible sets of constraint should be clear in the public mind.

4. Possibility of veto.

There has been some confusion all along in commentators' minds between the present Commission challenge on some of our zero rates and the more long term issue of tax approximation for which the submission of proposals from the Commission to the Council are imminent. These have not, so far as we are aware, been officially presented to the Council, but the generality of their content is well enough known and have been made public by Lord Cockfield. The Paymaster's reply to the letter by Lord Bruce of Donington might be a suitable vehicle to try to remove some of the misapprehensions including the somewhat alarmist suggestion that, if the UK were to lose before the European Court, it would automatically follow that VAT had to be applied at our present standard rate. We have said publicly (Press Notice in March 1986 copy attached) that our Treaty obligations bind us and that we should be obliged to tax at a positive rate any item where the Commission's case was upheld. This is the correct position and it bears repeating in

view of the current interest.

5. As a separate issue, we have just received in London a copy of a letter written by Etienne Reuter to Lord Bruce in which he protests about the statement by the latter in the House of Lords debate on 1 July 1987. Etienne Reuter says that it is incorrect and incomplete, and quite misleading. We do not think that there is advantage in trying to make capital of that in the present reply which is proposed for the Paymaster but we shall deal with it in response to the minute from you of 2 September 1987 in connection with the letter from Martin Eaton to the Treasury Solicitor.

6. Draft letter

The Attorney General has seen an earlier (similar) draft of the proposed letter for the Paymaster to send to The Times. He has said that he is delighted with the tone and particularly pleased that it is robust.



B J COCKERELL

Wm - (2/2/2012)

Sir

Lord Bruce of Donington's letter (16 September) raises some issues about VAT which need to be set straight.

Lord Bruce knows from exchanges in the House of Lords and from correspondence with Government ministers that, although there are no rules of the European Court which preclude publication by one party of its own pleadings, there is a convention that one party to pleadings before the Court does not disclose the pleadings of the other party without the latter's consent. The UK cannot disregard this. There is therefore a good reason why the UK Government's pleadings in the case before the European Court could not be published. ^{SMU} This is that their publication would disclose the pleadings of the European Commission. We have pressed the Commission to agree to disclosure, but have received a firm refusal; our hands are therefore tied.

That is, however, no reason for Lord Bruce to claim that our case is not being vigorously pursued. The oral hearing of the case took place on September 15 and was widely reported. Counsel for the United Kingdom Government, in a strong speech, made it clear that the Commission's challenge is an abuse of the legal procedures of the Community; that in general it is ill-founded in law; and that it is wrong in the particular cases under challenge.

We await the judgment of the Court. But as a lawyer Lord Bruce should realise that the United Kingdom is bound by its Treaty obligations on which membership of the Community is founded and will thus be bound by the Court's decision. Even if the case, or parts of it, were to go against us the Court would not fix a VAT rate for the items in dispute. talk of the imposition of 15% VAT on new building construction is entirely misplaced. We should need to study the judgment and the Government would need to consider what, if any, VAT change was called for on the specific items under challenge.]

I should clear up one other possible misunderstanding. This case before the European Court is separate from the Commission's proposals on VAT harmonisation which Lord Cockfield made public in July. ~~These~~ proposals - which may change in substance when they come to be discussed - could be adopted only by a unanimous decision in the Council of Ministers; that means that they could not be imposed against the United Kingdom Government's will.

P BROOKE
Paymaster General

Whereas we are
bound by our
Treaty obligations to
accept the decision of
the Court, we need



FROM: APS/PAYMASTER GENERAL
DATE: 1 October 1987

PS/CHANCELLOR

cc Mr Lavelle
Mr Scholar
Miss Sinclair
Mr Towers

PS/Customs & Excise
Mr Cockerell - C&E

*Oh / Content? (I think
we should also deal with No 10,
via a PS letter). 25/10*

**ZERO RATES INFRACTION CASE: CONFIDENTIALITY OF PLEADINGS
LORD BRUCE OF DONNINGTON'S LETTER TO THE TIMES: 30 SEPTEMBER**

I attach for the Chancellor's consideration a revised draft letter, approved by the Paymaster General, to be sent in reply to Lord ^{Bruce of} Donnington's letter in yesterday's Times.

Mr Cockerell is separately checking that the condition in square brackets is correct. The Paymaster feels that something of this sort needs to be included in the reply.

*I have pencilled
in Cockerell's amendments.
(His note is below)*

Deborah Francis.

MISS D L FRANCIS
Assistant Private Secretary

*Ok in
I have deleted para 4 because
(at present) I don't know (10
Frankly I don't know (10
(3) in paragraph 2
No further work on
in, I will check a v.
the rules of VAS, x I will
renewal "completed" in para 2.*



Treasury Chambers, Parliament Street, SW1P 3AG

The Editor
The Times
1 Pennington Street
LONDON E1 9XN

October 1987

*PM wants this Minister + The Times mt.
Ch. Cont. 2/10*

Lord Bruce's gasps of astonishment (30 September) have a synthetic quality. In case, however, his lack of understanding is genuine, let me expand on my earlier letter:

- i. the UK has a Treaty obligation to respect rulings from the European Court. [We have done this in the past - eg following the Court's ruling in 1983 on relative excise duties on beer and wine - and will do so in future]
- ii. the Government cannot decide now how it would react to an adverse ruling. We would have to study closely the detailed judgement, and consider our options;
- iii. whatever the ruling were to be, it ~~will~~ ^{could} not include the Court determining a particular positive rate, ~~for that does not lie within the Court's competence.~~ ^{since Community law does not prescribe one;}
- iv. ~~if the Court were to propose a positive rate (an outcome our vigorous defence does not readily countenance), the Chancellor's freedom to choose the precise rate would be unfettered, provided the rate were not so low that taxable persons would receive regular repayments of VAT on supplies to them. [This last condition is a Treaty requirement.]~~ ^{to be illegal if the zero rate is under challenge}

HON PETER BROOKE MP
Paymaster General
HM Treasury

FROM: Z EVEREST-PHILLIPS

DATE: 28 OCTOBER 1987

1. MR WALSH
2. PS/CHANCELLOR

cc. Mr Beastall
Mr Batt (or)
Mr Slaughter

IMF EXTERNAL AUDIT COMMITTEE

The Managing Director of the International Monetary Fund, M. Camdessus, has asked for the Chancellor's agreement to Mr Bennett, Deputy Director of the NAO, serving on the Fund's External Audit Committee for 1988.

Mr Bennett was appointed as a member of the EAC last year. The Fund traditionally retains one member from the Committee each year to maintain continuity from one year to the next. This member is required to act as coordinator of the EAC in his second year. Mr Bennett's appointment will require the approval of the Fund's Executive Board in due course. It is proposed that the other members will be from Burma and Chile.

Mr Downey at the NAO has been informed of the Fund's request and has agreed to Mr Bennett's serving on the Committee.

I would recommend that the Chancellor agree the request. A draft letter to M. Camdessus is attached for the Chancellor's signature. I should be grateful if I could be informed by 'phone when the letter has been signed so that I may inform UKDEL in Washington.



MISS Z EVEREST-PHILLIPS
IF1
X 5566



BF 12/11
Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

From: B H Knox
Date: 6 November 1987

CHANCELLOR

cc. Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Byatt
Mr Scholar
Mr Edwards
Miss Sinclair
Mr Cropper
Mr Tyrie

VAT ZERO RATES: GOVERNMENT PLEDGES

1. The minutes of OD(E)'s meeting on 1 October record Ministers' decision that "the text of all the relevant pledges [ie those on indirect taxes] made by Government spokesmen during recent election campaigns should be assembled and circulated to the Ministers concerned". A draft letter for you to send to OD(E) colleagues together with an Annex containing all the relevant statements of which we are aware are attached.

Internal circulation: CPS, Mr Jefferson Smith, Mr Finlinson, Mr Cockerell,
Mr Kent, Mr Allen, Ms French, Mr Oxenford, Mr Walton UKREP

2. In one sense we have exceeded the remit from OD(E), in another we have narrowed it slightly. The Annex contains a number of statements made in the House since the election which reiterate pledges made during the campaign. The reason for including them is that they are 'on the record' in a way which some of the others are not. On the other hand, the OD(E) remit referred to "recent election campaigns", which we believe was intended to cover both the 1987 general election and the elections to the European Parliament in 1984. However, as no commitments were made in 1984, so far as we can see, which went beyond those given during the general election campaign, there seemed no need to include them. This is explained in the covering letter.

3. We have deliberately excluded the statement made by the then Chief Secretary on "Breakfast Time" on 5 June 1987 (which was the subject of Mr Wilmott's note of 25 June). Mr McGregor arguably extended the Government's pledges to embrace books but it was decided at the time (PPS's minute to PS/PMG of 26 June) that the former Chief Secretary's remark did not alter the position and it has not been publicised since.

4. What the statements boil down to are "domestic" commitments not to extend VAT to food, gas, electricity and young children's clothes and footwear; and less specific commitments to reject any EC proposal which restricted our right to apply a VAT zero rate. In addition, the Prime Minister has made a number of statements [items] which could be interpreted as a more sweeping rejection of the Commission's VAT approximation package - in particular items 1(ii) and (v) in the Annex.

Byce Knox

B H KNOX

Rt Hon M-T-
P-M-
No 10.

DRAFT LETTER TO OD(E) COLLEAGUES

It was agreed at the meeting of OD(E) on 1 October that it would be useful to circulate the text of all relevant pledges on indirect tax made by Government spokesmen during recent election campaigns.

include


The attached list is intended to meet this remit. ~~In the event,~~ it does not ~~go~~ ^{extend} back as far as ~~the European Parliament elections of 1984 since it appears that~~ no commitments were given then which went beyond those given during the general election campaign. The list does, however, contain a number of references to post-election statements in the House which give 'on the record' confirmation of less formal earlier remarks.

The pledges only relate to VAT zero rating and can be summarised as

- a) the Government will not extend VAT to
 - i) food
 - ii) gas ~~and~~ electricity, ~~addition~~
 - iii) young childrens' clothing and footwear; and
- b) the UK will reject any EC proposals which restrict our right to apply a zero rate of VAT.

Considerable care has been taken - on the grounds of not constraining future Budget judgements - not to extend the undertakings under a) above to ~~other~~ ^{any further} categories of goods ~~(such as books and newspapers or passenger transport)~~ ^{or services.}. This stance must be maintainedⁿ.

I am copying this to other members of OD(E) and to Sir Robert Armstrong.


NIGEL LAWSON

VAT ZERO RATES: GOVERNMENT PLEDGES

1. THE PRIME MINISTER

- i) **Prime Minister's Questions, 30 April 1987: (OR Vol. 115, No. 99, Col. 409)**

Mr Maples: Will my Right Hon. Friend..... assure the House that the Government have no plans to raise the rate of VAT to the 25 percent that was reached under the last Labour Government.

The Prime Minister: Yes, and there are no plans to put VAT on food, either.

- ii) **Press Conference, 29 May 1987:**

Q: The Chancellor earlier this week categorically ruled out the imposition of any VAT on food. Does this mean that the Government intend to veto plans to approximate VAT rates throughout the Community, or can you confirm now that you intend to widen the VAT base in Britain?

The Prime Minister: We would veto plans. Any changes in Community tax have to be by unanimous vote... We would veto plans to come under a Community VAT system. In other words we, ourselves, would use our vote to veto a change in those laws. I want our VAT to be decided by us..... if the Community came in with a Community law to change our capacity to zero rate what we want to zero rate - then we should use our veto against that.

(Final sentence reproduced in The Times, 30 May, and Accountancy Age, 4 June)

iii) BBC Radio 4 "World This Weekend", 31 May 1987:

"We will continue to have zero rating on food, that is quite crucial. The question then arises about electricity and gas, about fuel. It is not our intention to put VAT on those things".

iv) ITV "This Week", 4 June 1987:

"If anyone tried to put VAT on children's clothes and shoes they would never, never, get it through the House".

"I have undertaken not to do it [apply VAT] on food - that was right from the beginning, and on gas and electricity. No we haven't got any particular plans to do it on other things, but I'm not going to constrain a Chancellor of the Exchequer. I don't know what the circumstances will be of any particular Budget".

v) Prime Minister's Questions, 16 July 1987: (OR vol 119; No. 20 cols. 1273-1274)

Mr Higgins: Does my Right Hon. Friend agree that the VAT structure with a single positive rate and zero rating for essential items is better than anything else in Europe, and that if we were to harmonise at all, it should be on our basis?... would my Right Hon. Friend agree with me that the abolition of zero rating would not be acceptable to the House?

The Prime Minister: We have made that clear. We must be able to determine our own structure of VAT. A number of other countries also take the view that they must be free to determine their own structure, and they are just as much against the proposal as we are. The possibility of this going through is negligible.

(iv) PMQ, 16 July (attached)

- vi) **Prime Minister's Questions, 23 July 1987: (OR Vol 120, No 25, cols 482-483)**

Mr Meale: Will the Prime Minister extend her pledge and give a categorical guarantee that she will veto any attempt to introduce VAT on bus and rail fares or on newspapers?

The Prime Minister: He is probably referring to the proposal before the Commission that there should be some approximation of value added tax. That proposal could only be passed by unanimous vote of all countries. It is not a question of vetoing - we should vote against it. That is not a veto. It is a vote against. A veto is the phrase used for the Luxembourg compromise.

Insert (A)
→ 2.
3.

THE PAYMASTER GENERAL

- i) **Written answer, 3 April 1987: (OR Vol 113, No 87, col. 629)**

Dr Hampson asked the Chancellor of the Exchequer what representations he has received from the Library Association concerning the continuation of zero rating on books and other literature after the harmonisation of value added tax arrangements within the European Community; and what response he has made.

Mr Brooke: "...the proposals will require unanimous agreement. Questions concerning the VAT treatment of books and other literature will therefore remain wholly a matter for national decision and subject to full Parliamentary consideration".

- ~~ii) **Treasury Questions, 9 July 1987: (OR Vol 119, No 15, cols 498-499)**~~

~~**Mr Martyn Jones** and **Mr Fatchett** asked the Chancellor if he had any plans to increase the value added tax base/extend the range of value added tax;~~

Mr Parry asked the Chancellor if he had any plans to impose value added tax on children's clothes;

Mr Brooke: My Right Hon. Friend has no such plans.

iii) **Written Answer, 9 July 1987: (OR Vol 119, No. 17, col. 256)**

Mr Wallace asked the Chancellor of the Exchequer if he has any plans to introduce value added tax on books; and if he will make a statement.

Mr Brooke: My Right Hon. Friend has no such plans.]

iv) **Statement issued 15 July 1987:**

"Clearly, we have not yet seen the full proposals. But the Community cannot adopt them unless there is unanimous agreement. And there is no question of our accepting anything that conflicts with the pledges the Prime Minister has given on our zero rates.

Other countries are as sensitive as we are to changes in indirect taxation. So we will not be alone on the issue, and it is therefore difficult to see the Cockfield plan making much progress in its present form".

(Third sentence quoted in The Times, 16 July)

4.

THE LORD PRIVY SEAL

i) **Prime Minister's Questions, 30 June 1987 (OR vol 118, No 8, col 370)**

Mr Hattersley: Will the Right Hon Gentleman repeat the assurances given by the Prime Minister during the general election campaign that the Government are opposed to the imposition of VAT on food, fuel, children's clothing, children's shoes, new building, books, periodicals and newspapers?

*either omit
or add
footnote
saying the
is standard
non-committal
line on pre-Budget
questions like
Use*

Mr Wakeham: I am happy to reaffirm what the Prime Minister said during the election campaign. The Prime Minister said that we have no intention of imposing VAT on food, gas, electricity, young children's clothes and shoes.

[later:]

.....I can assure the House that the undertaking that she gave during the general election campaign will be maintained.



FROM: S P JUDGE
DATE: 9 November 1987

MR CROPPER

cc PS/Chancellor
PS/Economic Secretary
Mr Scholar
Miss Sinclair
Mr Tyrie
PS/Customs & Excise

VAT ZERO RATES: GOVERNMENT PLEDGES

I gather that you are looking at Mr Knox's submission of 6 November before the Chancellor does.

The Paymaster General has noted that one passage that seems to be missing is the Paymaster's interview on the Today programme (Radio 4) on July 16, on which the Prime Minister was cross-examined at Questions the same day (Hansard attached).

S P JUDGE
Private Secretary

• Data Protection Act 1984 provisions take effect? Is he aware that the chairman of the British Medical Association consultants' committee is saying that it might cost as much as £30 for an access fee for people to get access to their medical records? Will he assure the House that the fee levels set by the regulations will not prohibit people from having access to their records because of financial constraints?

Mr. Renton: I do not agree with the hon. Gentleman's first contention. The orders will be laid around 20 October and there will be plenty of time for them to be debated in the House before they come into force on 11 November. With regard to the hon. Gentleman's question about the fee, my right hon. Friend the Home Secretary told the hon. Member for Leyton (Mr. Cohen) a written answer on 1 July that we would be announcing the level of the fee very shortly.

PRIME MINISTER

Engagements

1. **Mr. Franks** asked the Prime Minister if she will list her official engagements for Thursday 16 July.

The Prime Minister (Mrs. Margaret Thatcher): This morning I presided at a meeting of the Cabinet and had meetings with ministerial colleagues and others. In addition to my duties in this House I shall be having further meetings later today, before departing for Washington this evening.

Mr. Franks: May I draw the Prime Minister's attention to the latest unemployment figures released today, which show that for the 12th consecutive month the number of people unemployed is dropping? Is it not the case that in relation to the north-west, which shows the second largest drop, in a free and open economy at last the north is showing what it is capable of doing?

The Prime Minister: Yes, I join my hon. Friend in welcoming that latest reduction in unemployment, which is the 12th successive reduction. The north-west is one of the areas that is reducing the level of unemployment fastest. The north-west is also doing very well under this Government's policies of faster growth, privatisation and Trident, which is being built in my hon. Friend's constituency. It is also benefiting from an excellent new hospital in Furness. The north-west is doing very well.

Mr. Kinnock: The Prime Minister said that she would not support any proposals to impose VAT on food, gas or electricity. Why can she not bring herself to give exactly the same precise undertaking on children's clothing and children's shoes?

The Prime Minister: I made it very clear during the election precisely what undertakings I would give. I also made it very clear that although there were certain people in this House, particularly right hon. and hon. Members on the Opposition Benches who wish to constrain the Chancellor of the Exchequer, it is not part of my duty to constrain him in his annual Budget. That takes place only once a year, unlike what happened under the previous Labour Government, when Budgets took place frequently.

Mr. Kinnock: I am sorry, but on the subject of children's clothing and shoes the Prime Minister was anything but clear during the general election. Why does

she not say now, in exactly the precise terms that she has used when referring to other items that she would not have such a proposal coming before the House? Or would she, like the Paymaster General, suggest that such proposals would be vetoed? That is precisely what the Paymaster General said this morning.

The Prime Minister: I have already answered the right hon. Gentleman. He will go on raising scares and we will be able to point out how, on a day when the unemployment figures were down, he tried to raise another scare. [Interruption.] Of course he did.

With regard to the veto, I think he is referring to proposals that have come forward through the European Commission. They are not out in detail, but as he knows, partly due to our very vigorous fight on the Single European Act, any tax changes can be made only by a unanimous vote. Not only would this Government vote against Lord Cockfield's proposal, but a number of our European partners would do so as well.

Mr. Kinnock: The problem is the move to impose VAT on what are currently zero-rated items of considerable importance to the family budget. Does the right hon. Lady agree with the words of the Paymaster General that the Government would

"in fact veto VAT on food, fuel, children's clothing and shoes" —

Yes or no?

The Prime Minister: My hon. Friend the Paymaster General specifically confirmed what I said during the general election campaign, and that was his precise purpose. I am well aware of the words that he used. I am amazed that the right hon. Gentleman does not welcome the fall in unemployment.

Sir Ian Lloyd: My right hon. Friend's chief scientific advisers will doubtless have drawn her attention to the immense significance of the facts reported recently by our embassy in Tokyo, that the Japanese are marketing a 1 megabit semiconductor, are about to market a 4 megabit semiconductor, are designing a 16 megabit semiconductor and are reaching out to 64. As the issue has now moved into the public domain with the publication in the United States of the defence science task force report on semiconductor dependency, will my right hon. Friend seek to place this issue on the agenda for her discussions with the President of the United States so that the joint response in the West — the Asey programme and American efforts — can be co-ordinated?

The Prime Minister: I must confess to my hon. Friend that I do not think that that issue will be at the top of my agenda for this visit to the United States, which will be a short one. Other matters will be at the top. My hon. Friend is well aware of the substantial research and development budget that is paid for by the taxpayer, and I know that he is anxious to encourage more research and development expenditure from the private sector.

Q2. **Mr. Cohen** asked the Prime Minister if she will list her official engagements for Thursday 16 July.

The Prime Minister: I refer the hon. Gentleman to the reply that I gave some moments ago.

Mr. Cohen: Will the Prime Minister reconsider the introduction of a poll tax? Is she aware that in my constituency two adults will pay £1 a week more if it is introduced, that three adults will pay £8 a week more, that

mp

CONFIDENTIAL

FROM: P J CROPPER
DATE: 19 November 1987

CHANCELLOR

Ch,
Mr C's para 2 - the
second interpretation is correct
(see transcript, flagged). If you agree
with Mr C's para 3, we shall get a
revised letter typed up for signature.

cc PS/Paymaster General
PS/Economic Secretary
Mr Scholar
Miss Sinclair
Mr Tyrie
Mr Call
PS/C&E

*wd rather not
include the PM's
answer, since I believe
(per check) that
he is wrong
about
fact:*

VAT ZERO RATES: GOVERNMENT PLEDGES

You have reminded us to include your own VAT statements.

I attach:

1. Cuttings from 'Independent' and 'Today', 27 May 1987, reporting your BBC 'phone-in.
2. Extract from transcript of Central Office Press Conference 29 May 1987.
3. Ditto, 8 June 1987.

*some
forms of or
I believe
at
from VAT
(Cuba's
down)*

2. Your key input was in the 'phone-in, and there is a choice of wording. The 'Independent' reported you as saying:

"What I am saying is we definitely will not put VAT on food. I have no present intentions to put it on power, but I have to look at the situation in the light of events at the time and it is the same for any other tax you care to name."

*The
was
sh
also
include
begin
state
M... OK.*

'Today' reported you as saying:

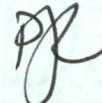
"I have no present intentions of putting it on power, but I have to look at the budgetary situation each year in the light of events at the time."

Which one do you wish to be enshrined? One had the word "budgetary", the other didn't.

3. I also attach transcript of the PMG's interview on BBC Radio 4, 16 July 1987. Would you agree that the part of the PMG's interview to enshrine is where he says:

"Food, fuel and children's clothing and shoes were the ones on which specific questions were asked during the General Election and specific pledges were given."

The word "questions" must have been omitted from the transcript.



P J CROPPER



CH/EXCHEQ <i>12/11</i>	
REC.	27 NOV 1987
ACTION	EST
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 London SW1P 3AL
 Telephone 01-270 5929

From the Minister for the Arts

C87/5211

The Rt Hon Nigel Lawson QC MP PC
 Chancellor of the Exchequer
 Treasury Chambers
 Parliament Street
 LONDON

Nigel Lawson

VAT ON BOOKS

In recent weeks I have been aware that pressure is being stepped up to preserve the present UK zero rate of VAT on books, newspapers and periodicals in the face of the European Commission's recent White Paper on completing the internal market.

I have been, and will continue to be, careful to avoid making any public statement of opinion on the continuation of the zero rate on books, other than to reiterate the Government's commitment to oppose on principle the withdrawal of the ability to apply a zero rate.

However, I am concerned about the possibility that, assuming the ability to impose the zero rate be retained, this might nevertheless result in a reduction in the number of the cases in which this is done. I need not repeat the strong arguments in favour of zero rating for books put to both me and you by the European Committee Against Taxing Books. But I do wish to emphasise that there is an important cultural dimension to be taken into account, and I should be most reluctant to see access to books diminished.

In resisting the Commission and in affirming our own, relatively enlightened, policy of encouraging literacy and the widest possible access to the printed word, there are some other points on the European front to bear in mind. One is that Heads of Government have singled out wider dissemination of the works of artists and writers as an objective to be pursued within the Community framework, and endorsed a report ("A People's Europe") to that effect. The other is that, partly in response to this, the Commission has begun to develop a relatively modest Community programme of encouraging cultural creativity in recent years. So

Plse let me have a note from Mr. Umm... my days @ that stage - as practically as possible to have journals zero-rated for a positive rate for other journals. (Some work has been done on this in the past.)

26 November 1987

the "tax on learning" arguments gain something in force from this context.

I know that you will bear these observations in mind when you are formulating your response to the Commission's White Paper. Meanwhile, I should very much appreciate being kept in touch with the developments in Brussels and the government's thinking on these as it emerges.

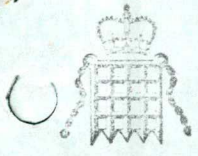
The strength of feeling on this will undoubtedly gather force over the next few months.

RICHARD LUCE

✓ *Rich*

VAT: JOHN TOMLINSON

Prayers for Wed



H.M. CUSTOMS AND EXCISE
KING'S BEAM HOUSE, MARK LANE
LONDON EC3R 7HE
01-626 1515

content with draft reply?

OR 13/7

No. 1 with discuss with O.R. Brussels.

From: P G WILMOTT
Date: 9 July 1987

PS/PAYMASTER GENERAL

cc PS/Chancellor
PS/Chief Secretary
Sir P Middleton
Mr Cassell
Mr Lavelle
Mr Scholar
Mr A Edwards
Mr Culpin
Mr Cropper

Ask PM to write up on behalf of

(He will write with Mr Chalkley. Look: attach with no further a while with no change attached)

VAT: LETTER FROM JOHN TOMLINSON MEP

I attach a suggested draft reply for submission to No. 10.

P G WILMOTT

Internal Copies: CPS, Mr Knox, Mr Jefferson Smith, Ms French, Mr Geddes.