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PART A

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PART A

1988 BUDGET MAINTENANCE
PAYMENTS

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PO -CH /NL/0339

PART A

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NOTE OF A MEETING HELD IN THE CHANCELLOR'S ROOM,
HM TREASURY AT 5.45 PM ON THURSDAY 25 FEBRUARY 1987

Present: Chancellor of the Exchequer
Lord Chancellor
Chief Secretary
Financial Secretary
Mr Scholar
Mr Culpin
Mr Cropper
Mr Tyrie
Mr Isaac (Inland Revenue)
Mr Stewart (Inland Revenue)

MAINTENANCE PAYMENTS: TRANSITIONAL ARRANGEMENTS

Papers: Mr Scholar's minute of 25 February; Mr Stewart's minute of 24 February; Financial Secretary's minute of 23 February, Mr Corlett's minute of 17 February; Mr Stewart's paper of 17 February.

2. The Chancellor, opening the discussion, invited the Lord Chancellor to comment on the main points in the paper. The Lord Chancellor made the following points:

(i) The arrangements proposed should not mean that the Courts needed to be notified before or on Budget day. The 30 June deadline would make it satisfactory for both English and Scottish courts if they were informed on the day following Budget day. The mechanics of this could be that the Revenue would provide his Department with an appropriate number of copies of the Budget day press notice concerning the arrangements which they could distribute immediately after the Budget Statement to the Courts;

(ii) He thought it would be difficult to distinguish between variations of agreements and supplementary agreements on the one hand, and formula agreements on the other. It might be



possible to devise a distinction between agreements under which payments were increased or decreased automatically, and those where they were not, but such a distinction could be difficult to justify and might be unworkable in practice.

3. The Chancellor noted that, if it were not possible to make a workable distinction between 'old' and 'new' agreements, it would not be possible to follow the route favoured by Mr Scholar, as set out in his minute. To do otherwise would, however, imply a degree of retrospection. The Lord Chancellor thought that this could be defended. The Chancellor concluded that the route in Mr Scholar's note should not be pursued.

4. In further discussion, it was noted that the vast majority of divorced couples would be better off under the new arrangements. If the tax free maintenance allowance were set at £2425, as proposed, around 90% of individuals affected would be better off. Moreover, it would be beneficial (in tax terms) to all couples where the payments were below £2425 to make new agreements so that ex-wives secured tax relief on the payments they received: ex-husbands would be unaffected by the change.

5. The Chancellor said that, in these circumstances, the courts were likely to be sympathetic to ex-wives seeking a new agreement on this basis. In order, therefore, not to clog the courts with such cases it would be desirable to devise an arrangement which would automatically give ex-wives some such relief. He accordingly invited the Inland Revenue to provide further advice on a scheme whereby all existing arrangements would be automatically transferred to the new system unless the husband specifically elected otherwise. This was his first preference. His second preference was a scheme whereby existing arrangements would remain within the old system unless the husband and the wife jointly elected to change.

6. In further discussion, the following points were also made:



- It was agreed to stick to the timetable set out in the papers;
- The Revenue should consider whether arrangements could be made, analogous to the '30 June' deadline, to ensure that those who made maintenance agreements on Budget Day morning outwith the Courts should be protected in the same way as those arrangements covered by Court Order were protected;
- The Revenue would consider what arrangements needed to be made for covenants which incorporated formula increases;
- These proposals were unlikely to clog the courts with people making new arrangements for payments in respect of children.

7. There was a full discussion of the level at which the tax-free maintenance allowance might be set. It was noted that there was little justification for setting the limit at £2425. A more defensible limit would be £1370. It would also make tactical sense to start at £1370, defend this in Committee, and be prepared to concede an increase at that stage if necessary. Setting the limit at £1370 might mean that these changes would provide a small revenue yield, rather than a cost. This would be presentationally advantageous. The Chancellor invited the Inland Revenue to provide further advice on the basis of this option.

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

J M G TAYLOR



cc Those present
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr McIntyre
Miss Sinclair
Miss Hay
Mr MacPherson
Mr Corlett (IR)
PS/IR
Mr Call

1988 Budget
Maintenance Payments

Part. A.

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carl Lewis

2. This minute is concerned with maintenance payments. At the meeting Ministers decided to give further thought to the level of the proposed monetary limit on relief for payers of maintenance. The charts attached to this minute give illustrative examples of tax liabilities under the present rules and the proposals, so that you can see the effect of possible monetary limits at various income levels from £5,000 to £60,000.

3. The assumptions made about income levels and maintenance payments are set out at the top of each chart. All assume that the family consists of husband, wife and two children.

4. The first two columns in the chart show the family's combined tax liability under the present rules, when married or divorced. The "divorced" column is subdivided to show how the tax liability is split between the husband (red section), wife (green section) and children (orange section, in Examples 9 and 10 only; because the maintenance paid to the children exceeds the single personal allowance, there is a small tax bill for the children in these cases). For readers with black-and-white copies - where the column is subdivided, the top section represents the husband's bill; the next section the wife's bill; and the third section (if any) the children's bill.

5. The next three columns show the tax bill under the proposed regime, with three alternative monetary limits on relief for the husband -

Option 1 - £1,370 (the difference between single and married allowance)

$$x 2 = \pounds 2,740$$

Option 2 - £2,500 (roughly equivalent to the present single allowance of £2,425)

Option 3 - £3,250 (roughly equivalent to the supplementary benefit rate for an adult, plus average housing costs).

6. At the Chancellor's meeting, Ministers thought that there should be no tax relief for Court Order maintenance payments made direct to the children (which are now made in that way to use up their personal allowances). The likely response would be that people would in future generally revert to getting Court Orders or making agreements for all the maintenance to be payable to the wife, since the payer would still then get relief for it (providing it was within the monetary limit).

7. The charts assume that this would happen. (If, alternatively, it was assumed that the husband would continue to get relief for payments to the children, subject to the overall monetary limit, the results would be the same. We are aiming to cover this in a later submission on various points of detail on the scheme).

8. There are some other assumptions we should record here -

- a. for simplicity, we have not illustrated the effect of independent taxation for the married couples. Independent taxation would not affect the figures except in examples 8-10, where it would reduce the married couple's present tax bill slightly;
- b. we have assumed that additional personal allowance (APA) would still be available to the parent looking after the children after the divorce. If APA is abolished, the tax bill on wives with earnings (or other taxable income) would be slightly higher than shown in the charts. But against that they would benefit from whatever increase in social security benefits replaced APA.

9. The charts show that tax bills for divorced couples in some cases would be higher than under the present rules. We are assuming, however, that there would be a transitional period during which the present rules would continue to apply to

existing Court Orders and maintenance agreements, so that people already paying maintenance would not suddenly be made worse off. Future divorcees would "lose" only in the sense that some of them would be worse off than if the existing system continued.

10. To illustrate the possible effects of the proposals, the examples show a variety of income levels and maintenance payments. Some cases will be much more 'typical' than others. So before looking at the results in more detail you may find it useful to see the numbers of people paying maintenance at different levels.

Broad distributional effects

11. Nearly 500,000 people obtain tax relief for maintenance paid to divorced or separated spouses and children. About 90% of these come within the "small maintenance payment" arrangements (under which weekly/monthly payments under UK Court Orders are paid without deduction of tax at source if they fall within specified monetary limits).

12. Of the 500,000 payers, about 120,000 pay more than £1,370. About 35,000 pay more than £2,500; these are mainly people with above average income, but they include about 5,000 with incomes below £10,000. At the upper end, some large payments are made; people paying more than £2,500 pay on average about £5,000 each.

13. About 20,000 people pay more than £3,250.

14. In effect this means that the proportion of people paying maintenance, who would get less relief under the new system, would be:

| <u>Limit for tax relief</u> | <u>Proportion of total people paying maintenance</u> |
|-----------------------------|--|
| £1,370 | 24% |
| £2,500 | 7% |
| £3,250 | 4% |

15. We have less information about the tax position of the recipients. And as a divorced or separated couple are two separate taxpayers, often handled by different tax offices, our statistics cannot correlate the husbands and wives directly. But DHSS statistics suggest that a substantial number of divorced or separated wives are on supplementary benefit, and these will normally be non-taxpayers.

16. No wives will pay more tax as a result of the changes (except as a result of possible abolition of APA). Some will pay less tax - mainly those who are earning. Some will have a new incentive to go out to work and earn income for themselves (there is an obvious parallel with proposals for dealing with the "earnings trap" on student covenants). Some wives will not gain because they pay no tax at present. Some of these may lose indirectly; if the husband's relief is restricted by the monetary limit, the Courts may award slightly lower maintenance than they would otherwise have done, to take account of what the husband can afford to pay.

Low income couples

17. Example 1 is a case where the husband has a very low income (£5,000) and cannot afford to pay much maintenance. It illustrates the point that low income couples, where the maintenance payments are relatively small, now pay more tax when divorced than when married. When married the husband gets the married allowance (£1,370 extra) whatever "maintenance" he pays. When divorced he gets relief for what he pays (here £700). The wife gets APA but this does not help her unless she has enough taxable income to make use of it.

18. In Example 1, Options 1-3 would leave the tax bill unchanged. (This assumes that the children's maintenance payments are switched to the wife or allowed to count in their own right - see paragraph 7 above).

19. More generally, this will be the result for low income couples, unless the total maintenance is more than the monetary

limit. If the wife was above the tax threshold (eg earning), she would be better off under the new rules.

20. Example 2 assumes a husband on slightly below average earnings of £10,000 a year, and a wife earning £3,500. It assumes maintenance payments of £1,000 a year; that is roughly average at this income level.

21. Under Options 1-3 the husband's tax bill is the same as now; his maintenance payments are within all the monetary limits. The proposals would wipe out the wife's present tax bill of £190. Her earnings make her a basic rate taxpayer, so the exemption for her maintenance payments improves her position. Thus the overall tax bill is reduced.

22. Example 3 makes the same assumptions as Example 2, except that the maintenance is £1,370 (equal to the difference between single and married allowances). Here the tax bill under the present rules is the same whether the couple are married or divorced. The proposals would reduce the tax bill by £290, by removing the wife's present tax bill on the maintenance she receives.

23. In Example 4, the husband is earning £10,000 and the wife £5,000. The maintenance totals £3,000 (£1,500 to the wife and £1,500 to the children). This is a much less typical level of maintenance than Examples 2 and 3; but it brings out the effects of the monetary limit in that limited area. The wife pays about £400 less tax than now, because her maintenance is exempted. With a £1,370 limit (Option 1), the husband's tax bill is increased by £440 because his relief is restricted; so the overall tax bill is slightly increased. With a £2,500 limit (Option 2), the husband's tax bill is increased by rather less, and overall the couple gain. With a £3,250 limit (Option 3), the husband's bill is the same as now, while the wife gains.

24. This example brings out the point that a small overall change may reflect a larger loss to the husband, offset by a gain to the wife. In practice the Courts would be likely to take

these tax effects into account in fixing the maintenance payments under the new rules; so the actual figures awarded might be somewhat lower than now.

Other couples

25. Examples 5-10 illustrates higher income levels, generally with high levels of maintenance. These are likely to represent relatively smaller numbers of cases, and they bring out what effect the options can have on certain assumptions.

26. Examples 5 and 7 are cases where the husband has £15,000 and £20,000 income respectively, and the wife has no income apart from her fairly substantial maintenance. Here the wife makes no gain; she does not pay tax at present because the maintenance payments are covered by her own and the children's personal allowances. The husband would pay more tax because his payments exceed the limits on relief.

27. Examples 6 and 8 show the same income levels but assume that the wife also has some earnings and that the maintenance payments are somewhat lower for that reason. Here the gain to the wife is noticeable. In Example 8, the tax bill would be higher overall under all the options. Here the gain to the wife is fairly small (because at present most of the maintenance is paid direct to the children and is covered by their personal allowances). But because the total maintenance is £5,000 the husband's relief would be significantly restricted by the monetary limit.

28. Examples 9 and 10 illustrate cases with much higher incomes and larger maintenance payments. In both of these the couple pay substantially less tax under the present rules when they are divorced than when they were married. The various options increase the total tax bill; but it is still less than the present tax bill when married.

29. All these examples make somewhat arbitrary assumptions about levels of incomes and maintenance, and in practice there will be an infinite variety of combinations.

Revenue effects

30. Our best estimates of the eventual net yield/cost of these proposals, at 1987-88 levels, are:

Option 1 - £1,370 limit on relief for the payer: yield of £20 million

Option 2 - £2,500 limit on relief for the payer: cost of £5 million

Option 3 - £3,250 limit on relief for the payer: cost of £10 million

These estimates are somewhat tentative at present since our information about the other income of maintenance recipients is rather sparse. We are carrying out some further work on this and plan to firm up these figures fairly soon. The main point to note from the estimates is that the eventual net yield/cost of these proposals is very modest and, for options 2 and 3, almost revenue neutral.

31. The costs during the transitional period will depend on the detail of the transitional arrangements, on which we will be making a separate submission. As some couples would gain from moving to the new rules straightaway, we are considering whether couples with pre-Budget Orders should be given an election to move on to the new rules if they wish. This would tend to increase the revenue cost in the early years, but would reduce the number of cases to which the old rules would still have to be applied.

Conclusion

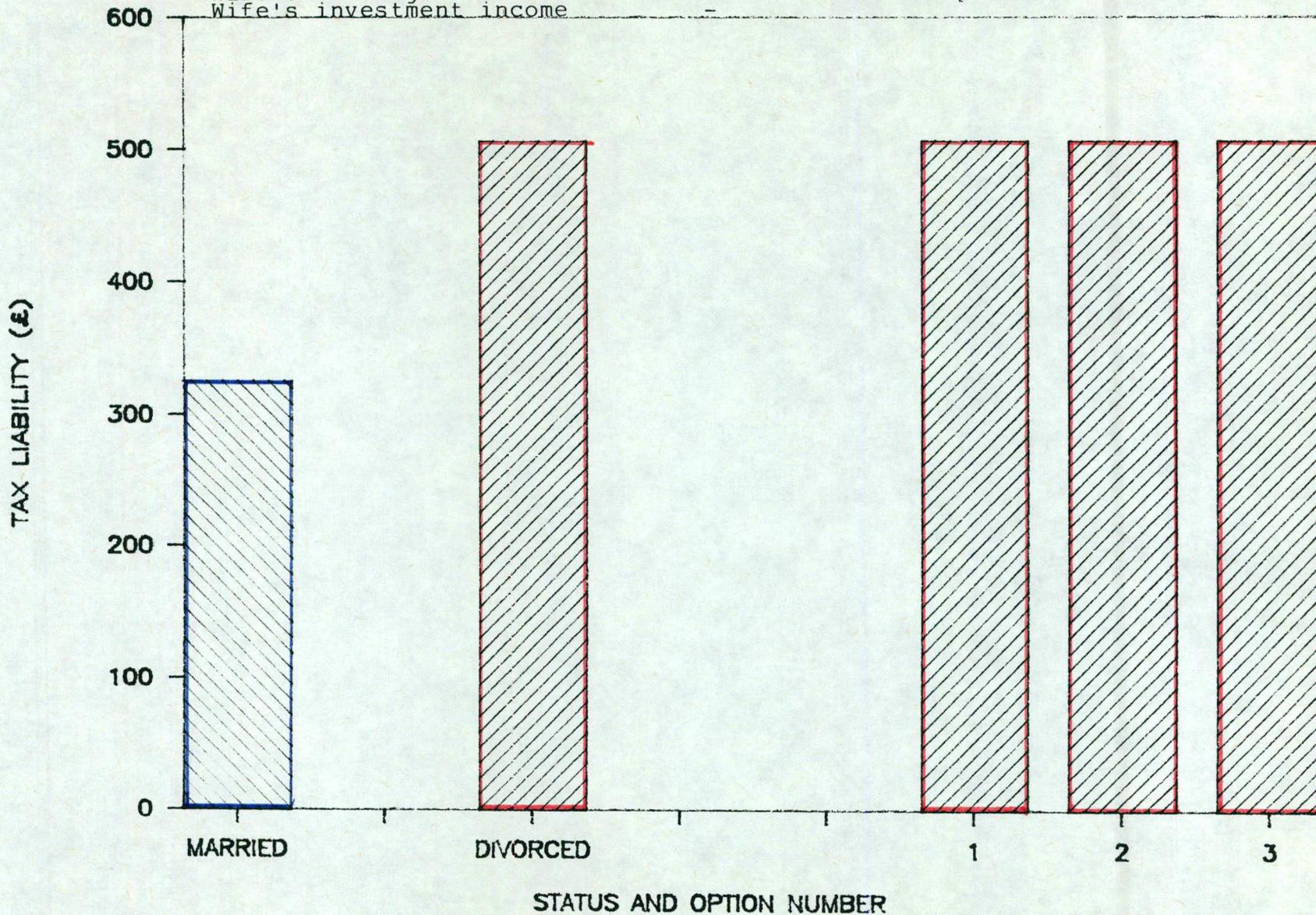
32. It would be helpful to have your views on where the monetary limit on relief should be set. We shall be letting you have a further submission on a number of more detailed points on the proposals, including transitional arrangements.

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C STEWART

TAX LIABILITY AT 1987-88 LEVELS

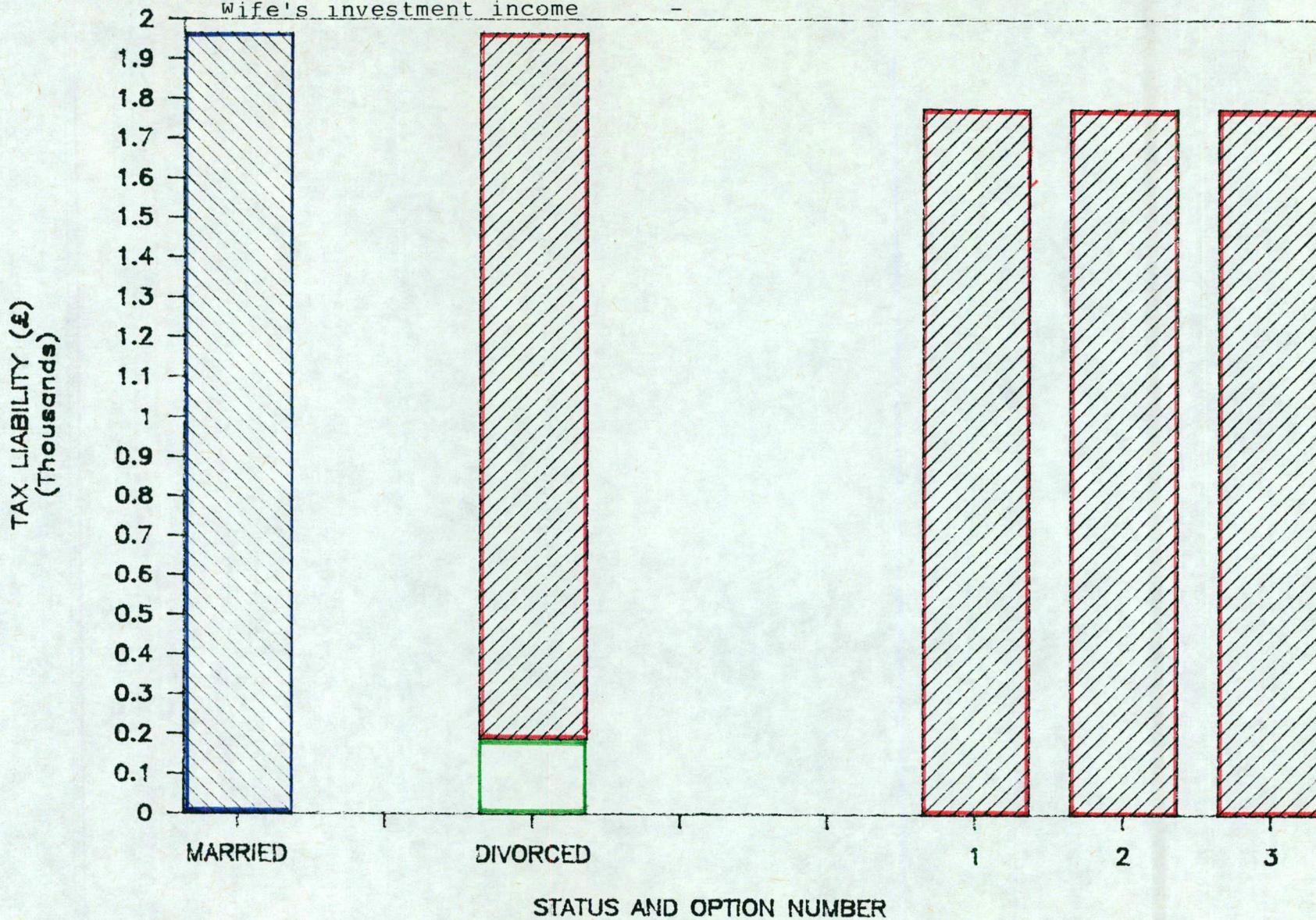
| | | | |
|--------------------------|-------|--------------------------------|------|
| Husband's earnings | £5000 | Maintenance paid to wife | £300 |
| Wife's earnings | £2000 | Maintenance paid to 2 children | £400 |
| Wife's investment income | - | | |



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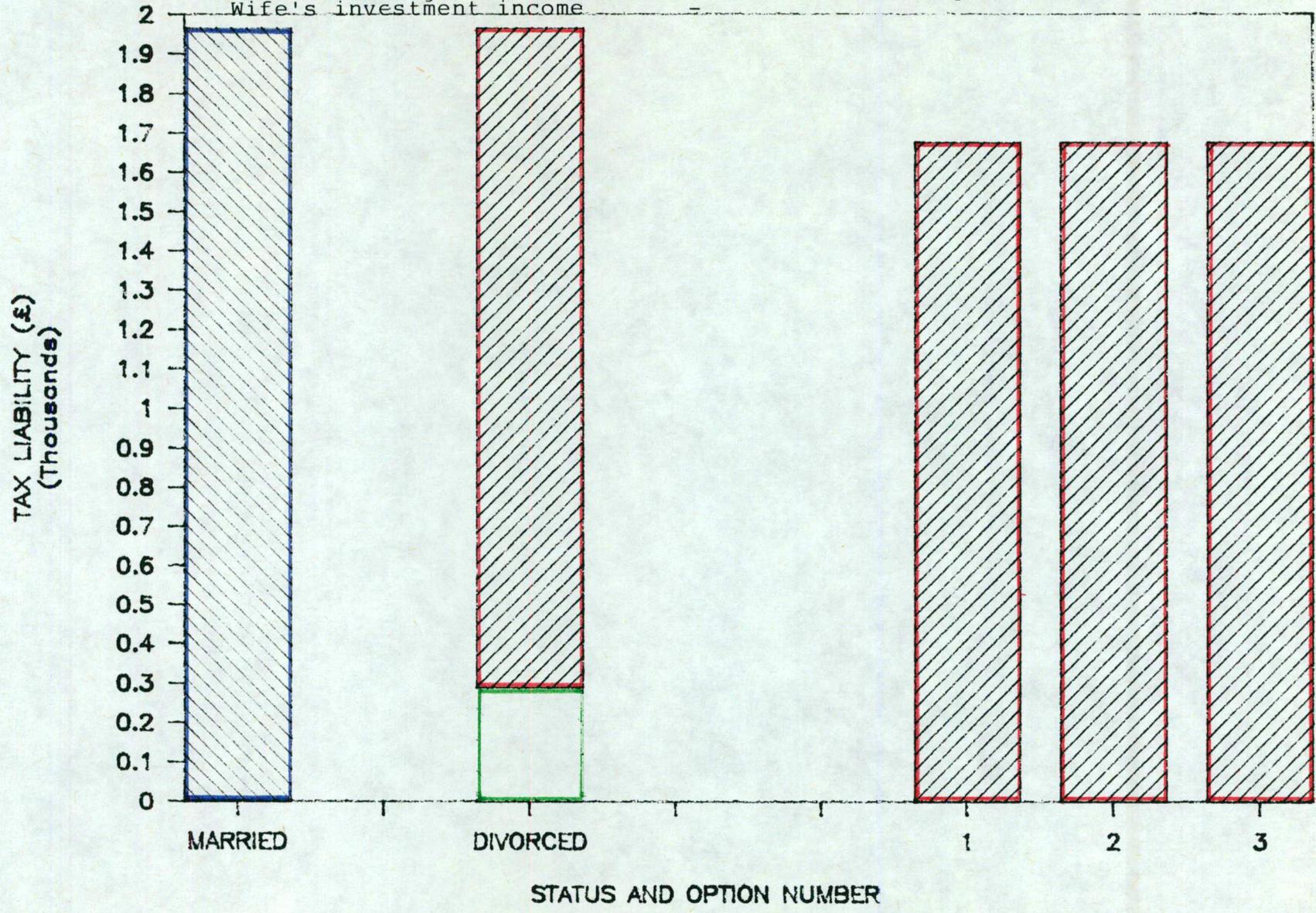
TAX LIABILITY AT 1987-88 LEVELS

Husband's earnings £10000
 Wife's earnings £3500
 Wife's investment income -
 Maintenance paid to wife £1000
 Maintenance paid to 2 children -



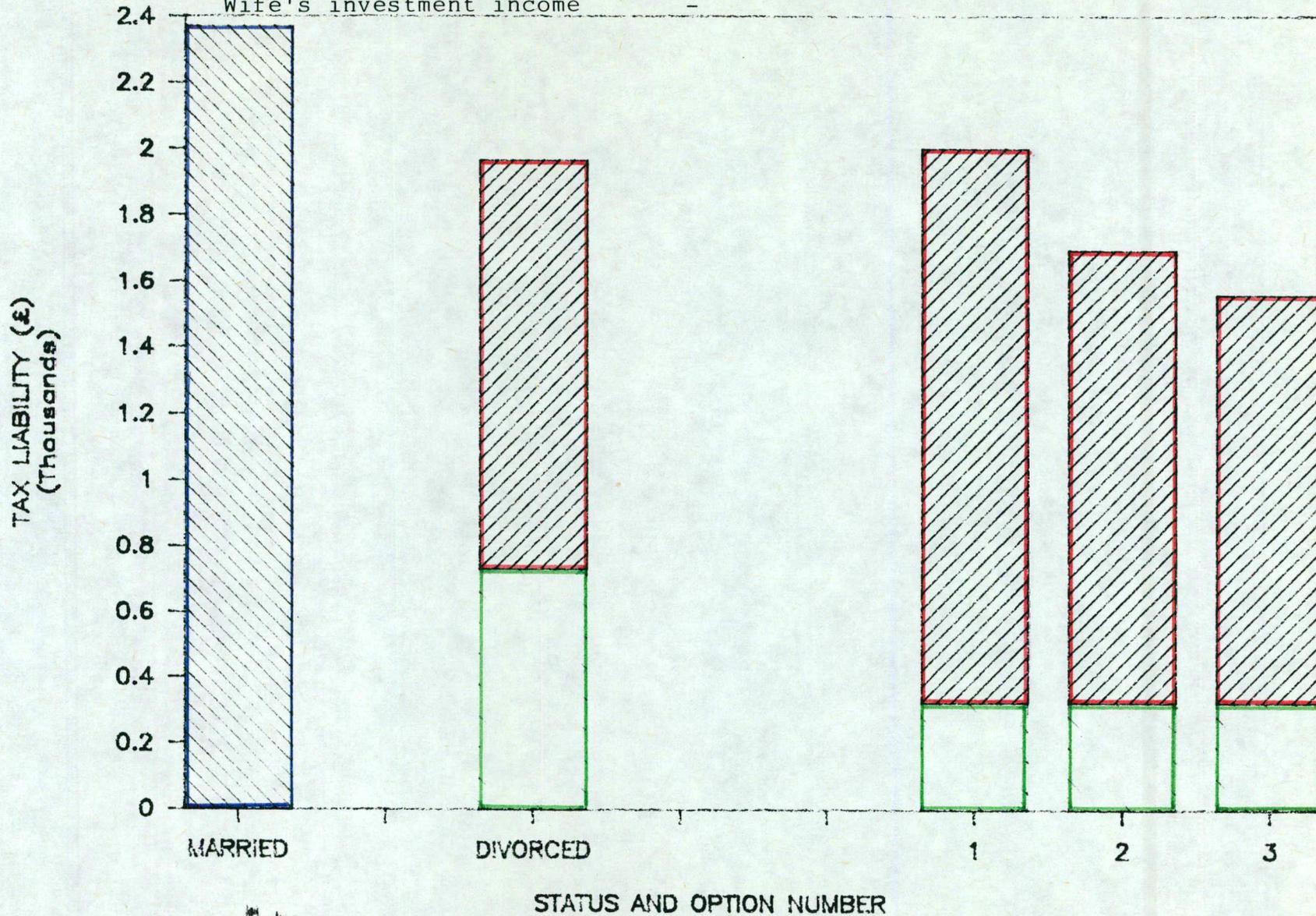
TAX LIABILITY AT 1987-88 LEVELS

| | | | |
|--------------------------|--------|--------------------------------|-------|
| Husband's earnings | £10000 | Maintenance paid to wife | £1370 |
| Wife's earnings | £3500 | Maintenance paid to 2 children | - |
| Wife's investment income | - | | |



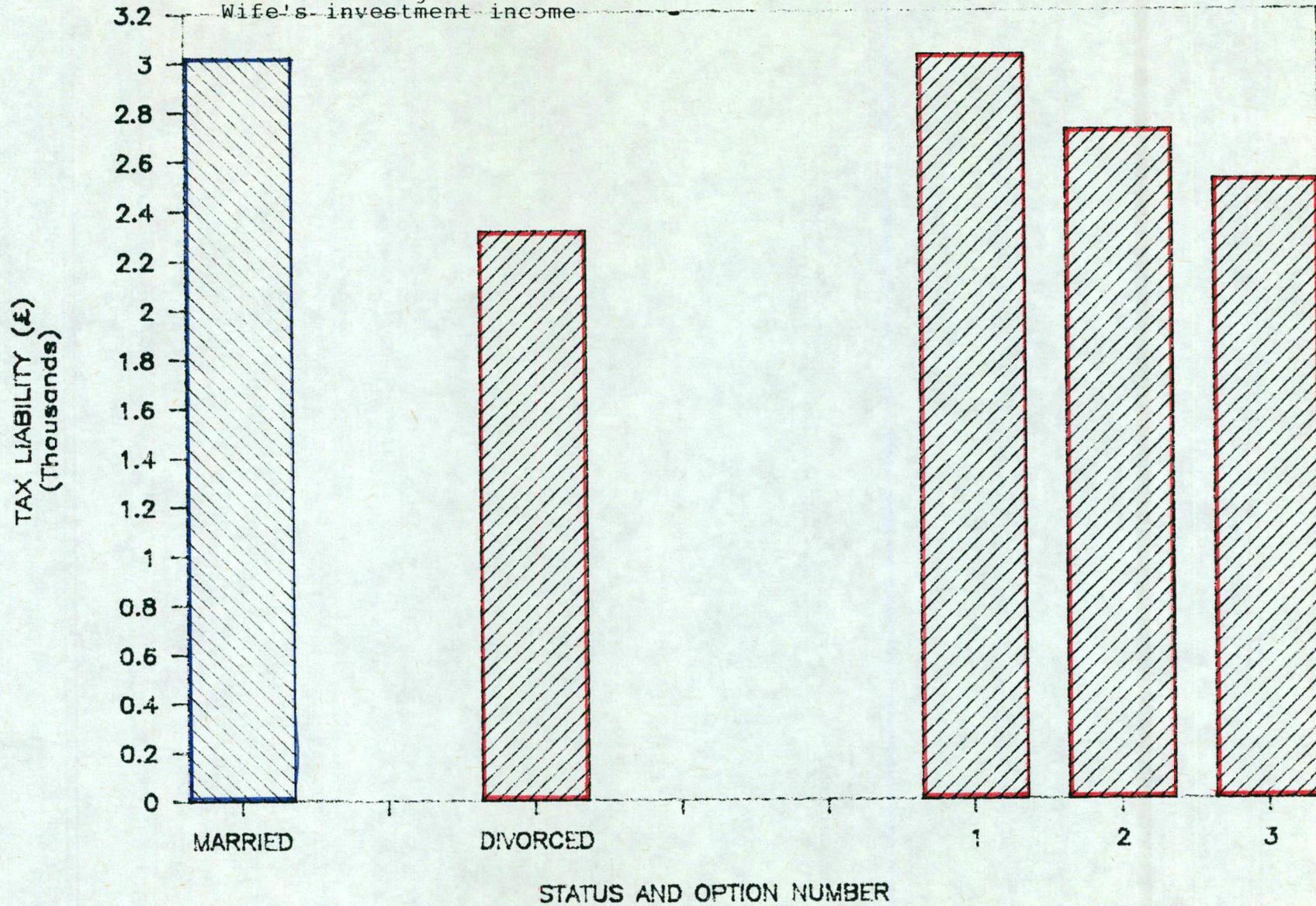
TAX LIABILITY AT 1987-88 LEVELS

| | | | |
|--------------------------|--------|--------------------------------|-------|
| Husband's earnings | £10000 | Maintenance paid to wife | £1500 |
| Wife's earnings | £5000 | Maintenance paid to 2 children | £1500 |
| Wife's investment income | - | | |



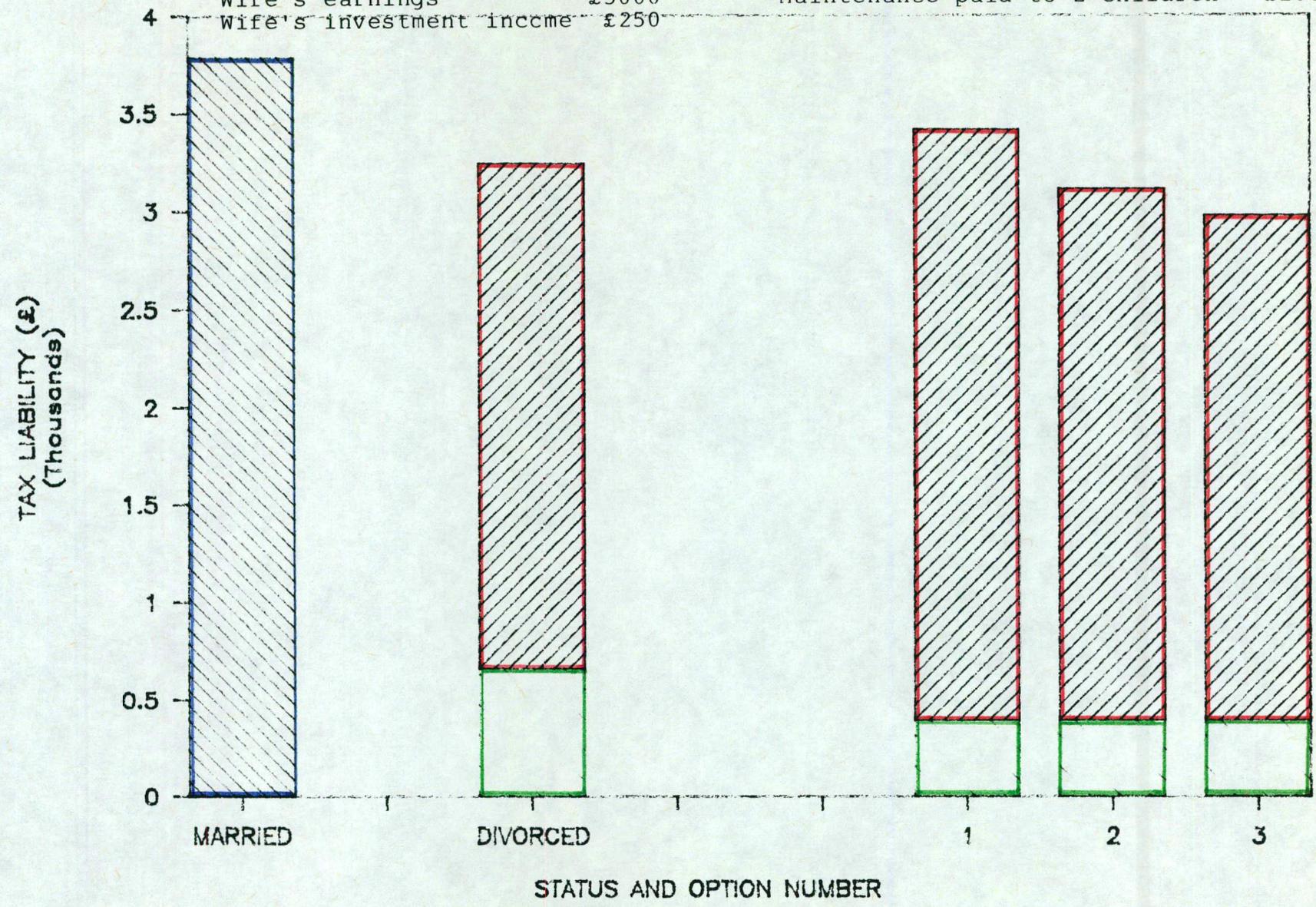
TAX LIABILITY AT 1987-88 LEVELS

| | | | |
|--------------------------|--------|--------------------------------|-------|
| Husband's earnings | £15000 | Maintenance paid to wife | £2000 |
| Wife's earnings | - | Maintenance paid to 2 children | £2000 |
| Wife's investment income | - | | |



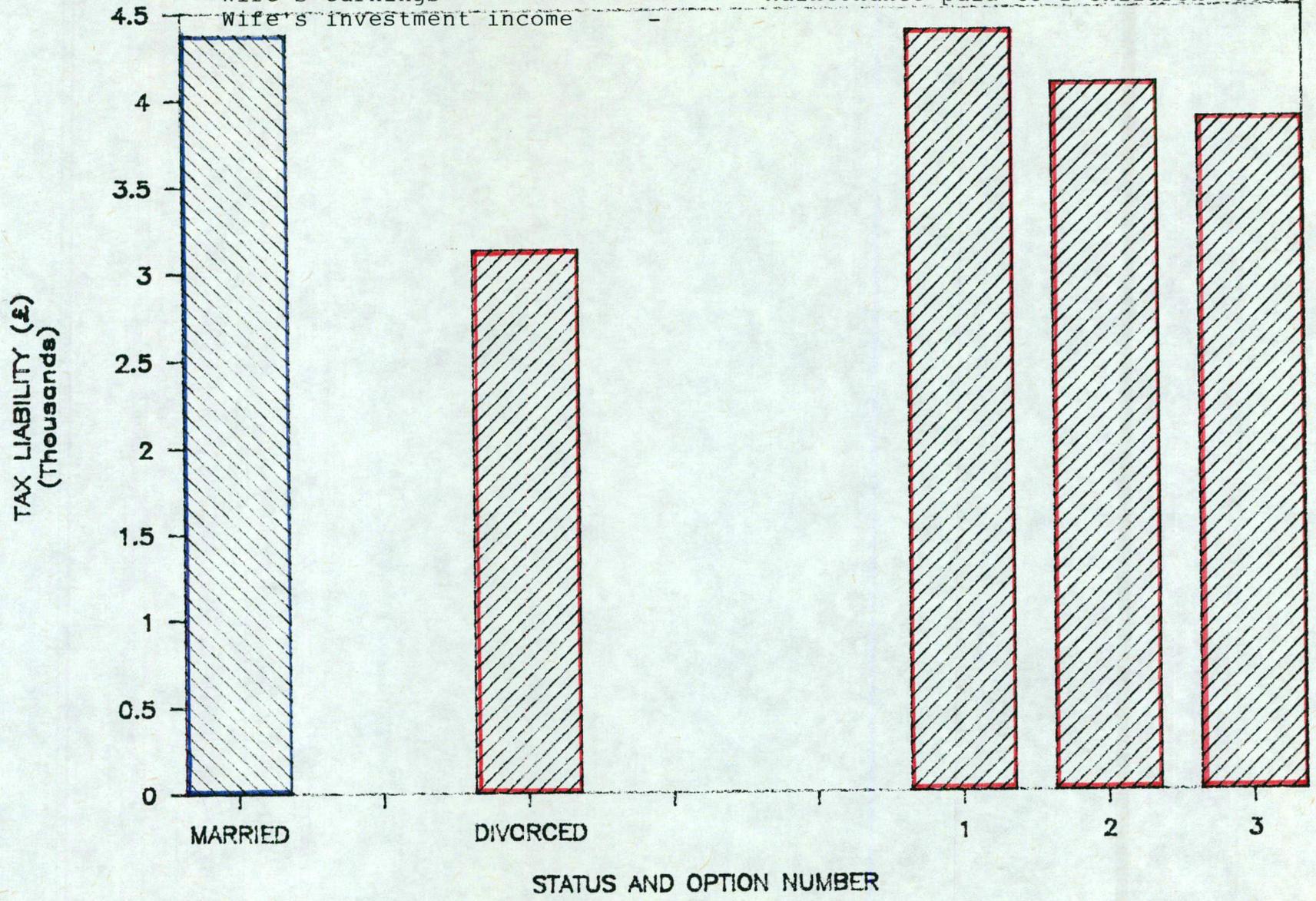
TAX LIABILITY AT 1987-88 LEVELS

| | | | |
|--------------------------|--------|--------------------------------|-------|
| Husband's earnings | £15000 | Maintenance paid to wife | £1000 |
| Wife's earnings | £5000 | Maintenance paid to 2 children | £2000 |
| Wife's investment income | £250 | | |



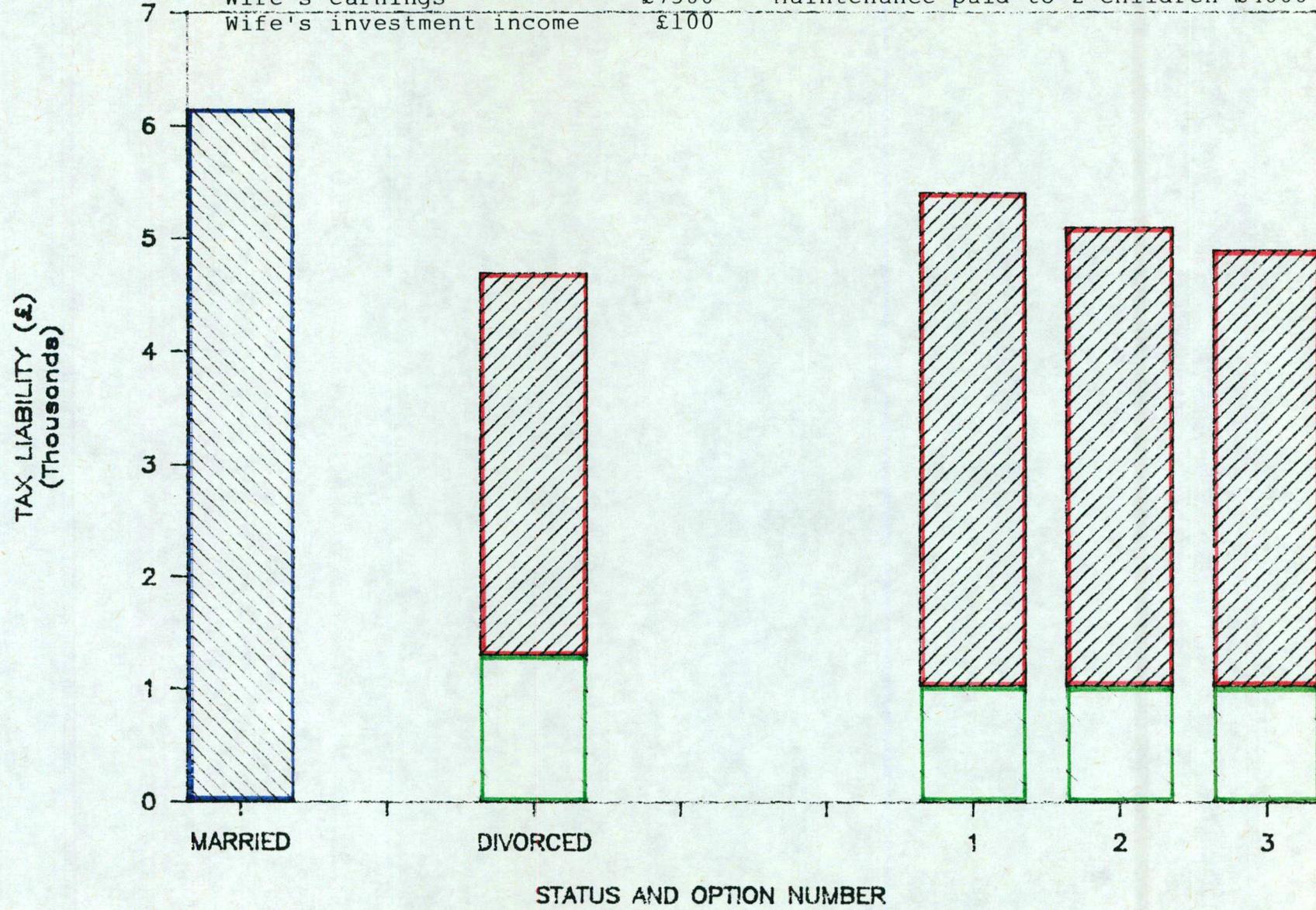
TAX LIABILITY AT 1987--88 LEVELS

| | | | |
|--------------------------|--------|--------------------------------|-------|
| Husband's earnings | £20000 | Maintenance paid to wife | £3000 |
| Wife's earnings | - | Maintenance paid to 2 children | £3000 |
| Wife's investment income | - | | |



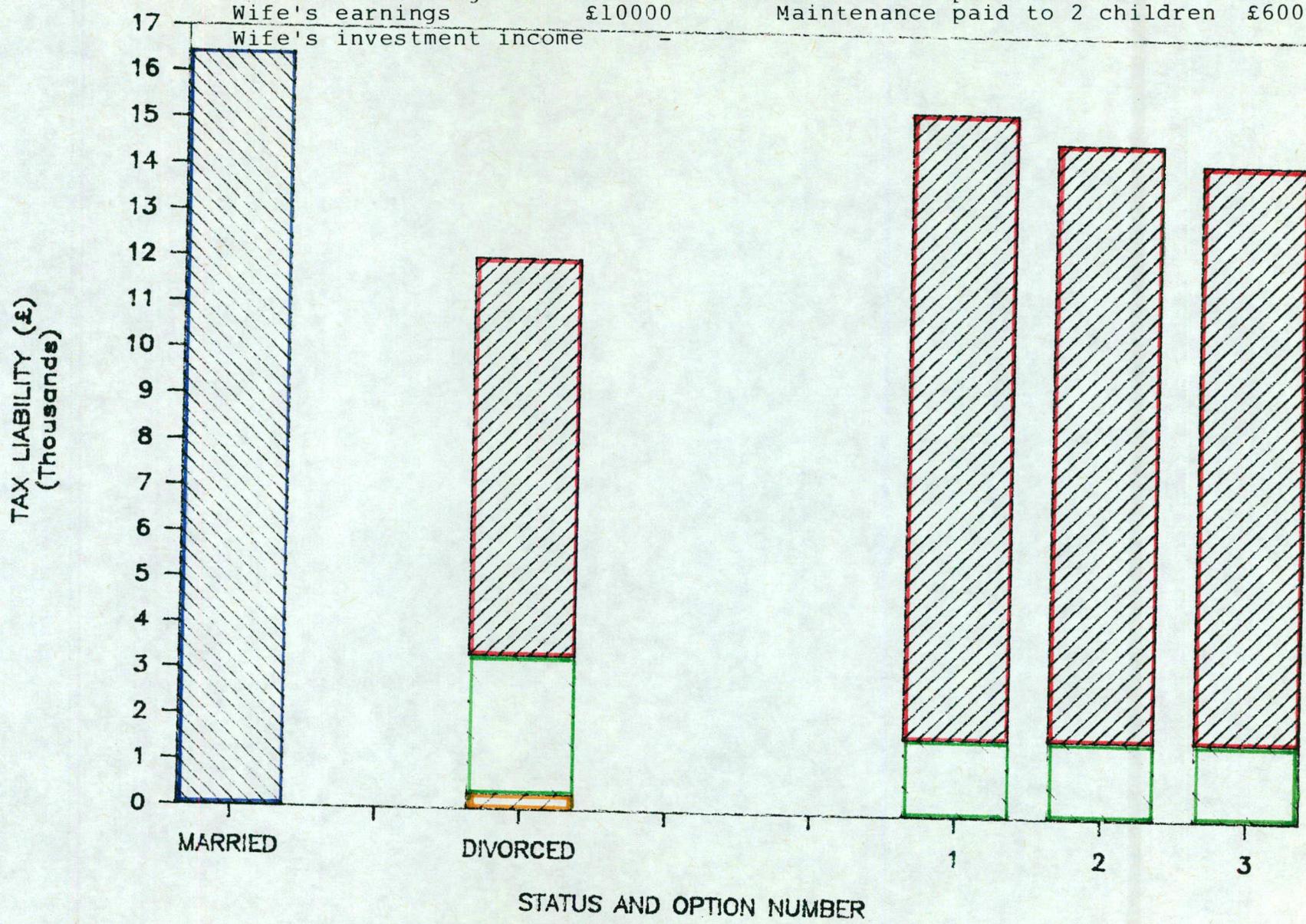
TAX LIABILITY AT 1987-88 LEVELS

| | | | |
|--------------------------|--------|--------------------------------|-------|
| Husband's earnings | £20000 | Maintenance paid to wife | £1000 |
| Wife's earnings | £7500 | Maintenance paid to 2 children | £4000 |
| Wife's investment income | £100 | | |



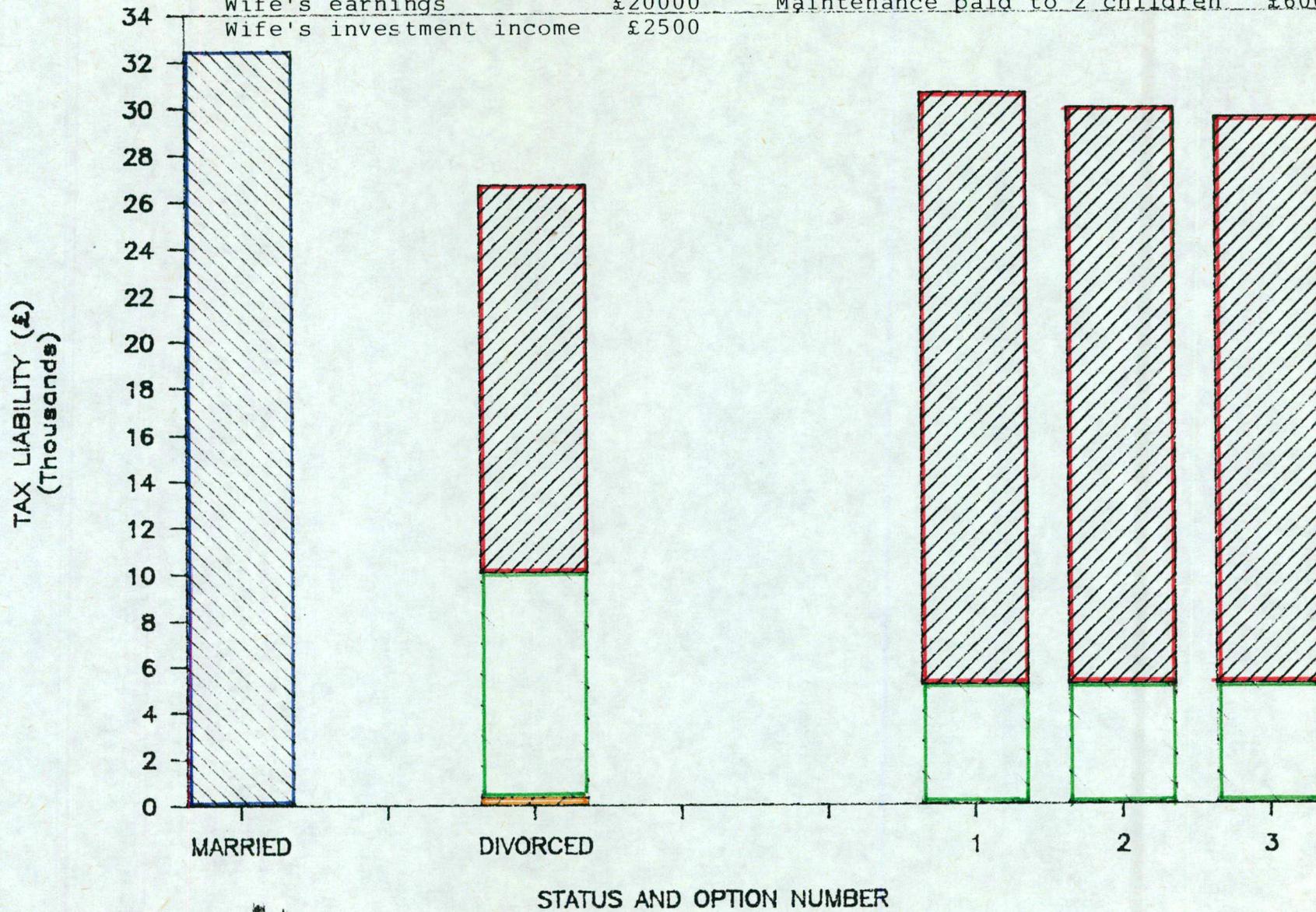
TAX LIABILITY AT 1987-88 LEVELS

| | | | |
|--------------------------|--------|--------------------------------|-------|
| Husband's earnings | £40000 | Maintenance paid to wife | £5000 |
| Wife's earnings | £10000 | Maintenance paid to 2 children | £6000 |
| Wife's investment income | - | | |



TAX LIABILITY AT 1987-88 LEVELS

| | | | |
|--------------------------|--------|--------------------------------|--------|
| Husband's earnings | £60000 | Maintenance paid to wife | £10000 |
| Wife's earnings | £20000 | Maintenance paid to 2 children | £6000 |
| Wife's investment income | £2500 | | |





MINUTES OF A MEETING HELD AT 11.00 AM
ON MONDAY, 12 OCTOBER IN CHANCELLOR'S ROOM, HM TREASURY

Those present

Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Sir P Middleton
Mr Anson*
Mr Cassell
Mr Scholar
Mr Gilmore*
Mr Burr*
Mr Tyrie

Mr Battishill - IR
Mr Isaac - IR
Mr Stewart - IR

(*paragraphs 1-8 and 11-12 only)

STUDENT LOANS AND COVENANTS

The Chancellor said that this was a complicated and politically sensitive area, but there was the possibility of an objective improvement and a considerable simplification in administration. He would like to see an end altogether to tax relief on covenants between individuals with tax relief retained only for gifts to charities. Mr Burr's very helpful paper considered ending tax relief on covenants in the context of moving to a mixed loan and grant system for students. In practice, the only system likely to win acceptance was one involving top-up loans only. It would be important to ensure that these were as substantial as possible in the hope that this would prove to be a first stage. Mr Burr had put forward a number of options and it seemed to the Chancellor that option 3 and option 5 should be focussed on. Either way, there would be a switch from tax relief to public expenditure, but this should not disqualify such a change. The Chief Secretary agreed.

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2. Continuing, the Chancellor said that he had originally favoured option 5, ie including student loans in a package. However, he was now of the view that this might prove too complicated operationally. The Review of Student Support was progressing very slowly indeed, and he would not want to hold up action on covenants because there were no decisions on loans. This pointed to Mr Burr's option 3. Any proposal from DES was likely to include either abolition or a substantial reduction in parental contributions and a reduction as part of a change to covenants would be helpful.

3. The Chancellor asked how many parents were paying their contribution by means of covenants. It was noted that estimates were uncertain, but probably the majority. The Chancellor said that the more parents who were currently covenanting the better from the point of view of neutrality of the scheme. Those who benefitted from the change were those who did not covenant and paid a low parental contribution.

4. The Chancellor said he was not attracted by Mr Isaac's suggestion of a MIRAS based approach which would not score as public expenditure.

5. Mr Anson said that by using the money from abolishing tax relief on covenants to reduce parental contributions in this first stage, we removed one card from our hand and that might make it more difficult to get a substantial loan scheme in place. However, he recognised that there was little choice. The Chancellor agreed that this was an important point. However, this could be used as an argument to persuade Mr Baker to reach conclusions more quickly on the Review of Student Support.

6. Mr Scholar said that the way the numbers had been calculated made everyone a small loser under option 3. A family was losing tax relief based on 27 per cent while receiving only a 20 per cent



abatement on parental contributions. He thought the percentage abatement for parental contributions should be looked at again. The Chancellor agreed. He was happy to sign up to option 3, but thought we needed to look again at the abatement for parental contributions.

7. The Paymaster General asked how the proposals were to be communicated to DES. His impression was that the reason for their delay on the Review of Student Support was that they were waiting to hear the Treasury's views. It was agreed that DES should be approached with option 3. The precise way in which this should be done would have to be considered and Mr Burr would be submitting advice shortly (see paragraph 12). If, in the event, DES proposed a package along the lines of option 5, the key question would be whether this was feasible within the timescale envisaged for the removal of tax relief on covenants.

Covenants from grandparents

8. Mr Battishill said that from the Inland Revenue point of view it was desirable to remove all inter-personal covenants - but the problem with covenants from grandparents was that, unlike covenants from parents, there was no way to offset the loss. The Chancellor commented that to the extent that any covenants were going to students, then this would be an argument for erring on the side of generosity in setting the percentage reduction in parental contribution. However, he hoped that the 1988 Budget would include some tax reductions - several of which would help the individuals concerned. Furthermore, the proposal was to protect existing covenants and this would make presentation easier.

Covenants and maintenance

9. The Financial Secretary said that he had considered the issues further since his minute of 31 July. The proposed reforms had

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merit. But divorce placed a financial burden on the divorcee which should not be overlooked.

10. The Chancellor invited the meeting to consider the main proposals as summarised in paragraph 62 of Mr Stewart's minute of 24 July:

- (i) it was agreed that covenant payments between married couples should be made ineffective for tax purposes, as an essential part of independent taxation (paragraph 62(i));
- (ii) it was agreed that covenants between other individuals should also be made ineffective, subject to possible preservation for deserving cases and to suitable arrangements being made for students through an alternative tax expenditure (paragraph 62(ii)). Some concession to the disabled might be made at Committee stage;
- (iii) maintenance payments gave rise to conflicting considerations. First, that divorce, and its consequences, was very expensive. Second, that the more we moved to independent taxation, the odder it looked to treat separated people more favourably than married people. It was noted that reform of the kind suggested would greatly simplify the current system, would help the low income wife, and remove the disincentive to work. The poorest would be made better off; losers would be concentrated amongst those with higher incomes. It was agreed to go in this direction. The Revenue should undertake a new distributional analysis. The figure for the limit on tax relief should be determined in the light of that analysis; the Chancellor's pre-disposition was for a higher figure than £1,370;
- (iv) it was agreed that maintenance payments should be tax free in the hands of the recipient (paragraph 62(iv));

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- (v) it was agreed that maintenance payments to all children should be made ineffective for tax.

In response to the Chancellor, Mr Battishill said that reform on these lines should give rise to staff savings of around 400 in the longer-term. The type of legislation would need to be considered carefully. The Revenue should examine the possibilities, including that all existing legislation should be repealed to enable a fresh start to be made.

11. It was noted that there could be problems of forestalling, and of differential treatment before and after the effective date for changing the legislation. The overall distributional effect would need to be examined. Losses to individuals in one area (eg school support) might be offset by increases in other areas (eg support to university students).

12. Discussions with DES would need to be handled carefully, to avoid leaks. Mr Burr should advise on the options for how this might be done and on the realistic prospects of getting a package agreed with DES in time. A fully coherent, worked through plan, should then be presented to DES at the appropriate moment. Mr Scholar should think further about consulting DHSS and other Departments; these should be brought in at the latest possible stage.

CR

CATHY RYDING

JF

J M G TAYLOR

13 October 1987



Inland Revenue

CONFIDENTIAL

The Board Room
Somerset House
London WC2R 1LB

FROM: A J G ISAAC
20 November 1987

CHANCELLOR OF THE EXCHEQUER

MAINTENANCE: CHILDREN

1. At your meeting on 12 October you decided that maintenance payments to children should be ineffective for tax purposes. The note on the distributional implications (Mr Stewart's minute of 13 November) assumed accordingly that the Courts would revert to their former practice, of directing that maintenance payments should in future be made to the divorced or separated wife, to cover (inter alia) the needs of the children, if they are in her care.

2. Mr Stewart's further note today makes the same assumption.

3. At the same time, we are all conscious of the sensitivity of what you have called "a minefield". In particular, discussion so far has centred on the typical case, where the divorced or separated wife has custody of the children. The attached note also looks at the perhaps still more sensitive minority of cases

| | | | |
|----|---------------------|---------------|--------------|
| cc | Chief Secretary | Mr Battishill | Mr J C Jones |
| | Financial Secretary | Mr Isaac | Mr Martin |
| | Paymaster General | Mr Corlett | Mr Eason |
| | Economic Secretary | Mr Lewis | Mrs Fletcher |
| | Sir P Middleton | Mr Beighton | Mr Stewart |
| | Mr Scholar | Mr Calder | PS/IR |
| | Mr Culpin | Mr Easton | |
| | Mr Riley | Mr Mace | |
| | Mr Cropper | Mr Davenport | |
| | Mr Tyrie | Mr R H Allen | |
| | Mr Jenkins (OPC) | Mr Yard | |

MAINTENANCE
PAYMENTS
CHILDREN

ISAAC
→
CH/EX
20/11

where neither the father nor the mother has custody. I hope that it gives you an opportunity to take stock of the particular issues concerning children and ensure that the approach is on lines that you approve.

4. For what it is worth, I think I would draw out the following main points.

- Something needs to be done if, as Ministers have indicated, you are not prepared to accept the "Sherdley" type of case - and its possible further developments in future - by which a father can go to the Court for an Order, which gives him tax relief for the support of his own children living with him.
- The problem exists independently of the changes in the tax treatment of maintenance for divorced and separated wives that you discussed on 12 October. It does not arise from those changes.
- The present approach (Ministers' decision on 12 October) represents a rational, consistent, and reasonably simple answer to these special problems, as well as simplifying the treatment of maintenance generally.
- However, the logic will look hard in some cases, in particular where the wife does not have care and custody of the children.
- An alternative approach could possibly be devised, which would provide tax relief for payment to children in certain kinds of situation; and that would not mean abandoning the wider reforms discussed on 12 October.
- But such compromise arrangements would mean recreating the kind of anomaly which inspired the House of Lords

to reach its decision in the Sherdley case. (Is it right that a father should have tax relief for the costs of maintaining and educating his children if - but only if (depending on the precise variant) - he has not married? Or if he has married, he is subsequently divorced? Or otherwise he has disclaimed any personal responsibility for bringing his children up?) The arrangements would also be a bit complex or messy in practice.

- As the note explains, such compromise arrangements could be more or less narrowly targeted.

5. There is the secondary (though not unimportant) point that a change here would cause us to take back on to the drawing board much of the detailed work we have done; and set back accordingly the earliest date on which we could instruct Parliamentary Counsel. But I would not wish to set this in the balance against the arguments of substance.

C.J.G.

A J G ISAAC

CHILDREN: MAINTENANCE

PRESENT POSITION

1. At the Chancellor's meeting on 12 October, Ministers decided that

a. a monetary limit should be set on the relief for maintenance payments between divorced or separated spouses, but that payments should be tax free in the recipient's hands;

b. maintenance payments to children should be ineffective for tax purposes.

2. Our subsequent papers have proceeded on the basis of these decisions. For example, Mr Stewart's note of 13 November on the distributional implications assumes (paragraph 4) that the Courts would revert to making arrangements for all the maintenance to be payable to the wife.

MAIN ISSUES

3. There are three main groups of issue which have pointed towards this conclusion.

- Sherdley

4. There are what might be called the "Sherdley" arguments (though that is perhaps no more than convenient shorthand for a rather wider debate). In the Sherdley case, the House of Lords decided that a father could apply to the Courts for an order against himself for the maintenance of his own children, living with him in his own house; and could claim tax relief accordingly. In reaching that decision, the House of Lords was swayed by the argument that it would be unfair

- to allow (as the present law clearly does) tax relief to the divorced father, in respect of payments which he

makes to his own children, where they are not living with him and he is not responsible for their upbringing; but

- to deny relief to the divorced father where the circumstances are identical, except that the children are living with him and he does accept responsibility for bringing them up.

5. As many commentators have since recognised, the Sherdley case created new anomalies, even in the narrow context of divorce. Interpreted narrowly, it seems almost to mean that a father can get tax relief for the costs of maintaining and educating his children, provided that either he does not marry or (if he does marry) he subsequently gets divorced. The only bar is to get married and stay married.

6. However, it seems on the whole unlikely that "Sherdley" is the end of this road:

a. It is already familiar law that an unmarried mother can get an affiliation order against the father, for the maintenance and support of their children (around one-fifth of all statutory maintenance payments are affiliation orders). Consistent with the Sherdley approach, about half these orders are in cases where an unmarried couple is living together with their children in the same household (a "common law marriage"). Subject to b. below, this represents a major tax penalty on marriage, which can be at least as valuable to the unmarried couple as MIR or the disaggregation of investment income.

b. The Courts already have power to order a husband to pay maintenance to his wife or children within a marriage, if she proves that he is failing to support them. Such orders are made now, but rarely. The question arises whether, following Sherdley, the Courts in England will be prepared to make Orders of this kind more readily. (As a matter of

procedure, only the husband and wife need be represented before the English Court; the Revenue would not be represented). It seems to be an open question how far a particular Court or Courts would be influenced by the potential "penalty on marriage" at a. above. And in Scotland we are advised that this could be done without involving the Courts at all. The possibilities here, following Sherdley, are just beginning to attract comment.

The potential Exchequer (and staff) costs at issue here are virtually open-ended. And Ministers have indicated that there needs to be remedial legislation.

7. We have considered whether it is possible to devise a more limited and narrowly targeted answer to the Sherdley problem. For example, we have considered whether legislation might provide that relief could be given by Court Orders for payment to children where

- someone other than the taxpayer (or his wife living with him) has custody and care and control of the children and
- the children do not share the same home as the taxpayer or reside with him (other than for short visits).

However, this approach has three main drawbacks.

- (i) It recreates precisely the anomaly which offended the House of Lords in the Sherdley case. In effect, the legislation would be saying that a taxpayer can get tax relief from maintaining and educating his children if - but only if - he himself accepts no personal responsibility for bringing them up.
- (ii) The legislation would be messy, and controversial. For example, the law of custody, care and control is itself difficult - and (inevitably) different in Scotland; and

the residence test has its own difficulties at the margin. (How short is a short visit? If the child is at boarding school, goes skiing at Christmas, and goes away for a summer holiday?)

- (iii) Its practical application also looks likely to be difficult. For example, even if staff resources were available, it would be virtually impossible to detect and challenge deliberately misleading information as to where a child was living, or how long he spent with the taxpayer in any year.

Other "targeted" approaches, so far as we have yet been able to identify them, seem likely to be still less attractive, and offer a more overt tax penalty on marriage.

- Recent tax planning

8. Second, the popularity of Court Orders to children is a relatively recent development, inspired by tax planning. They began to become popular after the war; they were first specifically recognised by matrimonial legislation in 1970; and Magistrates' Courts first obtained similar powers in 1981. The objective is to get relief at both ends: to the payer (claiming a deduction against his marginal tax rate) and to the recipients (a divorced wife and each individual child claiming the benefit of their personal tax thresholds, together with - where appropriate - their long basic rate tax bands). Legislation would do no more than restore what was the normal rule.

- Two households

9. Third, Ministers decided on 12 October that it would be reasonable for the divorced man to get somewhat greater tax relief than the married man because he has to support two households. That is a valid argument for payments to the divorced or separated wife, where separation is indeed likely to mean separate households. But this does not seem to apply for

children. All the big costs here: food, heating, clothing, education, are much the same, whether the parents are married, unmarried or divorced; and it is difficult to see any reason why they should be more expensive to maintain if they are brought up by (say) the grandparents rather than by the father.

THE MAIN CASE

10. In a typical case, the children will be living with the divorced or separated wife. Under the approach of 12 October, we assume that the Courts would revert to their earlier practice, of making all maintenance payments to her. Under this approach, payments would, of course, continue to qualify for tax relief, if payments are made to the wife for the maintenance or other benefit of the children - provided that the payment is to the wife and not to the children. (The commentators now describe it as a "tax trap", if the Court orders payments to be made to the wife for the children - because the form of the Order "wastes" the children's own tax exemptions.)

11. The second most common case would be where the children live with the father. Under the approach of 12 October there will be no tax relief for maintenance of the children in this case - which will be treated on all fours with the children of a continuing marriage.

OTHER CASES

12. There will be a minority of cases in which neither the father nor the mother has care or custody of the children of a divorce. Thus:

- the father may be unwilling; unable (perhaps because of some physical or mental disability); or unfit (perhaps because of a criminal record or serious character defect) to take care of the children;

- and the mother may be similarly unwilling, unable or unfit; or she may be dead.*

13. The question is whether the father should get tax relief for any maintenance he pays under a Court Order to his children in these circumstances. The extreme and most sympathetic case is probably that of the divorced wife's death. During her lifetime, the husband gets tax relief up to, say, £2,500 for the support of his divorced or separated family. Does this stop, when the wife dies and the children go to live with (for example) their grandparents, or their aunts? Put in this way (as no doubt it would be) that looks very harsh.

14. As against that, the logic is really rather clear. Precisely those consequences commonly follow if the wife dies and there has been no divorce. The widower gets no tax relief, if the children are being brought up by his deceased wife's parents, or by her sister and brother-in-law - just as he gets no tax relief (over and above the APA if he remains single) if he brings them up himself. (In theory, the grandparents could apply to the Courts for a Maintenance Order against the father, but it is as yet very much the exception to the general rule.) Both cases are tragic. But should a different consequence follow, if the children lose their mother after a divorce, rather than while she is still married? In either case, should there be a tax penalty if the father does take the children back into his own household?

15. Very much the same arguments seem to apply in the other cases where the wife is disabled or otherwise cannot or does not take care of the children.

* In all these examples I have taken the "father" as the taxpayer paying under the Court Order, and the "mother" as the person receiving the benefit of the Order. In some cases, of course, these roles will be reversed between the sexes.

16. It is for Ministers to judge whether they regard the logic here as acceptable, balanced against the alternatives. If Ministers feel that it is necessary to retain tax relief for the most sympathetic cases of this kind, we think that the best available compromise might be some limited or more narrowly targeted provision along the lines discussed in paragraph 7 above - accepting the defects recognised in paragraph 7. Such a provision might apply

- (i) for children generally; or
- (ii) what would be simpler, in a limited number of cases where maintenance has been awarded (with tax relief) to a divorced or separated wife, and she subsequently dies or (for some physical or mental reason) becomes disabled from looking after the children.



FROM: C STEWART

DATE: 20 NOVEMBER 1987

- 1. MR ISAAC *20.4*
- 2. CHANCELLOR

TAX TREATMENT OF MAINTENANCE PAYMENTS AND COVENANTS
(BUDGET STARTER 150)

1. This minute is concerned with maintenance payments. It covers a number of detailed points which you may wish to consider on the scope of the relief and the transitional arrangements.
2. Briefly, the maintenance proposals, following the Chancellor's meeting on 12 October, are that -
 - a. a person paying maintenance to his or her divorced or separated spouse would continue to get tax relief for them, but a monetary limit would be placed on the relief. My minute of 13 November gave examples to illustrate the effects of a range of limits;
 - b. maintenance payments direct to children would not qualify for relief. Mr Isaac's separate note discusses this difficult and sensitive issue;

STEWART
20/11

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|-------------------------------|---------------|--------------|
| cc <i>Financial Secretary</i> | Mr Battishill | Mr J C Jones |
| Chancellor | Mr Isaac | Mr Martin |
| Chief Secretary | Mr Corlett | Mr Eason |
| Paymaster General | Mr Lewis | Mrs Fletcher |
| Economic Secretary | Mr Beighton | Mr Stewart |
| Sir P Middleton | Mr Calder | PS/IR |
| Mr Scholar | Mr Easton | |
| Mr Culpin | Mr Mace | |
| Mr Riley | Mr Davenport | |
| Mr Cropper | Mr R H Allen | |
| Mr Tyrrie | Mr Yard | |
| Mr Jenkins (OPC) | | |

- c. the recipient would be exempt from tax on the payment;
- d. all maintenance payments would be paid gross (at present most are gross but some are net of tax, in view of the tax liability on the recipient).

The monetary limit

3. Multiple divorces. We assume that there will be only one ration of relief, however many ex-wives the taxpayer has. On this basis the limiting factor will be the amount of relief rather than the number of recipients; so that for instance a taxpayer who pays £1500 to each of two ex-wives would get relief on only £1370 under Option 1 and only £2500 under Option 2. Since the limit on relief applies to the payer (the payments are tax exempt without limit in the hands of the recipient) there is no problem of 'apportionment' where there is more than one recipient.

4. Relationship with married allowance. We shall need to ensure that the maintenance relief dovetails satisfactorily with the married allowance. For example, in the year of separation, the married allowance is given for the full year. If a divorced couple remarry, the married allowance for the year is apportioned on a monthly basis. We are giving further thought to the detailed provisions needed here for maintenance payments in the same year.

5. Co-habitation. If the preferred option is Option 1 (paragraph 5 of my minute of 13 November) so that the payer's tax relief is limited to £1370, this is equivalent to the married allowance, so there does not seem to be any compelling need to withdraw the relief if a divorced couple resume co-habitation rather than re-marry (this happens occasionally, though not very often). Even with Option 2 where the limit is £2500, the tax at risk in any one case is £305 at the present basic rate [27% of (£2500 less £1370)]. This hardly justifies the complicated and costly steps which

would be necessary to legislate to withdraw the new relief and to police it. We therefore recommend no action on this, and that the slight "penalty on (re)-marriage" should be accepted.

Scope of the relief

6. Voluntary payments. These are payments which are not made under a Court Order or legally binding agreement. They do not qualify for tax relief at the moment and we see strong reasons not to change this. Voluntary payments are most likely to occur in the early stages of marriage breakdown; but the ordinary married allowance continues until the couple are either divorced or permanently separated. Quite apart from the fact that relief would be difficult if not impossible to police - particularly where cash payment is alleged - there is the major practical difficulty that tax office staff would not know how much relief to give in PAYE coding since it would be difficult to predict the amount to be paid in any tax year. People who want to claim the new relief can, as now, readily do so by making a legally binding agreement without Court proceedings.

7. Foreign Court Orders. At present, no tax relief is given for maintenance payments ordered to be made by a foreign court, or made under a foreign deed or agreement. We know from our past experience in other areas, notably claims for personal allowances, that a foreign element can cause considerable difficulties when trying to establish whether tax relief is due. (There was notorious fraud amongst claims for child tax allowances for children alleged to be living in the Indian sub-continent.) Problems include trying to establish that documents produced to us (in a foreign language, with or without a translation) are genuine; and proving that the wife (and in the past, children) actually exist(s). Against that, people do argue from time to time that it is unfair to deny tax relief to

someone who makes payments under a foreign commitment rather than a UK one. Our advice is to continue to leave foreign arrangements out of it for the moment, but if Ministers are pressed to do something about them we can look at it again.

Transitional arrangements

8. As some people paying maintenance would get less relief under the new regime because of the monetary limit, it will be important to allow transitional relief so that they will not be immediately worse off. The simplest and most straightforward approach would be to allow payments under those Court Orders and agreements which were in force before Budget Day, and which continue unaltered, to be given the existing tax treatment. As with covenants, this would include arrangements which are linked to a formula, eg for the payment of school fees, where the payments may increase each year but the formula remains constant. Arrangements made on or after Budget Day (whether original or superseding an existing arrangement) and arrangements varied on or after Budget Day to increase or decrease payments would be subject to the new rules from the date of the new or varied Order or agreement.

9. There are four particular points to note here:

- a. as with covenants, we suggest that the new rules should apply to Court Orders and agreements made on Budget Day. There is less risk of abuse here by the making of "forestalling" arrangements on Budget evening than in the case of covenants, because the arrangement will represent the settlement of a dispute between the husband and wife. But it would look inconsistent to have different rules in the two cases;
- b. where an old Court Order or agreement is replaced, or the maintenance payments varied by a new one, we think it is right that the new rules should then apply to the

new arrangements, since the Courts and the various parties involved will have had the opportunity to take the tax consequences into account in settling the new arrangements. But it could be harsh if the new rules came into play merely because the original maintenance payment was topped up by a separate supplementary agreement - say, to allow for inflation. Here we suggest that the old rules should continue to apply to the original Order, but the new rules to the new one. The extra maintenance would thus get relief only to the extent that the total (old and new) maintenance fell within the monetary limit. This would produce a different result from a variation of the original Order; arguably that is illogical, but in practice it would be difficult to separate the "old" and "new" elements of variation Orders.

c. all this raises the question whether the old relief should run on indefinitely and without a time limit such as 6 years. If maintenance increases were made by supplementary agreements - as would be likely where the maintenance exceeded the monetary limit - the old rules could continue for very many years; this would make for some operational problems, and delay the full revenue and staffing effects. As with covenants, however, we think on balance that to minimise controversy about the reform, Ministers may prefer not to limit the transitional period to 6 years.

d. as for covenants, we think pre-Budget agreements (but not Court Orders) should be submitted to the Revenue by (say) 30 June 1988 if they are to benefit from the old rules.

10. In general, there seems to be no good reason to do anything special for arrangements made after Budget Day when it is reasonable to assume that the Courts, Solicitors and everyone concerned will be aware of the Budget proposals.

11. But it might seem harsh to apply the new rules to arrangements in the pipeline on Budget Day which are not yet finalised. We doubt whether it is practical to do anything about arrangements other than Court Orders in view of the scope for abuse in this area. But there will be problems for the Courts if cases they are already considering at Budget Day are suddenly switched to the new rules. We have therefore been considering whether a case could be made for allowing existing tax arrangements to apply to Court Orders for which application was made to the Court before Budget Day, provided that the Court Order was made within (say) 3 months after Budget Day. We are examining this possibility with our legal advisers. It is something on which we think the Lord Chancellor will need to be consulted in due course.

12. Some people with pre-Budget Court Orders or agreements will be better off under the new rules. Where payments are made within the limit, whichever Option is chosen, the husband will continue to get the same relief as now. But the wife will no longer be taxable on them. Where she is a taxpayer this will mean she pays less tax than now. In such cases we think a couple should be able to elect (once and for all) to switch to the new regime provided

- a. both elect to do so, and
- b. the election takes effect from the beginning of a tax year.

An election on these lines will have some revenue cost during the transitional period since gainers will elect but losers will not.

13. We have it in mind that if the new rules come into play mid-year because, say, an existing arrangement is varied or superseded, payments for part of the year will be dealt with under the old rules and part under the new rules. This

raises the question whether the monetary limit should be apportioned on a monthly basis. We are considering this along with the interaction between the married allowance and maintenance relief (para 4 above).

Questions for decision

14. The questions for decision are:
 - a. what should the monetary limit be on the relief (my minute of 13 November and separate minute today to the Financial Secretary); ^{behind}
 - b. is it agreed that there should be one ration of relief however many ex-wives the husband has (para 3);
 - c. is it agreed that relief should be confined, as now, to payments under legally enforceable Orders or agreements (para 6);
 - d. is it agreed that, subject to further consideration, payments under foreign Orders and agreements should not qualify (para 7);
 - e. Are Ministers content with transitional arrangements on the lines of para 8-13 above;

C

C STEWART



Inland Revenue

BUDGET CONFIDENTIAL

The Board Room
Somerset House
London WC2R 1LB

*[Mansel - in new
authorisation - tax-free
relief]*

FROM: A J G ISAAC
26 February 1988

CHANCELLOR OF THE EXCHEQUER

MAINTENANCE PAYMENTS: TRANSITIONAL ARRANGEMENTS

1. This note reports the result of our further work, since last night's discussion, on the rules by which existing maintenance payments may transfer from the old rules to the new rules. A separate note from Mr Stewart today reports on other matters discussed last night.

behind

THE BASIC PROPOSAL

- 2. To recapitulate, the rule for "new" orders is that
 - the payer will get tax relief on up to a total of £1,370 (at present values) on qualifying maintenance payments to one or more divorced or separated wives;
 - the payer will get no tax relief for other maintenance or affiliation payments, for example to unmarried mothers or to children;

ISAAC
TO
CX
26 FEB

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

Mr Battishill
Mr Isaac
Mr Corlett
Mr Stewart
Mr Davenport
Mr Golding
PS/IR

- payments (of any amount) will be free of tax in the hands of the recipient;
 - all payments will be made gross.
3. There will be transitional protection for "old" orders;
- there will be an opportunity to revise or vary these orders during 1988/89;
 - the payer will be entitled to retain tax relief on payments up to the total amount relieved during 1988/89 on the original or varied order;
 - there will then be a "cap". The payer can continue to get tax relief up to this amount in subsequent years, but not on any payment (whether under an old or a new order) exceeding the "cap";
 - the recipients will continue, as now, to be liable to tax on money received under old orders up to the "cap";
 - where payments are made net under old orders, they will continue to be paid net during 1988/89. From 6 April 1989 all payments will move over on to a gross basis.

THE QUESTION FOR DECISION

4. The question, discussed last night, is the procedure by which people can switch from the old to the new rules. In outline, a switch from the old to the new rules will be either neutral or positively advantageous in any case where

- (i) the payment is to a divorced or separated wife and the amount is (and is likely to remain) not more than £1,370.

A switch is likely to be disadvantageous in any case where

- (ii) the payment, or any series of payments, is or is likely to be for more than £1,370; and
- (iii) any other case where the payment is to an unmarried mother or to a child.

5. Our best estimate is that there are about 125,000 orders (25% of the total) at (ii) above. In addition there may be 90,000 (a further 20% of the total) of affiliation orders at (iii) plus a large number of payments to the children of divorced and separated families also at (iii) - though many of this latter could no doubt be converted back into payments to the separated or divorced wife, bringing them within the protection of (i).

THE CHOICES

6. You asked us last night to consider two possibilities:

a. "Opt in" to the new system. Under this approach, the payer can at any time opt to come out of the protection of the old rules and enjoy the benefit of the new rules. At one time we thought that this might need to be a joint election by the payer and the recipient. On reflection, however, we think that it is both sufficient and better to have this option at the sole choice of the payer.

(Sufficient, because a choice to "opt in" can in itself never make the recipient worse off (he or she will become exempt on their income); and better, because we are finding some considerable legal complications in establishing who has the right to enter into an election on behalf of an infant child. Under this approach it remains, of course, possible that a husband may unreasonably refuse to opt, in a case where it would benefit his divorced or separated wife, but do him no harm. However, he would be equally able to block the change under a joint election. In the last resort, this is a case where the wife may have to seek redress from the Courts.)

b. "Opt out" of the new system. Under this approach, all orders would come into the new rule from April 1989 (that is, after the one-year grace period) unless the payer took the initiative to opt to remain under the old system.

(Again, of course, there remains the possibility that the husband might unreasonably opt out, where it gives him no benefit, but harms his divorced or separated wife. The remedy is the same as with a refusal to "opt in".)

*needs
low wife*

7. Your preference last night was for "opting out" (course b.). However, I think you felt either "opt out" or "opt in" was preferable to our earlier suggestion, that all recipients of "old" maintenance payments should be given a tax-free ration of £1,370.

8. The attractions of "opting out" are perhaps

- Those who want to remain under the old rules will tend to include the minority of better off people, with access to better advice. (However, there is the very significant exception of people with small maintenance orders for payment to children or unmarried mothers.) On general principles, it must make sense to place the onus of opting on the big people, rather than on the small people.

- Operationally, we would like to get as many people as possible on to the new rules as quickly as possible. "Opting out" recruits inertia on our side.

9. However, there are arguments on the other side.

10. As we discussed last night, some people would argue that it is unreasonable, or even "retrospective", to place on taxpayers the onus of making a positive election, if they want to retain the benefit of "existing rights". You concluded last night that the existence of a right to "opt out" was a sufficient answer to

Another important point is that it means ex-wife does not have to approach husband to opt in - she may well want to have no dealings with him at all.

(in cases where she gains & he doesn't lose).*

that line of criticism - at least if the need to "opt" could be limited to the better off and better advised.

11. On reflection overnight, "opting out" looks likely to bring with it some perhaps more troublesome practical complications.

- For the transitional year, 1988/89, we were all clear last night that "opting out" before 6 April 1988 was not a possibility. Equally, I think we accepted that we should not try to stop people coming on to the new rules for 1988/89 - if only because they can in any event easily do so through the Courts. For 1988/89, therefore, we have an "opt in" rule.
- The proposal is that we should then switch to an "opt out" rule for the following year 1989/90. There is some awkwardness in having "opt in" and "opt out" running simultaneously - and some scope for confusion. There is room for judgment whether this is acceptable even where an election is made in good time, before the beginning of 1989/90.
- The problems get much worse where there is a late election, made after 5 April 1989 for 1989/90 (and Murphy's Law ensures that some people will elect late). An election to "opt out" can work to the recipient's disadvantage (money which he or she thought tax free would come back again within the charge to tax, as now). We don't see how we can reasonably ask the wife to go through 1989/90 (or subsequent years) in uncertainty whether her alimony is liable to tax or not. If we are right, any late election must therefore be a joint election, so that the recipient has the power to block it. But this in turn means that, if the wife withholds her consent unreasonably, the payer may have to go to the Courts if he wants to enjoy the benefit of the transitional protection. There would also be the

problem of establishing the authority for a joint election on behalf of infant children, discussed above.

12. It is difficult to put any figure on the number of cases where people would need to make a late election to "opt out" - except to acknowledge that, if there can be such cases, there will be (and the quick review immediately following suggests that the numbers could well be large)..

- The risk should be least in the case of PAYE. If the taxpayer receives a code showing his tax relief reduced from (say) £10,000 to £1,370 and explaining that this will fix his tax relief for 1989/90 and subsequent years unless he appeals before 6 April 1989, this should act as a reasonably powerful reminder. However, experience with MIRAS suggests that many people do not look at their codes carefully, until their first pay day - too late (and the duplication of work in then re-adjusting both the payer's and the payee's PAYE codes would have a cost).
- For others, including people under Schedule D, there will be no such automatic stimulus in the system, until they get their tax assessment, again much too late.
- And there will be people with a reasonable excuse - sick, ill, abroad, in the midst of some personal disaster. In principle, we would want to be able to accept late elections in cases of this kind. But the fact remains that their late election could affect the tax liability of a third party - the divorced or separated wife, the unmarried mother, or the child.
- Finally, the large numbers of payments to children (whether born in or out of wedlock) means that an "opting out" approach would require positive action by correspondingly large numbers of small maintenance payers - either to opt out or to go to the Court in

order to have payment switched to a divorced or separated wife. It is far from clear that "opting out" would require positive action by fewer people (or necessarily always better advised people) than "opting in").

13. We will continue to think this through over the weekend. At present, we see the balance of advantage pointing rather decidedly in favour of "opting in". This looks very much more simple and straightforward than "opting out" - though of course less simple (and therefore somewhat more costly to operate) than the original proposal for a straight "tax-free ration".

cfel.

A J G ISAAC



Inland Revenue

Policy Division
Somerset House~~COPY NO OF~~

FROM: C STEWART

DATE: 26 FEBRUARY 1988

- lae 26.2*
1. Mr Isaac
 2. Chancellor

MAINTENANCE PAYMENTS (STARTER 150)

1. At your meeting yesterday, you asked us to consider a number of points further for your meeting on Monday morning.
2. Very early decisions are needed on these, so that Parliamentary Counsel can continue with drafting. Because these changes need to operate from Budget Day, much of the detail will need to be included in the Resolution so that it can be given provisional statutory effect under the Provisional Collection of Taxes Act. So the drafting timetable is much tighter than for ordinary Finance Bill Clauses. Under the Provisional Collection of Taxes Act, if the underlying provisions in the Bill are "rejected" during the passage of the Bill, the Resolution itself falls. We understand that it may be a matter of degree whether an amendment amounts to a "rejection", but at the least there are likely to be more problems than with a normal Clause in making substantial amendment during the Bill.

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

Mr Isaac
Mr Corlett
Mr Davenport
Mr Stewart
Mr Yard
Mrs Fletcher
PS/IR

STEWART
TO
CX
26 FEB

Limit on new maintenance relief

3. At your meeting you said you would like to consider reducing the proposed limit on relief for people paying maintenance to ex-spouses under the new regime, from £2,425 (equivalent of single allowance) to £1,370 (differential between single and married allowances).

4. Up to now, the defence of the proposed £2,425 limit has been that it is right to give the divorced husband a little more relief than the married husband, because the same income has to support two separate households. Some of the expenses will be much the same either way - eg food and clothes - but other expenses will be increased - eg gas and electricity.

5. With a £2,425 (single allowance) limit, we estimate that the proposals would eventually yield £m20. The revenue effect in 1988-89 would be a cost of £m10, and in 1989-90 £m5. With a £1,370 limit, the eventual yield would be £m35; the revenue effect would be a cost of £m5 in 1988-89, and break-even in 1989-90. These are very tentative estimates, and we may need to refine them further.

6. About half a million ^{people} at present claim tax relief for maintenance payments. These include about 90,000 ^{unmarried} people paying maintenance to or for ~~unmarried~~ children under Affiliation Orders. New Orders will get no relief under the new rules, and these cases will therefore be future losers whether the limit for the divorced and separated is £1,370 or £2,425.

7. Of the 400,000 or so divorced or separated people paying maintenance, about 125,000 (31%) pay more than £1,370 and about 35,000 (9%) more than £2,425. (At present many of these pay direct to the children; such payments would get no relief under the new rules, but we assume that the payments would in future be made to the wife so that they qualify for relief.)

8. Reducing the limit to £1,370 does therefore increase significantly the number of potential losers.

with
transfers
amounts
relief?

Covenants - formula variations

9. You asked whether a covenant could include a formula which would increase the payments automatically and still get tax relief. In the light of the relevant case law it is possible to do this, depending how the formula works. The dividing line is not entirely clear-cut, but the question is whether the formula predetermines the actual amount to be paid in future years. For example, a formula providing for a 10% increase each year would not work. But a formula which did not fix an amount which could be calculated in advance could work - eg linked to future school fees.

10. Your concern was whether it was defensible to permit formula increases to run on in the case of covenants but not for maintenance arrangements. Once a covenant has been made, it will generally run its course unchanged; it is not subject to variation in the way maintenance arrangements commonly are. The Courts are not involved. And attempting to freeze the relief for covenants in (say) 1989-90 would be more difficult because some covenants are expressed in "net" terms (so that the gross equivalent varies according to the current basic rate of tax) and others are in "gross" terms. This would make a frozen limit very difficult to operate.

11. We think therefore that covenants and maintenance can be distinguished. Although the freezing of the limit on maintenance relief at the 1988-89 level would prevent any further "formula" increases after that date, the rules would permit the maintenance payments to be varied, if the couple wish, during 1988-89 - which it would not be possible to do with a covenant, without bringing the original covenant to an end and starting a new one.

Maintenance agreements made on Budget Day

12. There was also concern at your meeting about the proposal that the new rules should apply to maintenance agreements made on Budget Day itself, but before the Budget Speech, on the basis of the present tax rules. (For Court Orders, there should be no

*counts-
intuitive*

problem because the old rules would apply to Orders made up to 30 June, provided they were applied for before Budget Day.) It would be difficult to have a similar rule for maintenance agreements, because there is no clear-cut test for deciding whether the process had started before Budget Day. But under the matrimonial legislation, it is open to either party to a maintenance agreement to go to the Court to have the agreement altered, where there has been a change in the circumstances in which the financial arrangements in the agreement were made. So if the couple could not agree between themselves that an agreement made on Budget Day should be altered in the light of the new tax rules, one or other of them could go to the Courts.

Variations of pre-Budget arrangements

13. Under the proposals, a pre-Budget Order or agreement could be varied or superseded by a new one, and the old rules would continue to apply for 1988-89. Once the frozen limit for 1989-90 and subsequent years had been fixed, any further variations would have no effect for tax purposes.

14. The question was raised at your meeting whether it was right to treat a variation or replacement of a pre-Budget Order or agreement differently from an entirely new (first-time) Order or agreement. The purpose of allowing variations etc to stay within the old rules is to avoid a payer losing possibly a substantial amount of relief merely because he needs to make some small increase or reduction in the pre-Budget payments. The distinction between a variation of the original agreement and the replacement of the original agreement by a new one for the same recipients is a fine one. It may depend, for example, on how many detailed changes are being made in the separation arrangements as a whole - eg access to the matrimonial home, as well as any changes in maintenance payments. But we think that a variation or a replacement Order or agreement should not be able to bring a new recipient within the scope of the old rules. Thus payments to a new recipient would come within the new rules.

cs

C STEWART



Inland Revenue

Policy Division
Somerset House

FROM: C W CORLETT
FAX No. 6766
EXTN. 6614
2 March 1988

FINANCIAL SECRETARY

MAINTENANCE: FOREIGN COURT ORDERS
(STARTER 150)

1. At your meeting on 22 February, you suggested that in future payments under foreign Court Orders might be granted the same tax relief as payments under UK Court Orders.
2. Now that the broad shape of the maintenance package has been settled, I am able to let you have a further note on this. It recommends giving recipients the same relief, but not payers.

Present position

3. A UK payer of maintenance under a foreign Court Order is not normally entitled to relief at present.
4. One exception is where he gets a UK Court, with the co-operation of his ex-wife, to make a UK Order to stand in the place of the foreign one, in which case the payments qualify.

cc Chancellor of the Exchequer
 Chief Secretary
 Paymaster General
 Economic Secretary
 Mr Scholar
 Mr Culpin
 Miss Sinclair
 Mr Cropper
 Mr Tyrie
 Mr Jenkins - Parliamentary
 Counsel

Mr Isaac
 Mr Beighton
 Mr Deacon
 Mr Stewart
 Mr Davenport
 Mr Yard
 Mrs Fletcher
 Mr Boyce
 Miss Dougharty
 PS/IR
 Mr Corlett

5. There are also some exceptional circumstances where either a quirk in the present law or a narrow concession sometime in the past means that a few people have obtained relief. For example, the rules for the taxation of income from abroad provide that the recipient can set against that income certain deductions, including foreign maintenance. This produces the anomalous result that a UK resident gets relief if he has foreign income, but not if he does not.

6. A UK recipient of foreign maintenance is, like recipients under a UK Order, taxable on amounts received.

Issues

7. The question is how these payers and recipients should be treated in future.

The payer

8. We recommend that payers should continue to get relief where they get a UK Court to substitute a UK Order for a foreign Order (paragraph 4. above). I understand the Lord Chancellor did not object to this at the recent meeting with the Chancellor.

9. Furthermore, we recommend taking this opportunity to tidy up the quirks in the law (and some of our practices) by closing the gaps under which relief can be obtained in certain pretty anomalous circumstances (paragraph 5. above).

10. We strongly recommend against any further widening of the new relief. This is because, whereas it might be possible to keep a reasonable check on Orders made in some neighbouring European countries, the way would be opened to a general relief for UK payers making payments under Court Orders or agreements made anywhere in the world. It was just that type of relief based on events outside the UK which, you may recall, led to widespread abuse during the 1960s when child allowance claims were made in respect of

alleged children living abroad, particularly in the Indian sub-continent (and also in the Irish Republic). These claims were supported by an extensive and often highly professional "industry" producing birth certificates and affidavits, which purported to have been issued abroad, but were in fact forged. It proved an impossible task trying to determine the genuineness of documents written in a variety of languages and dialects. The abuse developed into something of a public and political scandal, and was eventually one of the reasons for abolishing the income tax child allowance and replacing it with the child benefit (which is available only in respect of children resident in the UK).

11. If relief - even of a limited amount - was now made available in very similar circumstances on the basis again of foreign documentation, there is little doubt that news would quickly spread, and attempts would soon be made to claim on the basis of forged documents from obscure corners of the world. We would in most cases be unable to check their authenticity, and the system would - again - be brought into disrepute.

The recipient

12. On the other hand, there is a good case for allowing UK recipients of foreign maintenance the same exemption as will be available to post-Budget recipients of UK maintenance. First, there is much less scope for abuse here. Second, justifying a difference in treatment between recipients would be much more difficult.

Conclusion

13. We therefore recommend -

- i. leaving relief for payers of maintenance to separated and ex-wives to be available only where a UK Order is substituted for a foreign Order, so that the new relief automatically follows;
- ii. exempting recipients of maintenance under future foreign obligations (on the same basis as it is proposed to exempt future recipients under UK arrangements).


C W CORLETT

Copy No. 1 of 15

FROM: J P MCINTYRE
DATE: 3 March 1988

CHANCELLOR

Ch:
If you are content, we shall fix a meeting with Mr Moore in the early part of next week.

cc PS/Chief Secretary
PS/Financial Secretary
Mr Scholar
Mr Culpin
Miss Peirson
Miss Sinclair
Mr Gibson
Mr Cropper
Mr Tyrie
Mr Call
Mr Corlett - IR
Mr Stewart - IR
PS/IR

mid
mid-wk, 1/3

MAINTENANCE PAYMENTS

You asked for a short briefing note so that you could mention this proposal to Mr Moore. This is attached.

2. You might also want to warn Mr Moore of the decisions to abolish Minor Personal Allowances, which will affect, for example, those who maintain elderly or infirm relatives. This is also covered in the note.

3. I suggest that you ask Mr Moore to nominate an official in DHSS with whom we could go over the details and the line to take in briefing.

JM

J P MCINTYRE

BUDGET AND SOCIAL SECURITY

1. Two proposals Mr Moore should be aware of. But will have only minor implications for his programme.

Maintenance

2. Propose to reform tax treatment of maintenance payments. Payments under new maintenance Orders etc will be tax-free for recipient. Payer will get relief, up to a limit, for payments to his divorced or separated spouse; but no relief for other payments, eg to children of divorced or unmarried mothers.

3. Present rules will run on until April 1989 for pre-Budget Orders; then special transitional rules to continue protection for them.

4. In some cases, the courts may decide to set new maintenance awards below current levels to take account of the end of tax relief for the provider. If so, those single mothers affected, who are getting means-tested benefits, will receive higher benefits in compensation. This will happen automatically under the new social security system, in which assessment is based on net incomes. So, operationally, there should be no action for DHSS to take. But expenditure on means tested benefits may be marginally higher (perhaps a few millions). And presentationally we will want to defend the change partly by referring to the fact that social security will compensate the poorest.

Abolition of Minor Personal Allowances

5. These are three minor allowances: for people maintaining elderly or infirm relatives; for widows and widowers who have a resident housekeeper; and for elderly or infirm people who maintain their sons or daughters so that they can be looked after by them. Allowances have not been raised for 20-30 years; most valuable is worth only 75p a week to a basic rate taxpayer. Anachronistic and expensive to administer. Only a tiny handful of those losing the allowances (330,000 in all) will not gain overall from the Budget.

? 20p

Safe home 145

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decrease

6. In defending abolition, we will want to say that social security is the best way of helping those in these groups who need it.

Handling

7. Details and briefing can be discussed further by officials. Could Mr Moore nominate an official for this purpose?

FROM: M C SCHOLAR
DATE: 25 FEBRUARY 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Culpin
Mr McIntyre
Miss Hay
Mr Macpherson
Mr Cropper
Mr Tyrie

Mr Isaac - IR
Mr Corlett - IR
Mr Stewart - IR
PS/IR

MAINTENANCE PAYMENTS: TRANSITIONAL ARRANGEMENTS

I am unpersuaded by one element in the new transitional arrangements proposed in Messrs Corlett's and Stewart's minutes of 17 February, and endorsed by the Financial Secretary's minute of 23 February.

2. If we deal with "formula orders" (paragraphs 10-12 of the Financial Secretary's minute) as now proposed we will deny ourselves the possibility of saying that existing arrangements will be unaffected by the changes proposed. I believe that this would do serious damage to our presentation.

3. I would much rather stick with what we earlier were intending, so that if an existing agreement incorporated a formula automatically increasing the payments due each year, that agreement would run under pre-Budget tax arrangements; but if a new agreement was reached after the Budget, that would run on the post-Budget regime.

4. I do not see that this would be greatly complicated or hard to understand. And I do not see how we would justify removing tax relief

*Robt. This is, I think,
what we did with
LARR -*

from an additional payment after 1989 provided for in a pre-Budget agreement made in the expectation of tax relief. It will not do to say that existing payers and payees have got a year to "sort themselves out": what if they cannot agree or if the Court makes an Order less favourable to one of them than the previous Order?

5. The fact is that in some circumstances the husband will not be able to get tax relief he was earlier expecting: if his additional payment is above the "cap" - ie above the maximum he is prepared to pay or is ordered to pay in 1988-89 - and is above £2425, it will not qualify for tax relief even though before 15 March 1988 he thought it would. His remedy is to seek a new agreement with his ex-wife, or a new Court Order: neither may be at all attractive to him, and none of this would have arisen but for the Budget changes.

6. Do we anyway really want to oblige what may be significant numbers of people to undergo the painful process all over again of reaching agreement with estranged wives or securing Court Orders?

MCS

M C SCHOLAR



Inland Revenue

Policy Division
Somerset House

COPY NO 1 OF 17
FROM: C STEWART
DATE: 24 FEBRUARY 1988

*Ch./
FST's note behind.*

Chancellor

*25
24/2*

MAINTENANCE PAYMENTS (STARTER 150)

I attach a note summarising the maintenance proposals briefly, which you may find useful for your meeting with the Lord Chancellor tomorrow.

cs

C STEWART

cc Chief Secretary
Financial Secretary
Mr Scholar
Mr Culpin
Miss Sinclair
Mr McIntyre
Mr MacPherson
Mr Cropper
Mr Tyrie
Mr Call

Mr Isaac
Mr Corlett
Mr Davenport
Mr Stewart
Mrs Fletcher
PS/IR

MAINTENANCE PAYMENTSPresent rules

1. No relief for "maintenance" (eg housekeeping allowance, pocket money) between ordinary married couple, or for their children.
2. Person paying maintenance under Court Order or legally binding agreement to his divorced/separated spouse gets tax relief (without monetary limit) for the payments. Divorced, separated or unmarried parent (mainly payments to children under Court Order) also gets relief. Recipient is taxable.
3. Payments are made gross if "small maintenance payments" (ie weekly/monthly payments under a Court Order, up to a specified limit). Other payments have tax deducted at source (ie paid net).

Proposals

4. New regime for most new maintenance arrangements.
 - Recipient of maintenance will not be taxable on it.
 - Payer will get relief up to equivalent of single allowance for payments to divorced or separated spouses. (One ration, however many ex-wives he supports).
 - No relief for other payments.
5. New regime will apply to payments under

- a. maintenance agreements made on or after Budget Day (unless they are varying or replacing a pre-Budget arrangement);
- b. Court Orders made on or after Budget Day, except -
 - i. Orders varying or replacing pre-Budget orders, and
 - ii. Orders applied for before Budget Day and made by 30 June.

6. For existing arrangements, present rules will continue to 5 April 1989, whether Order or agreement varied or not. From 6 April 1989 -

- a. all payments will be made gross;
- b. payer will retain relief for payments up to the total amount (the "cap") which qualified for relief for 1988-89;
- c. recipient will remain taxable on payments up to the amount received for 1988-89;
- d. any increase in payments above 1988-89 level will be tax-free for recipient; and payer will get no relief for them.

But payer and recipient will be able to elect jointly to transfer to the new rules if they wish, from April 1988 or later. This may be to their advantage - eg if husband pays £2,000 and wife is working (and so paying tax on her maintenance at present).

Bull points

7. Proposals

- will simplify system for the future-easier for couple and Courts to understand tax implications for divorce/separation;

- should encourage future divorced or separated wives to earn personal allowances available against earnings
- will remove anomalies and "penalties on marriage" - eg Sherdley cases (divorced parent getting Order against himself for maintenance of child living with him), and unmarried couples living together and getting Order to maintain child
- in due course should reduce burden on Courts by removing applications made purely for tax reasons.



FROM: FINANCIAL SECRETARY
DATE: 23 February 1988

CHANCELLOR

cc Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr McIntyre
Miss Hay
Mr Cropper
Mr Tyrie
Mr Isaac IR
Mr Corlett IR
Mr Stewart IR
PS/IR

MAINTENANCE PAYMENTS: TRANSITIONAL ARRANGEMENTS ETC

I held a meeting yesterday to discuss Clive Corlett's minute of 17 February and Charles Stewart's paper of the same date. You wanted a note before our meeting with the Lord Chancellor on Thursday.

Transitional Arrangements

2. The substantive issue is whether the previously-agreed transitional arrangements need to be amended in three respects:

- (i) Should "existing ex-wives" be given a £2425 exemption?
- (ii) Should all existing maintenance payments that are made on a net basis be switched over to a gross basis from April 1989?
- (iii) Should a cap be placed on the amount of relief available in future years to people making maintenance payments under the existing tax regime?

Existing Ex-Wives

3. The question here is a political one: do we believe that there will be a major row if we tax maintenance payments in the

BUDGET: CONFIDENTIAL

hands of existing ex-wives but relieve from tax payments made to post-Budget ex-wives?

4. There is a point here since for people making maintenance payments below the £2425 cap, the new regime will be unambiguously more favourable than the existing regime:

- (i) For existing Orders: the payer gets full tax relief, but the payee is taxed;
- (ii) For new Orders: the payer gets full relief (because his payments are below the cap) and the payee pays no tax.

5. The Revenue suggest that if we did exempt the first £2425 of existing ex-wives' maintenance, this would not only buy out the potential resentment of this group, it would also simplify the system (by taking a few more maintenance recipients out of tax), but at little cost, since many of the recipients of small maintenance payments will be non-taxpayers.

6. My own view is that the resentment of existing ex-wives may not be much of a problem. If people complain about the apparent inequity we can argue that:

- (i) To the extent the new tax regime is more favourable, the Courts will doubtless take that into account. Overall, therefore, new maintenance recipients will not necessarily be better off than existing recipients;

- (ii) The old tax regime was more generous than the new regime to the payer;

- (iii) No existing ex-wives will lose: existing rights will be protected.

- (iv) The payer and recipient could jointly elect to switch to the new rules if they wished (see below, paragraph 12).

7. Nevertheless, if a major row does develop - and I recognise that this is a real hornet's nest - I would be prepared to concede exemption at Committee Stage.

Net and Gross Payments

8. At present large maintenance payers make their payments net of tax. The Revenue suggest that since all payments in respect of post-Budget Orders will be made on a gross basis confusing and complicated situations could arise in which people were making payments which had both gross and net elements. This would happen, for instance, where a current net payer took out a further Order post-Budget.

9. In order to simplify this messy transitional system with net and gross payments running side by side, the Revenue suggest that from April 1989 all payments should be made on a gross basis. This seems unobjectionable - it will not change the amount of relief available, but simply the mechanics of when and how the relief is paid. I am therefore content with this proposal although I think the Revenue should consider how to minimise the cash-flow losses to large payers from the switch to gross payments.

Cap on Existing Relief

10. Here the problem is how best to deal with those existing Orders which incorporate a formula automatically increasing the payments due each year and similarly, how to deal with Orders that are varied or supplemented post-Budget. Originally we were intending to treat "formula" orders quite generously and "variations" or supplementary orders less generously:

- (a) "Formula increases" in maintenance payments were to be fully tax-relieved, and also taxed in the hands of recipients
- (b) If payments were increased by a new or revised Court Order or agreement, the new tax rules were to apply.
- (c) If a separate supplementary agreement were made for extra payments the old rules were to apply to the original payments and the new rules to the new payments only.

11. The Revenue now consider that the separate arrangements for Formula Orders, variations and supplementary agreements will be difficult to justify and will be highly complicated for people to understand.

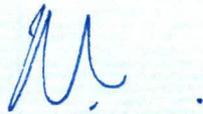
12. I agree with this appraisal and accept their recommendation that instead of introducing these arbitrary rules we should let the system run on until April 1989, and then give people the choice between the new tax regime and a version of the old regime under which the relief available to the payer would be frozen at the 1988/89 level. This would give existing payers/payees one year (1988/89) to sort themselves out - by changing "formula Orders", making supplementary agreements or whatever. (For example, those with "Formula Orders" could use this window of opportunity to take out Supplementary Orders). The key point is to ensure that all existing people are properly informed of the choice that faces them on 5 April 1989 so that they do not lose out through ignorance.

OTHER ISSUES

13. Mr Stewart's paragraph 46 lists a number of further detailed questions for decisions. I would make the following suggestions:

- (i) The frozen limit for relief post April 1989 should be calculated with reference to the total payment made by the husband in 1988/89 (paragraphs 11-14). This is the more generous and simpler approach
- (ii) The old rules should apply to Court Orders made up to 30 June but applied for before Budget Day provided the Lord Chancellor thinks this is feasible (paragraphs 20-22)
- (iii) The new rules should apply to payments due between Budget Day and 5 April under post-Budget arrangements even if this means adding to the length of the Finance Bill (paragraph 25)

- (iv) "Old payments" should be taken into account in deciding whether new payments fall within the £2425 limit (paragraph 29-31)
- (v) Consultations should take place with named individuals under strict security from the Home Office, the Lord Advocate's Department and the DHSS (paragraphs 32-37)
- (vi) The minor points in paragraphs 39-40 are satisfactory but on reflection I am not convinced that we should tax payments made under Foreign Court Orders. I have asked the Revenue to look again at this
- (vii) I am content with the proposed relationship between the MCA and the relief for maintenance payments (paragraph 42-44).



NORMAN LAMONT

FROM: J P MCINTYRE
 DATE: 22 February 1988

FINANCIAL SECRETARY

cc PS/Chancellor
 PS/Chief Secretary
 PS/Paymaster General
 PS/Economic Secretary
 PS/Sir P Middleton
 Mr Anson
 Mr Scholar
 Mr Culpin
 Miss Peirson
 Miss Sinclair
 Mr Gibson
 PS/Inland Revenue
 Mr Corlett (IR)
 Mr Stewart (IR)

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 FST
 22/2

MAINTENANCE PAYMENTS

Mr Stewart's paper of 17 February (circulated with Mr Corlett's paper of the same date) refers to the need for consultation with other Ministers on these proposals, including Mr Moore (paragraphs 32-37 of Mr Stewart's paper).

2. Although, as far as we and the Revenue can tell, the operational consequences for DHSS should be slight, there are nonetheless good reasons for telling Mr Moore in advance. As Mr Stewart says, this is partly a matter of courtesy. But more important, in presenting and defending the decision, we will be relying heavily on the fact that the social security system will increase payments to those on benefit to reflect any Court decisions to reduce maintenance awards. To make sure that this part of the argument is properly and consistently presented on Budget Day and subsequently, we ought to consult DHSS in advance. It would also be helpful to make absolutely sure that there are no operational implications which DHSS ought to have thought through before the announcement.

3. For these reasons, we would recommend that Mr Moore is told about the decision a week or two in advance of the Budget, perhaps next week. We and the Revenue could then speak to one or two of their officials to explain the decision and agree briefing.

JM-

J P MCINTYRE



Inland Revenue

Policy Division
Somerset HouseFROM: C W CORLETT
FAX No. 6766
EXTN. 6614
17 February 1988

1. MR ISAAC *ISAAC*
2. FINANCIAL SECRETARY

MAINTENANCE PAYMENTS: TRANSITIONALS ETC (STARTER 150)

1. I am sorry about the length of the attached paper. The bulk of it concerns the transitional arrangements - ie what is to happen about existing, pre-Budget Day maintenance Orders and agreements. These rules have, inevitably, to be more complicated than usual, and they will be of significant interest to lawyers and the parties concerned. So we thought that it was right for Mr Stewart to set them out in full for you.

2. Transitional provisions do not normally have to be this detailed, or take such a lot of working-up. It is usually a fairly straightforward matter to provide that those who are currently benefiting from a relief shall be allowed to

cc Chancellor of the Exchequer

Chief Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr Anson
Sir A Wilson
Mr Byatt
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Odling-Smee
Miss C Evans
Mr Hudson
Miss Sinclair
Mr Riley
Mr Cropper
Mr Tyrie
Mr Call
Mr Jenkins - Parliamentary
Counsel
Mr Unwin - Customs & Excise
Mr Knox - " "

Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr Easton
Mr Calder
Mr Mace
Mr Davenport
Mr Stewart
Mr Yard
Mr Golding
Mr J C Jones
Mr Allen
Mr Boyce
Miss Dougharty
Mrs Fletcher
PS/IR
Mr Corlett

CORLETT
→
FST
17/2

continue to do so after it is no longer available for newcomers.

3. In this instance, however, there are three main complications.

4. First, the amount of relief has no automatic, self-regulating limits. An existing Order, for example, may incorporate a formula which automatically jacks it up each year; or may be varied or supplemented to achieve the same result. It does not seem right that someone paying maintenance this year of £1000, for example, should be entitled to full tax relief if he has increased it to, say, £20,000 by 1992. That goes well beyond "protection for existing relief".

5. So we are recommending a cap on the amount to be relieved in future years. But to avoid the complaint that the amount of maintenance at Budget Day was just about to be increased, or that it is otherwise unfair to limit it at its present level, we are suggesting that the cap be fixed by reference to the amount of maintenance paid next year (1988/89). This allows people a full 12 months in which to put their affairs in order, in the full knowledge that the cap will apply thereafter.

6. Second, large maintenance payments are at present made net (tax deducted at source by the payer) and most small ones are paid gross (no tax deducted). Under the new system, post-Budget Day Orders will all be paid gross. To continue a mixture of payments net and payments gross, into the indefinite future, would perpetuate one of the complications of the present system.

7. So we are recommending that, from April 1989, all payments - both under existing and new Orders - should be paid gross. That will make for a simple rule from that date. It does not reduce the amount of relief available; it is essentially a matter of mechanics.

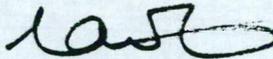
This does have the disadvantage of making more existing recipients have to account for tax.

8. For the coming year 1988/89, however, the present rules will continue to run. So the Budget Day message for 45,000 or so existing net payers is simple: keep on doing exactly as you are now. That gives us 12 months breathing space in which to get the message across about the pending change, so that the move in April 1989 to a system of all payments being made gross is achieved as smoothly as possible.

9. Third, there is the new system of £2425 relief for new, divorced payers and full exemption for new ex-wives. Existing ex-wives, though protected in relation to their current arrangements, may look across at post-Budget ex-wives and feel hard done-by, having to continue to pay tax on what they receive. This could give rise to some resentment which (however unjustified in principle) could be difficult to handle.

10. So we are recommending that a £2425 exemption should be given to existing ex-wives, even though the payer will continue to get relief as well. Those receiving less than this amount will pay no tax. Those receiving more, will pay tax only on the excess. This will be less expensive than might appear at first sight - about £m20 a year - because of the large number of maintenance payments which are already untaxed in the recipients hands, often because they are paid to the children and set against their personal allowances. Exempting all maintenance to existing ex-wives, while continuing to give the husband relief at the "old" level, would give substantial benefits to some people at the upper end of the income scale and would be difficult to justify.

11. To sum up, these new proposals are designed to minimise the scope for resentment or confusion on the transition, in general by plumping for simpler and more generous arrangements than in the original transitional scheme.


C W CORLETT



Inland Revenue

BUDGET SECRET: TASK FORCE LIST

Copy No. of

Policy Division
Somerset House

FROM: C STEWART

DATE: 17 FEBRUARY 1988

1. MR CORLETT *17/2*
2. MR ISAAC *17/2*
3. FINANCIAL SECRETARY

MAINTENANCE PAYMENTS: TRANSITIONALS ETC (STARTER 150)

1. This note deals with a number of points on the maintenance proposals:

- a. The transitional arrangements for maintenance Orders and agreements made before the Budget;
- b. The question of consultation with certain other Ministers before the Budget;
- c. some points of detail on which decisions are needed.

| | | |
|----|------------------------------------|----------------|
| cc | Chancellor | Mr Battishill |
| | Chief Secretary | Mr Isaac |
| | Paymaster General | Mr Painter |
| | Economic Secretary | Mr Corlett |
| | Sir P Middleton | Mr Beighton |
| | Sir T Burns | Mr Easton |
| | Sir G Littler | Mr Calder |
| | Mr Anson | Mr Mace |
| | Sir A Wilson | Mr Davenport |
| | Mr Byatt | Mr Yard |
| | Mr Scholar | Mr Golding |
| | Mr Culpin | Mr J C Jones |
| | Mr Sedgwick | Mr R H Allen |
| | Mr Olding-Smee | Mr Boyce |
| | Miss C Evans | Miss Dougharty |
| | Mr Hudson | Mrs Fletcher |
| | Miss Sinclair | Mr Stewart |
| | Mr Riley | PS/IR |
| | Mr Cropper | |
| | Mr Tyrie | |
| | Mr Call | |
| | Mr Jenkins (Parliamentary Counsel) | |
| | Mr Unwin | |
| | Mr Knox | |

STEWART
→
FST
17/2

A TRANSITIONAL ARRANGEMENTS

2. One of your objectives in the maintenance reform is that no-one with an existing Order or agreement should be made worse off. We propose some changes from the transitional scheme recommended earlier. These are intended to make the mechanics simpler, while still protecting relief for pre-Budget arrangements.

Original proposal

3. The original proposal which Ministers approved before Christmas was that -

- a. the old rules would continue to apply, without time limit, to maintenance Orders and agreements made before Budget Day. Thus the new monetary limit (£2,425, equal to the single allowance) on relief would not apply; the recipient would continue to be taxable on the payments; and the payments would be made either gross or net according to the present rules;
- b. where a pre-Budget Order or agreement included a "formula" rather than fixed amounts (eg that the amount should be increased as necessary to meet the rate bill on the house occupied by the ex-spouse) the amount paid after Budget Day would be relieved in full, however much it increased;
- c. if however payments were varied by a new or revised Court Order or agreement, the new rules would apply from then on. The payer's relief would be limited to £2,425 (or nil if the payments were to anyone other than his divorced or separated spouse); the recipient would be exempt from tax on the whole payment; and all payments would be made gross; but
- d. if a separate supplementary agreement was made for extra payments - eg to allow a small increase for

inflation - the old rules would continue to apply to the original payments, and the new rules would apply to the new payments only.

Difficulties with the original proposal

4. It was recognised that the arrangement for supplementary agreements was not completely logical. But it was intended as a way of enabling a husband who was already paying more than £2,425 a year to make a small increase in his payments without a substantial loss of tax relief because the new limit then came into play. More detailed work on this approach has highlighted a number of problems and complications:

- a. a small increase in the payments would be permitted without loss of "old" relief; but a reduction in payments would bring the new rules into play, which would be harsh;
- b. payers (and recipients) would have to cope with a mixture of "net" payments and "gross" payments, which could be very confusing;
- c. the distinction between a "supplementary agreement" and a variation of the original Order or agreement is a very fine one. Treating them differently is likely to produce anomalous results, and put a good deal of pressure on the dividing-line as lawyers search to find ways of getting the most favourable results for their clients.

The new proposal

5. We recommend a new approach to avoid these drawbacks. Broadly, it involves allowing the old rules to continue to apply to pre-Budget maintenance arrangements until April 1989, and then switching to the new rules, but giving payers an option to freeze their relief for later years at the 1988-89 level. The aims are to maintain protection for pre-Budget arrangements, but to

simplify the mechanics of the system for the future, avoid the need for a special rule for "formula" increases, and introduce a partial exemption for "pre-Budget" ex-wives so as to ease the transition and put them more nearly in the same position as newly divorced wives.

1988/89

6. For pre-Budget maintenance Orders and agreements, the old rules would continue unchanged until 5 April 1989, whether or not the Order or agreement was varied in the meantime. The payer would thus continue to get relief without limit for 1988-89. The recipient would remain taxable on the maintenance. But we recommend that divorced and separated wives should be exempted from tax on the first £2,425 (equivalent to the single personal allowance) of maintenance they receive. This would mean that

- where a husband paid £2,425 or less to his divorced or separated wife, the result would be the same as if they were on the new rules. The husband would get full relief. The wife would be exempt from tax on the maintenance. (This also simplifies the system by making it unnecessary to provide a right for them to elect to switch to the new rules.);
- where the husband paid more than £2,425, he would continue to get full relief for 1988-89, but the wife would be taxable only on the excess over £2,425.

7. Children would be taxable on maintenance paid to them under pre-Budget arrangements, without the £2,425 exemption. The payer would still be getting tax relief for the maintenance - unlike people subject to the new rules. So it is reasonable not to give the £2,425 exemption to children.

1989-90 and later years

8. From April 1989, pre-Budget Orders and agreements would be switched to the new rules. But the payer of the maintenance

(see also para 17)

would have a right to elect for a special regime under which his relief would be frozen at the 1988-89 level. If the payer exercised the election, the recipient would then remain taxable on the maintenance, but divorced and separated wives would be exempt on the first £2,425 they received. All maintenance would be paid gross.

9. Thus if a husband was paying his ex-wife £5,000 a year in 1988-89 under a pre-Budget Order, and he then elected to have the "frozen" level of relief, he would get relief for 1989-90 on the first £5,000 of maintenance he paid, and the wife would be taxable on £2,575 (£5,000 minus £2,425). Thus the first £2,425 would be treated in the same way as if paid to someone on the new rules - relief for the payer, exemption for the recipient. The remaining £2,575 would also get relief (unlike the new rules), but the wife would remain taxable on it.

Advantages of this approach

10. This approach has a number of advantages:

- a. it maintains protection for people with pre-Budget arrangements. They would stay on the old rules for 12 months, whether or not they increased their maintenance in the meantime. They would therefore have a full year to decide how to adjust their maintenance arrangements for the longer term, in full knowledge of the rules which would apply from April 1989. People with pre-Budget arrangements paying more than the new £2,425 limit would be able to keep their relief at the 1988-89 level; so they would not lose from the change.
- b. Switching all payments to a gross basis from April 1989 would give a simpler and more uniform system. Exempting the first £2,425 of the wife's maintenance would also be a simplification, as well as avoiding complaints that wives with pre-Budget maintenance arrangements were less favourably treated than wives

divorced after the Budget, who would be on the new rules.

Fixing the level of relief for the payer

11. The frozen limit for people with pre-Budget arrangements could be fixed in two possible ways, which have different results if maintenance is being paid to more than one recipient:

- a. apply it to the total payment the husband is making;
- b. apply it separately to the amount paid to each recipient.

For example:

| <u>Payments to</u> | <u>1988-89 payments</u> | <u>Payments after Order varied in (say) 1991</u> |
|--------------------|-------------------------|--|
| Wife | 3000 | 4600 |
| Child 1 | 1500 | - |
| Child 2 | <u>1500</u> | <u>1900</u> |
| | <u>6000</u> | <u>6500</u> |

12. On approach a., the husband would continue to get relief for £6,000 after the variation of the Court Order. But the wife would be taxed on £575 (£3,000-£2,425) and child 2 on £1,500 - ie the payments they received in 1988-89. (It would be too complex to apportion the £6,000 total between the wife and child 2 after the new Order.) This is a generous approach, since the relief (£6,000) can be much more than the amount remaining taxable (£2,075 ie £4,500-£2,425). The drawback is that it could be manipulated by arranging for the maintenance to be redistributed among the recipients - for instance, in this example, by reducing the wife's maintenance to £600 and increasing the child's to £5,900, so that the wife would not be taxed at all, and the child taxed on £1,500, compared to relief on £6,000 for the husband). The scope for switching would no doubt be picked up by the Press

and by practitioners, with further articles of the sort which we all find annoying now.

13. Approach b. avoids that drawback. The payer would continue to get relief for £4,500 - £3,000 to the wife and £1,500 to child 2. He would get no relief for the extra payments to either. The wife and child 2 would be taxed on the same amounts (less the £2,425 exemption for the wife). This is more restrictive than approach a. Some people might argue that the father should still get the same total relief as in 1988-89 even though he is no longer maintaining child 1. But the response would be that the relief for his remaining pre-Budget obligations had been fully protected. The distribution of his payments had subsequently changed, and he could not expect to be protected against the tax consequences of that.

14. Either option would be operationally feasible. The choice depends on how you see the balance between possible manipulation and clear retention of the ceiling for presentational reasons. We recommend approach b.; approach a. leaves scope for embarrassing Press articles on the familiar theme of how to exploit the maintenance relief, and with the exemption of £2,425 for the wife, even approach b is fairly generous.

Detailed points

This destroys the simple line that no existing arrangements would be affected

15. There are some more detailed points we should bring out here. First, where the payments were based on a "formula" - eg linked partly to the rates on the house the wife lived in - there would be no special protection for increases after April 1989. Increases in 1988-89 would get full relief for that year, and would then be reflected in the frozen limit for future years where the payer elected for that regime. The formula payments under existing agreements might of course continue to increase automatically after April 1989. But we think the absence of relief for them is defensible, because the couple would have had ample opportunity during 1988-89 to alter their maintenance arrangements if they wished in the light of the new rules.

How? Husband may not want to shell out more to ex-wife up front.

16. Second, it is arguable that it is generous to base the frozen limit on the relief given for 1988-89, rather than 1987-88. The couple could deliberately increase their maintenance in 1988-89 in order to increase the frozen limit on relief for future years. But in practice most maintenance payers are unlikely to pay any more than they have to, merely in order to get extra tax relief. Some cohabiting unmarried couples with children might do so; but the recipient would remain taxable on the maintenance.

17. Third, we envisage that the election to have the frozen limit from April 1989 should be available to the person paying the maintenance - ie normally to the husband rather than the wife. We think this is fair, because if the election is not made, the husband paying more than £2,425 will be worse off under the new rules. The election also has tax consequences for the wife, since it means she will continue to be taxable on part of her maintenance. But she will have been fully taxable on her maintenance in previous years. So although she would be fully exempt if the election was not made, the election will not make her worse off than she was in previous years. And it is quite likely that if the husband was not allowed to keep his previous level of relief, the level of maintenance he paid to her would be reduced.

Conclusion on main transitional arrangements

18. Overall, transitional arrangements on these lines would be more satisfactory than the proposals we originally put forward:

- they bring the present complex rules to an end in April 1989, but allow people with pre-Budget arrangements a year to consider how to adjust their maintenance for the future, and give them the right to keep their relief at its 1988-89 level if they would lose by the switch to the full new rules;
- by exempting the first £2,425 of "old" payments they will help ex-wives, and keep a fair balance between

those with pre-Budget and those with post-Budget arrangements;

- all payments will be made gross from 1989, which will be simpler for taxpayers, professional advisers and the Revenue alike. The switch from net to gross payments may possibly cause concern to some payers - particularly those not within PAYE. But again they will have a full year to make any necessary adjustment to their maintenance arrangements before the change takes effect.

19. If you agree to the revised approach in general, the only question is ^{whether} you agree ^{with} Option b in paragraphs 12-14 above.

Cases already in the Courts at Budget Day

20. My note of 20 November (paragraph 11) said that we were considering whether the old rules should continue to apply to Court Orders made within (say) three months after Budget Day provided that the application had been made to the Court before Budget Day. The purpose of this was to avoid disrupting the business of the Courts in the period immediately following Budget Day, and to allow cases which were already at an advanced stage to be completed on the basis of the old rules.

21. We now recommend that there should be a rule on these lines, with 30 June as the deadline for making the Order.

22. No doubt there may be some pressure that more time should be allowed. The general answer to that is that the provision is not intended to allow all cases which started before Budget Day to be completed by 30 June. Unless the case was at a reasonably advanced stage, it is arguable that the parties and the Courts can and should assess the maintenance on the basis of the new rules. But the precise date is something on which the Lord Chancellor and Lord Advocate will have views because of the possible impact on the Courts' business (see 34 below). This is a point on which you could be flexible.

Arrangements made on Budget Day

23. Mr Hudson's note of 15 February asked about maintenance Orders and agreements made on Budget Day. For both covenants and maintenance payments Ministers decided that in general the new rules should apply to arrangements made on or after Budget Day. But the proposal at paragraph 21 above will relax that rule for Court Orders made on Budget Day. The Order will have been applied for before Budget Day, and will have been made before 30 June. So the old rules would still apply to it.

24. The new rules would still apply to maintenance agreements and covenants made on Budget Day. This is essentially to prevent people making arrangements on Budget evening to secure extra relief for the future by preserving the benefit of the old rules. There is clearly less risk of that with maintenance agreements than with covenants (which are usually no more than a gift, rather than the settlement of a matrimonial dispute). On the other hand it may be awkward to deal with maintenance agreements differently from covenants; and some covenants are made for "maintenance" of a student child or an unmarried mother.

Payments under Arrangements made between Budget Day and 5 April 1988

25. Parliamentary Counsel has however raised with us the point that if the new rules are to apply to payments due between Budget Day and 5 April 1988 under post-Budget arrangements, it will be necessary to amend both the present legislation (for payments made in last few weeks of 1987-88) and the new consolidation Act (for 1988-89 onwards), thus adding to the length of the Bill. It will also mean applying the new maintenance relief to a fairly small number of cases for the tail end of 1987-88. We have therefore been considering whether, in the interests of simplification, the old rules could continue to apply to post-Budget arrangements, for payments due in 1987-88 only.

26. For example, if a covenant was made on or after Budget Day, and the first payment was due by 5 April 1988, the first payment

would qualify for tax relief, but the 6 subsequent payments in later years would not. Similarly if a new maintenance agreement was made in the same period, any payments due by 5 April would be dealt with under the old rules.

27. The question is whether this would give unacceptable scope for people to make arrangements after Budget Day to obtain tax relief at least for the current year. We think the main risk would be with covenants. For example, a grandparent might make a covenant before 5 April in favour of his grandchild; make the first payment by then; and then let the covenant lapse. (Payments for future years would be legally enforceable, but there might be a tacit understanding that they would not be enforced.) If the later payments were not made, we could perhaps seek to challenge the original covenant on the grounds that it was never intended to run for 7 years (unless there was some specific change of circumstances in the meantime - eg the payer lost his job). But checks would be staff-intensive and not necessarily successful. At the very least, the Budget Day publicity would need to make it clear that the covenant would have to be legally enforceable to qualify for any relief at all and that we would be looking out for covenants which were not being properly implemented.

28. This is not an easy question to decide. If payments due up to 5 April 1988 under post-Budget arrangements are allowed to get relief for 1987-88, there is a risk that some people will take advantage of it. On the other hand many may think it not worthwhile, in view of the 7-year commitment. On the whole we favour allowing relief for payments due in 1987-88, in the interests of simplification, for those sharp enough to make a quick covenant after Budget Day and prepared to do so in the knowledge that only the first payment will qualify for relief.

Operation of the £2,425 limit

29. In some circumstances, the old and the new rules could apply in the same year. For example, the taxpayer has been paying maintenance to his first ex-wife since before the Budget, and divorces his second wife in November 1988. In this type of case there will have to be rules about how the £2,425 limit applies

for 1988-89 and later years when he is still maintaining both ex-wives.

30. The question is

- i. whether the full £2,425 limit should be available to cover the "new" payments (ie those made to the second wife under a post-Budget Order), in addition to full relief under the old rules for the earlier payments; or
- ii. the new payments should qualify for relief only to the extent that the old and new payments together do not exceed the £2,425 limit.

31. We recommend ii. Thus if £2,000 maintenance has already been paid under the pre-Budget Order, £425 of the payments due under the new Order to the second ex-wife would qualify for relief in the same year. If £3,000 was payable under the pre-Budget Order, none of the new payments would qualify. Option ii is closer to the treatment of the man supporting two ex-wives both divorced after the Budget; in that case the £2,425 relief would have to cover both.

B CONSULTATIONS WITH OTHER DEPARTMENTS

32. It will be necessary to have some consultation before the Budget with the Departments most directly affected by the maintenance proposals. This is partly a matter of courtesy, but beyond that the proposals will have important direct effects on some of their responsibilities.

33. First, the proposals will have an impact on the Courts. The Lord Chancellor is responsible for the High Court and County Courts, and the Home Secretary for the Magistrates' Courts. The Lord Advocate has equivalent responsibilities in Scotland. Generally, we think the proposals will in due course help the Courts, by making the tax consequences of divorce simpler and so easier for the Courts to take into account. And the removal of

May be OK, but could be presented as taking away existing relief (by comparison with divorce post wife after Budget day)

relief for payments to children should cut out applications which are being made purely to secure tax relief.

34. In the short term, however, these Ministers will be concerned that the proposals do not cause disruption in the period immediately following the Budget. The proposal that Orders made by 30 June on applications made before Budget Day should stay on the old rules (see 20-22 above) should be helpful here. They may also want to satisfy themselves that the Courts can handle applications for changes in pre-Budget maintenance arrangements before April 1989. The Ministers should, we think, be given an opportunity to express a view in advance of the Budget. In any case, we will need to arrange with their Departments for the issue of immediate guidance to the Courts after the Budget so that they have an authoritative statement of the new proposals.

35. The Secretary of State for Social Services will also have an interest in the proposals because of the possible knock-on effect on social security benefits. (He has of course already been consulted about the APA but not about the maintenance proposals.) He too may want to consider whether DHSS need to give any immediate guidance to their offices after the Budget.

36. We understand that the Chancellor has already seen the Lord Chancellor. We recommend that the other Ministers concerned with the Courts should be approached shortly. If it is left later, it will be difficult to make any adjustments that may prove necessary to the detail of the proposals in time for drafting and for the Budget announcements and publicity material.

37. Consultation with Mr Moore on maintenance could be left until a little nearer the Budget if you wish.

C OTHER POINTS

Scope of the proposals

38. There are three points we should mention on the scope of the proposals, which have emerged as drafting of the detail has

proceeded. No decisions are needed, but you may like to be aware of them.

39. First, we shall need to ensure that in restricting relief for covenants and maintenance payments, the legislation does not leave it open to people to get the same results by a slightly different route - ie by making a transfer of income in a different legal form. The legislation will thus need to deal with transfers of income generally. But we are not of course aiming at commercial transactions or at cases where (say) someone is making payments to someone else for goods or services. (Technically, we are concerned with "annual payments", which must be pure income ^{from} the recipient, as distinct from a gross receipt against which expenses have to be set.)

40. Second, we envisage that the relief for payments made between divorced spouses should cover, in addition to maintenance payments, payments required by the Court Order or maintenance agreement to be made to third parties in satisfaction of a liability of the other spouse. For example, the amount of maintenance payments due to be made to the ex-wife may vary from year to year because they take into account electricity bills for the house she lives in. Alternatively, the husband may be ordered to pay her electricity bill direct. Either way, relief would be available for the payments. (But there would be no relief for payments for which the husband already qualifies for relief in some other way - for example if he is required to pay mortgage interest for her and is already entitled to mortgage interest relief for the payment.)

41. Third, it was agreed at the Chancellor's meeting on 25 November that there should be no relief for payments under foreign Court Orders or agreements. But you asked that any EC angles should be examined (paragraph 10(iii) of your minute of 24 November. We understand that there is nothing in EC law to require us to treat a maintenance order made by a Court in an EC country as if it had been made by a UK Court. There are arrangements under which a UK Court can be asked to enforce payment or maintenance awarded by a Court in an EC country and

some other countries, but that is more a question of mutual enforcement of debts and does not affect the status of the original divorce or maintenance Order.

Relationship between maintenance relief and married allowance

42. My note of 20 November (paragraph 4) promised further thought on the precise relationship between the married allowance and the maintenance relief in the year of separation or remarriage. In principle a husband should not be entitled to maintenance relief if he is entitled to married allowance for the same spouse for the same period. But it would be very complicated to ensure that there was no overlap between married allowance and maintenance relief in any circumstances. For example, in the year of divorce, married allowance is given for the whole year; but the husband will normally be paying maintenance for the second part of the year.

43. We have considered restricting the maintenance relief due in these and similar circumstances. But our conclusion is that that would be too complicated, particularly where there is more than one ex-wife, or one ex-wife and one current wife, and that the rules should be that -

- married allowance should be available according to the normal rules;
- maintenance relief should be available for payments made while the couple are divorced or permanently separated, but not for payments before then.

44. Some husbands will thus get full married allowance (£3,795) plus full maintenance relief (£2,425) for the year in which they divorce or are reconciled. This may seem generous in some cases, but it will be simpler to work and unlikely to lead to complaints.

D REVENUE AND MANPOWER COSTINGS

45. We estimate that the maintenance proposals will eventually have a net tax yield of about £m20, and that during the transitional period there would be a small net cost - about £m20 annually in the first two years, then falling off gradually. The transitional cost reflects the fairly generous transitional arrangements proposed in this note. We are revising the manpower costings in the light of these proposals and will report again shortly.

E QUESTIONS FOR DECISION

The questions for decision are

- a. Whether the transitional arrangements should be revised on the lines suggested in paragraphs 5-17 above;
- b. If so, how the "frozen limit" should be calculated (paragraphs 12-14);
- c. Whether the old rules should apply to Court Orders made up to 30 June but applied for before Budget Day (paragraphs 20-22);
- d. Whether the old rules should be allowed to apply to payments due up to 5 April 1988 under post-Budget arrangements (paragraph 25-28);
- e. Whether any "old" payments should be taken into account in deciding whether "new" payments fall within the £2,425 limit (paragraphs 29-31);
- f. Whether there should now be consultation with Home Secretary, Lord Advocate and Secretary of State for Social Services (paragraphs 32-37);
- g. Whether you are content with the treatment of the detailed points in paragraphs 39-41 on the scope of the relief;

- h. Whether the relationship between married allowance and maintenance relief should be as described in paragraphs 42-44.

CS

C STEWART



FROM: A P HUDSON

DATE: 15 February 1988

MR CORLETT IR

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

PS/IR

MAINTENANCE PAYMENTS: START DATE

In the course of discussing pamphlets on Friday (12 February), the Chancellor paused over the question of the start date for the new maintenance arrangements.

2. His present understanding is that the new rules apply to maintenance agreements and Court Orders made on or after Budget Day. But where does this leave, for example, the Order that is made on the morning of Budget Day on the basis of the present tax regime, and in good faith?

3. The Chancellor is sure that you will have thought this through at some stage. Please could you let me know what the position is (or direct ^{me} _h to the relevant papers, if it is already been put to Ministers).

A handwritten signature consisting of several vertical strokes and a horizontal line across the top.

A P HUDSON

Hudson
15/2