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PART A

1987 BUDGET DEPUTATIONS AND REPUTATIONS

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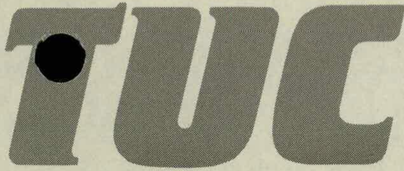

Trades Union Congress

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Your reference:

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Date: February 4 1987

Rt Hon Nigel Lawson MP
Chancellor of the Exechequer
Treasury Chambers
Parliament Street
London SW1

PS/ Mr Walters: Mess. Tyrie + Ross-Goobey

Dear Mr Lawson

TUC Budget Submission

Further to my letter of January 29, I am enclosing two copies of the page proofs of the TUC's 1987 Budget Submission. I shall send you a printed copy of the Submission next week.

I trust that you will give the TUC proposals careful consideration and I look forward to our meeting when we can explain our proposals in more detail.

Yours sincerely

Norman Willis

General Secretary.

Encs:

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ACTION Mr Walters
COPIES TO CST, FST, EST, MST
Sir P Middleton
Sir G Littler
Sir T Burns

Mr Tyrie, Mr FER Butler,
Mr Ross-Goobey, Mr Monck,
PS/IR
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TUC Budget Submission 1987

News from the TUC

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3PM TUESDAY, FEBRUARY 3, 1987

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Foreword

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The Budget debate must be about rebuilding British Industry and drastically cutting the dole queues — this is certainly the central aim of the proposals set out in this submission. The TUC has already taken a leading role in an initiative launched through the National Economic Development Council to make sure British industry takes full advantage of the recent fall in the exchange rate to boost exports, and not, as in the past, to increase profits.

This Budget submission shows how economic growth and jobs can be created by investment in the infrastructure such as housing, schools, hospitals, roads; in vital public services such as education and health; and in industry, particularly in local industry in the higher unemployment regions and in the inner cities.

The adoption of the proposals would make a major contribution towards reducing registered unemployment but this is only the starting point. Further action will be needed in the 1988 Budget; in developing special training and employment measures targetted on the unemployed; and in starting the long-term industrial strategies to boost investment in new equipment, R&D and training — the essential ingredients for a thriving economy and full employment.

The Government has a duty to consider these proposals carefully and make the 1987 Budget, a Budget to revitalise industry and get the unemployed back to work.

Norman Willis

Norman Willis
TUC General Secretary
February 1987

Introduction

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1 The 1987 Budget should be judged on whether it strengthens the British economy and not on the short term popularity it brings the Chancellor and the Government.

2 At present the UK economy is being weakened by the continuing presence of over 3.5 million unemployed men and women. By any argument that is a waste of economic resources, a waste of potential skills, experience, and hard work. The TUC contends that our economy will not be strengthened unless those potentialities are realised and people put back to work.

3 The starting point of this Budget submission therefore is the objective of reducing unemployment by one million in two years. In contrast the Government has accepted that its policies mean registered unemployment remaining at 3 million for the rest of the decade. Any fall that may occur in 1987 is likely to reflect the growth in special employment measures such as the Community Programme and not the creation of permanent jobs.

4 A genuine reduction of 1 million off the unemployment register is a major challenge, not least because of the big increase in those no longer counted as unemployed but still seeking work due to the Government's manipulation of the statistics. It will not be easy or automatic: to pretend otherwise would be an insult to the millions of jobless. Neither is it a policy without some risks. The legacy of the last seven years is a weakened economy through cutbacks in industrial investment, production and skills training. Moreover, the Government's privatisation programme based on deliberate underpricing of national assets, selling £10 notes for £5, has encouraged a quite irresponsible attitude to investment in British industry through

the Stock Market. The Chancellor has only himself to blame for the disease he so accurately describes as *"short-termism"*.

5 On top of the speculative fever in the City, a consumer boom, fuelled by easy credit and income tax cuts, is sucking in imports at an alarming rate. The problem could be made far worse if the Chancellor uses the 1987 Budget to cut the basic rate of tax rather than to increase investment. The Chancellor clearly hopes that a crisis of confidence can be staved off until after a general election.

6 This budget submission therefore sets out the first part of a two-year package to reduce unemployment by one million. It focusses on areas of spending which can be expanded quickly, such as housing repair and maintenance, in order to have an immediate impact on the dole queues. By the second year, stronger emphasis can be given to industrial policy measures such as R&D which inevitably have a longer lead in period but which are vital to the revival of the economy, in particular our manufacturing base.

1: Economic prospects

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1.1 This chapter examines the economic prospects that form the backdrop to the 1987 Budget. It also looks ahead to the prospects for the rest of the decade. It highlights the growing balance of payments crisis which would be accentuated by budget tax cuts. It sets out the Government's 'hidden agenda' which would only be revealed if it were re-elected; high on the agenda would be a further round of public spending cuts.

Prospects for 1987

1.2 The Chancellor has claimed that the Treasury forecasts set out in the Autumn Statement point to 'generally satisfactory prospects for developments in the economy over the coming year'. Unfortunately not only is the Chancellor wrong in the short-term but current economic developments are storing up even more serious long-term problems.

1.3 On the basis of past experience the outturn in 1987 is not likely to be as favourable as the Treasury forecasts, set out in Figure 1.1, suggest. In 1986 for example, the growth of national output is likely to have been closer to 2.5 per cent than the 3 per cent forecast at the time of the 1986 Budget. Moreover, on all the key indicators – output, inflation, trade and employment – independent forecasters are less optimistic about the prospects for 1987.

1.4 A recent survey by the Association of British Chambers of Commerce suggests that the prospects for manufacturing exports and jobs are bleak. It emphasised that the outlook for the traditional manufacturing heartlands – the West and East Midlands and Merseyside – was particularly worrying as there was a 'continuing and disturbing deterioration' in nearly all the main economic indicators.

Figure 1.1: Prospects for the economy

	What happened 1985	*March forecast for 1986*	*Revised forecast for 1986*	*New forecast for 1987*
Economic growth (Gross Domestic Product)	+3½ pc	+3 pc	+2½ pc	+3 pc
Spending by consumers	+3½ pc	+4 pc	+5 pc	+4 pc
Government and local authority, current spending	+½ pc	+1 pc	+1½ pc	+1½ pc
Investment (private and public)	+1 pc	+5 pc	+2 pc	+2½ pc
Exports	+6 pc	+5 pc	+1 pc	+3 pc
Stockbuilding (changes 25 pc of GDP)	+½ pc	0	0	+½ pc
Imports	+3 pc	+6 pc	+5 pc	+4½ pc
Balance of payments (current account)	+£3.6 bn	+£3½ bn	0	−£1½ bn
Public Sector Borrowing Requirement (excess of spending over revenue)	£7 bn	£7 bn	£7 bn	£7 bn
Retail price index (fourth quarter to fourth quarter)	+5½ pc	+3½ pc	+3½ pc	+3½ pc
Unemployment (GB excluding school leavers)	3.05 m	—	3.1	3.06

Note: All at constant 1980 prices, allowing for inflation.
Source: "Guardian" (7/11/86) from Treasury forecasts.

1.5 The Government's own figures show that economic growth has been sustained by a 'consumer boom', which has in the short-term concealed growing weaknesses in the real economy. On the one hand, consumer spending is forecast to grow by 4-5 per cent per year in

1986-87 and on the other investment growth will be nearer 2-2.5 per cent a year.

1.6 The recent consumer boom has effectively by-passed UK industry. The National Institute for Economic and Social Research (NIESR) has recently concluded that 'an exceptionally high proportion of the increase in expenditure on consumer durables seems to have been absorbed by imports'. In the third quarter of 1986 manufactured consumer good imports increased by nearly a fifth while domestic output of the same items was virtually unchanged. On these trends, the volume of imports could be nearly a tenth higher in 1987 than in 1986. One of the most worrying features of the UK economy is the sharp deterioration in the trade balance. The Treasury forecasts a balance of payments deficit of £1.5 billion and a manufacturing trade deficit of £7.5 billion in 1987. Other forecasts, for example, by the NIESR, suggest an even worse balance of payments position.

1.7 Against this background it comes as no surprise that unemployment is forecast to remain high. The Autumn Statement implies that adult unemployment will still be over 3 million by 1990. The rate of job creation has fallen sharply. Most of jobs being created are part-time, while most of jobs lost since 1980 have been full time.

Longer-term prospects

1.8 The longer-term prospects, on the basis of current policies, are a cause for even greater concern. The NIESR has looked at economic prospects and developments in the economy into the 1990s. The study shows that the UK economy will not grow fast enough over the next decade to produce a significant reduction in unemployment. This is entirely consistent with press reports of the Government's own planning assumptions on unemployment in their recent submission to the EC Commission on regional aid.

1.9 This 'low-growth-high unemployment' future is based on two factors. First, the decline in the trade balance will act as a brake on growth. The sharp rise in import penetration in key industrial sectors between 1979-85, shown in Figure 1.2, is set to continue. Secondly, the 'supply side' of the economy has been seriously weakened over the last seven years by the scrapping of industrialised capacity, low levels of R&D and investment and severe cutbacks in education and training. This will severely limit the ability of British industry to respond to the changing demands of world markets, particularly in growth areas. In the motor sector, for example, NIESR sees little prospect of past UK output levels

being achieved. The use of industrial robots provides one example of the UK failing to respond to technological developments. The UK has only half the number of robots per employee as West Germany and the USA. Moreover, imports make up over three quarters of UK robots whereas all the robots in Japan and the US are home produced.

Figure 1.2: Imports' share of British market

	1979 (%)	*Year to Sept 1985 (%)*	*% increase since 1979*
Man-made fibres	45	70	58
Electrical & electronic engineering	31	46	48
Chemicals	29	40	36
Textiles	33	44	33
Motor vehicles and parts	41	51	24
Metal manufacture	27	39	45
Footwear and clothing	29	35	21
Mechanical engineering	29	35	21
Whole of manufacturing industry	27	34	26

Source: DTI, British Business, 16/1/87.

1.10 The causes of the 'supply side' constraints are set out below:

- Investment: total investment in the economy is barely above the level of seven years ago, and manufacturing investment is still over 15 per cent lower. In many sectors of the economy, new investment is below the rate needed to replace the existing capital stock – the plant, machinery and buildings.
- Training: apprenticeships have been cut back drastically. In engineering, apprenticeships are down from 30,000 a year in the mid-1970s to below 10,000. UK companies spend seven times less than US companies on training and 14 times less than German companies.
- Research and development: Britain spends less on civil research and development than most of our major competitors.

1.11 The National Institute argues that substantial supply-side improvements are needed if a significant reduction in unemployment is to be achieved. It points to the need for 'major efforts in technological updating, and re-organisation of production and marketing.

The creation of considerable new capacity will also be necessary since in many areas the present productive equipment is simply not capable of replacing a sizeable part of imports'. If these changes take place then NIESR sees no reason why manufacturing production should not expand rapidly.

1.12 However change on this scale will only occur if the Government works closely with employers and unions to implement an effective industrial strategy. The risks of failure are too great to leave UK industry exposed to the vageries of the market place. Strategic government intervention to boost investment, R&D and training is therefore vital to the long-term success of industry and the economy as a whole. An increase in the underlying ability of the economy to grow fast enough to bring down unemployment in the long term will only occur if policies are introduced which will boost investment, R&D and training.

The Government's strategy

1.13 The Chancellor's Autumn Economic Statement confirmed that the Government's strategy now rests on three factors: first, short-term relaxation of public spending plans; second, increased public asset sales; and thirdly, tax cuts. While there has been some change in the direction of Government policy, the Medium Term Financial Strategy (MTFS) remains broadly intact. Public spending is set to fall as a share of national wealth, the privatisation programme continues, and the Chancellor is still holding out the prospect of tax cuts in the Budget.

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Spending plans

1.14 The Chancellor has recognised that cutting public spending is electorally unpopular. The November Autumn Statement, since confirmed in the annual Public Expenditure White Paper published on January 14, was therefore designed to give the impression that he had experienced a change of heart and would be significantly increasing public expenditure.

1.15 However, the Chancellor is largely trying to make a virtue out of necessity. Much of the announced increase in the spending is not the result of careful planning but reflects overspending which is of necessity already occurring. Moreover, the scale of the increase in

spending announced in the Statement is wholly inadequate and it will not compensate for the decline in recent years. A further increase of around £1.7 billion would have been needed simply to maintain the share of public spending in GDP at the 1986-87 level. An increase of almost £13 billion would be needed on top of the 1987-88 planning total to restore public spending to the same share of GDP as in 1980.

1.16 The most worrying point is the hidden agenda that the Chancellor is unlikely to put before the electorate. There are strong signs that in the face of deteriorating economic prospects in the latter part of 1987 and 1988 this Government, if re-elected, would quickly announce a reversal of these plans and another round of spending cuts. This was the strategy adopted in 1983 when the Budget included, amongst other measures, a major increase in house improvement grants which was rapidly cut back after the General Election. In order to preserve the MTFS, the Chancellor would need to look to further wide-ranging cuts in public spending, on health, education and housing. The biggest impact would be on local authorities, where existing cuts are already putting essential services under strain. Major reductions in the range, quality and number of public services would almost certainly follow.

Public asset sales

1.17 Public asset sales have become a central part of the Government's strategy because the receipts from public asset sales are being used to finance the Chancellor's tax cuts. The Chancellor would not be in any position, within his current borrowing targets, to make tax cuts in the absence of the £5 billion public asset receipts in 1987-88.

1.18 This of course represents one of the clearest examples of the Chancellor's 'short-termism' — he will be trading in long-term investments which would benefit the country as a whole for a short-term gain which will do little to improve the underlying structure of the economy. On present trends, the Chancellor would be left with a massive revenue gap when asset sales inevitably come to an end.

Tax cuts

1.19 The Chancellor's long term strategy is to cut basic rate income tax to 25p in the

pound before the Government has to seek re-election. Every 1p in the £ off the current basic income tax rate costs the Government over £1 billion, which could be better spent on public services and public investment. Moreover the tax burden on many lower income workers will still have increased over the last seven years even if these cuts take place. Cuts in the basic tax rate is a less effective way of helping the poor, particularly families with children and the elderly, than increasing benefits and pensions.

1.20 Income tax cuts are one of the least cost-effective ways of creating jobs and increasing output. An equivalent increase in spending on public services would create almost five times as many jobs and an increase in public investment would create two and a half times as many jobs.

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Conclusions

1.21 The Chancellor is taking a gamble that the short-term consumer boom, sustained by tax cuts, will last up until the next Election. The strategy of 1983 will be repeated if the Government is re-elected, with any stimulus to the economy quickly smothered once the Election is past. The Chancellor's 'hidden agenda' is likely to see widespread spending cuts in health, education, and housing, with local authorities taking the brunt of the burden.

1.22 The economic prospects, on unchanged policies, are bleak. Unemployment will remain above 3 million. The trade deficit in manufactured goods will be over £7 billion, with little prospect of a significant improvement. Investment and output will remain sluggish.

1.23 What these prospects show us is that the Government is content to see a divided economy – with a weakened industrial sector – and a divided nation, with large areas of the country characterised by growing unemployment and poverty. The Government has abandoned its key responsibilities to intervene in the economy to secure a major reduction in unemployment and to reduce divisions in society.

1.24 Whatever Government is elected in 1987 or 1988 it will, on present policies, inherit a desperately weak economy. The decline in manufacturing and the trade deficit are at the heart of Britain's economic problems and have to be reversed if the bleak long term future in prospect is to be avoided. A revival of manufacturing with managed trade, public investment and sustained demand for domestic manufacturing products is vital. The TUC would like to see a different Government with different economic policies, but the situation is so dangerous that this Government must act now.

2: Public investment

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2.1 The evidence of widespread neglect is everywhere and affects everyone, from the families having to live in damp and crumbling houses; the pensioners who have to negotiate cracked pavements; the commuters who each day suffer the consequences of cut-backs in public transport investment; the staff and patients who have to put up with antiquated hospitals; the teachers and children working in dilapidated and inadequate school buildings; and those in danger from burst water mains, crumbling sea-defences and polluted rivers, estuaries and beaches.

What the Government says

2.2 In 1986 the Government applied to the European Community for regional assistance aimed at improving the infrastructure. This report has not so far been published, but a summary has been made available. As an example, in Greater Manchester the report looks at the need for replacement work on roads, sewers, water supply, railways and houses. It goes on to say:

> *"Replacement of these assets has not kept pace with the rate of decay resulting in a serious situation in which some aspects of the infrastructure are in a state of collapse . . . The scale of the problem is, however, far in excess of the level of resources which are available and there is therefore a danger that the infrastructure problem will continue to worsen."*

Housing

2.3 The evidence shows widespread decay and neglect, particularly in housing. The national figures are bad enough. In the private sector in 1981 there were nearly 1 million unfit houses, nearly 700,000 houses lacking basic amenities, such as an indoor toilet, and 3 million houses needing major repairs. In 1985, the Government itself estimated that over 80 per cent of the local authority housing stock – 3.7 million dwellings – need repair work. The total repair bill of the private and public sectors now stands at over £55 billion.

2.4 Yet these figures do not bring home the true state of housing. The TUC can show examples from every region, not just in the cities but in towns and rural areas; not just in the Assisted Areas but also in the South East and East Anglia. This is shown in detail below in four regional examples, but a similar story could be told in every region of the country. In Birmingham in the West Midlands, for example, about one dwelling in five needs major repairs; in Derby in the East Midlands nearly one dwelling in three is unfit, lacks basic amenities; or is in disrepair. In the Northern region there are 150,000 unsatisfactory dwellings. Scotland and Wales also have extensive housing needs.

2.5 *In the North West* detailed figures from the Government's own 1985 Local Authority Stock Condition Survey show that in *Greater Manchester* alone an extra £1 billion is needed on the housing stock, but on the basis of 1985-86 investment levels the repair backlog would take 18 years to clear (*ie*, not until the year 2004). Nor is the problem confined to the big cities: in *Lancaster*, the repair backlog is over £44 million and in *West Lancashire* the repair backlog is nearly £18 million. Yet at 1985-86 investment levels it will take both local authorities over 30

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years to clear the existing backlog. In *Cumbria* as a whole the repair backlog is £151 million, and will take over 17 years to eliminate at 1985-86 investment levels.

2.6 Just three examples from a survey carried out by the *South West TUC* of local authorities in the region show that *Bristol* estimates a repair bill of over £142 million, with 2,900 houses unfit or lacking basic amenities and 11,000 in need of renovation. *Thamesdown* has investment needs of nearly £60 million, with over 11,400 dwellings in need of repair. *Taunton* has investment needs of £21 million, with 250 houses unfit and lacking basic amenities, and 2,400 houses in need of major repairs.

PHOTO

2.7 In *Yorkshire and Humberside*, the TUC Regional Council highlighted a 20 per cent increase in waiting lists in *Barnsley*. *Bradford* wants to spend £50 million on housing, but has only been given £18 million. *Kirklees* needs to spend £80 million, but can only spend £5 million. *Wakefield* needs to build 11,500 houses by 1991, but can only build 40 per cent. In *Rotherham* the local HIP programme has been cut by 50 per cent since 1979. In *Leeds* there are 27,000 unfit houses, over 2,600 lack basic amenities, and one-third of houses are in major disrepair.

2.8 In the *South East*, the Department of the Environment estimates that in the private sector there were 208,000 unfit properties, 175,000 lacking basic amenities and 407,000 needing major repairs. In the public sector, there were 250,000 unfit properties, 230,000 lacking basic amenities, and 600,000 properties needing major work. Most of these were in London, but substantial numbers remain in the rest of the South East.

The Government's response

2.9 The Government's response has been to slash the new build programme since 1980, and, since, 1983 cut improvement grants.

2.10 The Government has said that local authorities can top up their investment programme by using the money from selling-off council houses. This is not a long term basis on which to plan public investment. Moreover, the Government allows local authorities to re-invest only a small share of the total money they get from sales. The result is that local authorities now have over £7 billion accumulated from council house sales, and this is growing at £1 billion a year.

2.11 While local authorities are piling up money they are not allowed to spend, the repair bill is going up by £900 million a year according to a recent report from the Audit Commission. At present local authorities spend £170 a year on each of their houses, but according to the Commission this needs to be £500 if the current repair backlog is to be dealt with by the year 2000. Again, TUC Regional Councils can point to well documented local examples: in the South West, Thamesdown has £20 million in capital receipts and £60 million worth of disrepair. Recent Government announcements about more spending on house repair are well short of what is needed to start the fifteen year repair programme suggested by the Audit Commission.

2.12 Bad as the existing housing is, there is also a pressing need for new houses. The Government effectively abandoned the council house building programme in 1980, except for special groups such as the disabled and elderly. But according to official figures, there are nearly 1.2 million people on waiting lists. Nearly 250,000 are, by official definitions, in overcrowded accommodation; and another 250,000 are elderly or disabled. Over 400,000 are having to share accommodation, including 70,000 single parent families.

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Hospitals

2.13 Despite Government claims about the high level of capital investment in hospitals, the fact remains that many still date from before 1919. Moreover, the repair backlog in the NHS remains untackled: official estimates say it could be £1.7 billion. The new hospital building programme, which Ministers have made so much of in public, is increasingly reliant on selling off existing NHS buildings and land. Moreover, the programme is slipping behind, with nearly half the major projects due to start in 1986-87 having been postponed.

Schools

2.14 The state of Britain's schools is a national scandal. For years annual spending on repair and maintenance has been running at less than half the minimum needed to keep them in a reasonable condition. On secondary schools alone the backlog is estimated at £500 million by the Audit Commission. This is adversly affecting our children's education. The 1985 School Inspectors' report says:

> *"The state of repair of much of the country's building stock is deteriorating. Long standing problems, linked to little sustained improvement in recent years, are threatening to make some school buildings almost unusable. This continued neglect constitutes a serious financial problem for the education service. Furthermore, grim neglected buildings do nothing to stimulate and encourage pupils and teachers."*

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Road maintenance

2.15 In July 1985 a report from the Audit Commission concluded: "the amount of maintenance funds provided in 1985-86 is insufficient to meet even the normal maintenance programme", let alone deal with the backlog of repairs on trunk roads. In 1984-85 less than half of all bids for extra spending were actually met. There is a backlog of maintenance on motorways which will not be cleared until the early-1990s. There is also a far more massive backlog on local authority roads, which the increased spending announced in the Autumn Statement will do little to remedy.

2.16 This failure to tackle the backlog problem will mean the final bill will be much higher than if repairs are done promptly. The Audit Commission said in July 1985:

> *"A continuing failure to 'spend now to save later' will incur substantial additional real costs in terms of direct expenditure; and there will be continued disruption, inconvenience and associated costs for industry and the travelling public. The Department of Transport recognise that the optimum solution in terms of value for money would be to invest the necessary additional funds as quickly as possible. But there is no indication that such funds will in fact be made available."*

Water supply and sewers

2.17 In 1983 the Water Authorities estimated they needed to spend £16 billion between then and the end of the century to meet all their investment needs, but estimated that current levels of investment were at least 30 per cent below this. The result is that most authorities expect deficiencies in basic services to persist into the 1990s. According to their own level of service indicators, it is anticipated that in 1989 there will still be 900,000 households with inadequate water pressure, over 220,000 are likely to experience supply failure, and many will receive water bacteriologically deficient. Even these figures may be optimistic, for example, in late 1985 up to 300,000 people were cut off in the City of Leeds when an old water mains burst. The water authorities expect to have at least 4,300 sewer failures in 1988-89, compared with just under 3,600 in 1983-84 – an increase of a fifth.

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Pollution

2.18 There is also little prospect of any improvement in the cleanliness of Britain's rivers. For example, by 1989 the North West still expects nearly 30 per cent and the South West over 20 per cent of these areas' rivers to be below the standards they set. In England alone, 1.8 million people are expected to be connected to unsatisfactory sea-outfalls, while 60 per cent of outfalls in Wales will still be unsatisfactory. At least 3.1 million households have below standard effluent treatment.

Sea defences

2.19 Sea-defences are also expected to be below standard, with a repair backlog of at least £1 billion. For authorities such as Anglian, over half the sea-defences are below standard and for Northumbria and Yorkshire the figures are 45 per cent and 40 per cent respectively.

Reconstruction of Britain

2.20 The TUC has set out wide ranging proposals for a five year public investment programme. In the early years, however, public investment will be concentrated on repair and maintenance work, particularly in housing, schools, hospitals, roads and water supply and sewers. Much of the work will be carried out in higher unemployment regions and inner cities, both to maximise their economic and social benefits and minimise constraints.

Contract compliance

2.21 The investment programme will be underwritten by local authority 'contract compliance' procedures. These will help reinforce the positive benefits from the programme, particularly in promoting equal opportunities and racial equality; and in the case of construction also help rebuild the industry's training base and discourage the growth of bogus self-employment. This will be part of a wider commitment to decasualise the construction industry by establishing a register for employers, and to boost training in both the public and private sectors to alleviate possible skill shortages in the future.

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Conclusions

2.22 The benefits of such a programme will not only be in creating jobs in the construction industry and the industries which supply it, and in the higher unemployment regions and in the inner cities. With contract compliance and other supporting policies, for example, on training, the quality of employment can be improved. Moreover, better maintained schools will improve the education of our children; better hospitals the quality of patient care; better housing will improve the living standards of many of those in need, especially the elderly and also families with young children.

2.23 The TUC is therefore calling for an emergency repair programme. This is still far short of the total needed, and the TUC has set out a five year public investment programme, *The Reconstruction of Britain*, which will tackle the worst deficiencies. The repair programme however, can be started quickly, is labour intensive, and would not suck in many imports. The main points are:

- increase spending on house repair in the public sector in line with the Audit Commission's recommendations; restoration of cuts in private sector improvement grants; increase provision for increased public sector housebuilding; this would cost *£1,950 million.*
- improve spending on school and hospital repairs; this would cost *£180 million.*
- boost water authority investment levels to allow improvements in service indicators before 1990; this would cost *£50 million.*
- increase road maintenance programme, particularly for trunk and local roads to allow authorities and DpT to eliminate backlog in a more cost-effective manner: this would cost *£200 million.*

The total cost of the above would be *£2,400 million.*

3: Public services

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3.1 Public services will make a key contribution to reducing unemployment. As an illustration of what can be done, this chapter looks at some immediate priorities for expansion in the public services, particularly in health, personal social services and education, as part of a wider approach to boost public services, including transport and environmental improvement. The proposed spending increases are in *addition* to the changes announced in the Autumn Statement.

3.2 The scale of the proposed increases represents what could be practicably achieved in the first year. It does not mean these increases will satisfy all unmet needs. Public spending cannot be turned on like a tap; in certain areas it could take years to put right the damage caused by years of spending cuts. Further detailed discussions will also need to take place on the problems that may arise in carrying out these proposals, and expanding other public services, particularly in areas such as environmental improvement and transport. A number of local authorities are currently drawing up local jobs plans which should help to identify some of the issues, such as training, which need to be addressed.

Why expand public services

3.3 There are many good reasons for expanding public services. Spending cuts over the last seven years have reduced the quality of the service that can be offered in health, education, local bus services and many other areas. The real living standards of the majority of the population who rely on public services would therefore be dramatically improved by extra public spending.

3.4 Expanding public services is a cost effective way of creating job, many times more so than cuts in direct taxes. Public services are labour intensive, and this means there is a greater saving from unemployment benefit payments and increased tax revenues. They also have a low import content: public services, such as the NHS and schools, buy a higher proportion of their supplies from UK companies than the private sector.

3.5 Public services can often provide higher quality services and jobs than the private sector. The contracting out of public services to the private sector, for example, has generally produced an inferior service as contractors have sought to maximise profits by cutting standards and the pay and condition of employees. It is essential to make sure future services are of a high quality and meet the needs of individuals and families. The private sector, guided by market forces, has shown itself unable to meet these social needs. Only the public sector can adequately fill this role.

3.6 The return of contracted-out services to the public sector and the expansion of existing services would provide an immediate improvement in the quality of life for many people, but particularly those in need. For example, the housebound would find their lives less isolated and the scope for greater mobility increased through improved 'dial-a-ride' schemes. The ill would receive more support and faster treatment, with less queueing and waiting in dinghy surroundings. Those without access to private transport would have better, more reliable public transport services.

3.7 Public services also provide greater scope for introducing effective equal opportunities policies. Disadvantaged groups such as the long-term unemployed, women and ethnic minorities can be targetted for recruitment and greater emphasis can be given to their training needs.

Health and personal social services

3.8 The National Health Service and local authority social services have faced a growing gap between needs and resources in the last four years. The Government's failure to back the needs of the NHS has meant a £1.3 billion shortfall for hospital services, according to the

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latest report of the House of Commons Social Services Committee.

3.9 The TUC has consistently called for growth of at least three per cent a year in real terms to match NHS needs and resources and to provide improved services. The TUC has identified a number of priority areas, such as primary and preventive health care. Many of these priority areas will require comparable growth in the personal social services, particularly for the elderly, mentally ill and mentally handicapped.

3.10 Urgent action is needed as a first step in developing a comprehensive service in the face of growing needs. The TUC is calling for:

- action on the backlog of programmes, such as primary and preventive health care;
- improved staffing levels in the nursing, technical and support services;
- more maintenance and works staff to preserve the fabric of the service; expanded training programmes across all staffing grades to meet future needs.

Total budget increase in 1987-88 = *£600 million.*

Education

3.11 In the Chancellor's Autumn Statement the real increases in education spending was only 0.3 per cent in real terms, when actual spending levels are compared. This has to be set against successive spending cuts since 1979. An emergency injection of extra resources in 1987-88 would begin to restore the thousands of jobs lost in the service since 1979 and reverse the decline in educational provision. Immediate priority areas are:

- boosting expenditure on books and equipment;
- restoring academic and related jobs in higher education;
- reversing cuts in local authority teaching and ancillary jobs;
- reducing class sizes overall and making more provision for smaller classes for special needs;
- progressing towards universal under-fives provision;
- phasing in an education maintenance allowance scheme for 16-18 year olds to encourage more of the age group to stay in full time education and go on to further and higher education;
- restoring the value of the student mandatory award and extending grants to part time students, together with restoring opportunities in higher education.

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Total Budget increase in 1987-88 = *£1,000 million.*

Other Public Services

3.12 Other areas of public service such as transport, leisure and recreation and environmental improvement work would also be developed to meet growing local needs and provide jobs.

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Conclusions

3.13 An expansion of public services, particularly in health care and education, will meet social and economic needs and provide many of the new jobs required if registered unemployment is to fall significantly. The TUC is therefore calling for:

- increased health and social service provision in the NHS and local authorities: this would cost *£600 million*;
- increased education spending in immediate priority areas: this would cost *£1,000 million*.

Total cost of increased public service spending would be *£1,600 million*.

4: Industry

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4.1 Britain's economic development is critically dependent on the rebuilding of British manufacturing industry. No other sector can realistically replace manufacturing as a source of wealth creation, particularly in the vital area of overseas trade. That is why the TUC has given priority to the rebuilding of industry in our wider economic policy proposals, through industrial planning and industrial democracy.

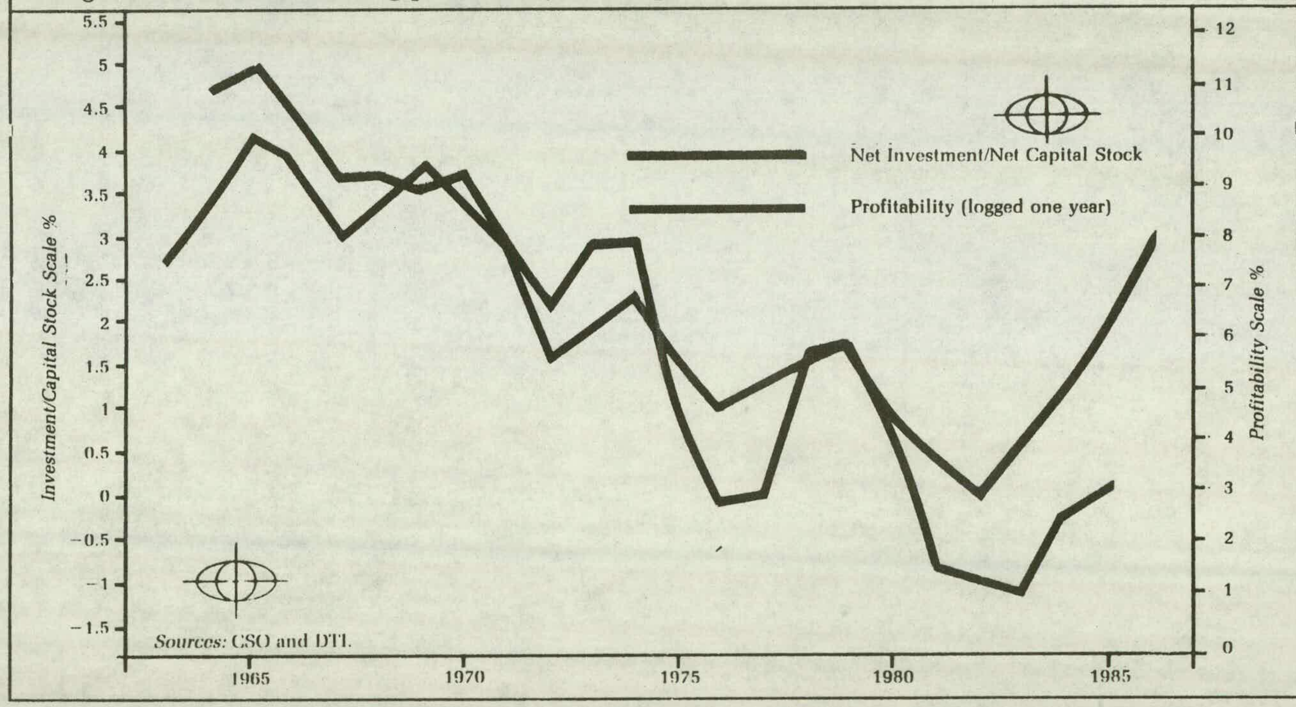
4.2 British industry has emerged from the depths of the recession not leaner and fitter, but smaller and weaker. Manufacturing is still producing less and investing less than it was in 1979. By 1983, Britain was for the first time importing more manufactured goods than it was exporting. This trade deficit had, by 1986, grown to £5,000 million; and by next year even the Government thinks the deficit will be £7,500 million.

4.3 Employment fell drastically in the early 1980s in manufacturing. Jobs are still going at the rate of 10,000 a month.

4.4 The decline in British industry has been accelerated by the Government's neglect of national industrial interests, which has seen strategic manufacturing industries such as aerospace and motor vehicles increasingly dominated by foreign multi-nationals. This has been allied with the deliberate run-down of traditional industries, such as shipping, steel and coal, which remain essential to an industrialised country. The Government's lacks a credible industrial policy, most recently illustrated by the decision to close down the highly successful Coal Firing Scheme to promote conversion to coal fired boilers in industrial markets. This reflects the Government's failure to take responsibility for the long-term strategic allocation of resources in the

national economy. The Government seems to believe that a recovery in profits will, through free market forces, lead to substantial re-investment by British industry. This has simply not happened. The profits have come but investment has lagged behind. This is shown in Figure 5.1.

Figure 4.1: Manufacturing profitability and capital stock growth



4.5 British industry cannot be rebuilt overnight, and the scope for immediate action in a single Budget is therefore limited. Nonetheless, the Budget as a whole helps provide an expansionary framework for industry and for the vital long term policies by Government in areas such as research and development, industrial investment, and education and training; and in effective action to slow down the growth in imports and to boost exports. This will include the development of new tax incentives to encourage both longer term investment, and increased investment in research and development and training. The TUC believes that a major boost is required in spending on research and development, as highlighted in the recent report by the House of Lords Committee on Science and Technology. This is an essential part of the long-term recovery in British industrial performance, as shown in relatively successful industries, such as pharmacueticals, where spending on research and development is high and increasing. These longer-term policies are set out in the *1986 TUC Economic Review*.

4.6 However, the Government can take immediate action to relieve some of the pressure on industry, and halt the loss of jobs. The TUC has identified three priority areas which any Government could put into effect and which will have a swift and rapid impact on British industry. These are increased aid to exporters; increased resources for local and regional assistance to industry; and in training.

Assistance to exporters

4.7 The Government can provide immediate assistance to exporters by providing more generous aid through the Export Credit Guarantee Scheme (ECGS); and by active involvement in helping British companies bid for overseas work on major construction and engineering projects. The TUC is playing a leading role in an initiative agreed at the NED Council for each industry to look at the opportunity to boost exports over the next few years.

- Increased aid to British exporters could cost *£140 million*.

Investing in British industry

4.8 British industry invests less than our major

industrial rivals in productive assets, but has spent huge sums in recent years on takeovers and mergers which have done little to strengthen the industrial base. It is critical to Britain's long-term survival that the funds being used to finance mergers and overseas investment are invested directly in British industry, and the TUC has therefore put forward a proposal for a National Investment Bank. However, while it will take time to establish the National Investment Bank, there already exist a number of local Enterprise Boards which can offer immediate assistance to industry in a number of areas.

4.9 The five main Boards are Lancashire Enterprises, the Greater London Enterprise Board, the Merseyside Enterprise Board, the West Midlands Enterprise Board; and the West Yorkshire Enterprise Board. However, many more local authorities also provide substantial aid, mainly through the provision of industrial sites and factory buildings, and by assisting worker co-operatives and local enterprise agencies.

4.10 The Government should seek to encourage and develop these local Boards, and the wider local authority role in assisting industry and commerce. The Government should restore the funding of the Co-operative Development Agency (CDA) and Industrial Common Ownership Movement (ICOM) which they cut in

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the early 1980s; and set aside additional funds to help regional bodies such as the Wales Co-operative Development Centre.

4.11 The TUC is therefore calling for the following measures:

- doubling the section 137 rate limit to 4p in the pound for assistance to local industry and commerce, including support for worker co-operatives, and local Enterprise Boards;
- restore funds to national and regional co-operative development bodies, the CDA, and ICOM, and the Wales Co-operative Development Centre;
- commit resources to developing community partnerships through Business in the Community and local Enterprise Agencies;

The total cost of the above measures could be up to *£100 million.*

Regional policy

4.12 The Government's review of regional industrial policy in 1984 savagely cut the regional aid budget, and spending is running at only half the average level in the early 1980s. Moreover, the Government has pursued a policy of cutting back the geographical coverage of regional aid, and in 1984 cut the rate of grant in the highest unemployment areas. Rebuilding a cost-effective and efficient regional policy will require not only more resources, but the redesignation of the Assisted Areas and the restoration of capital investment grants. The TUC's longer-term regional policies are set out in the TUC policy statement *Regional Development and Planning.* The TUC will be discussing these proposals, including the scope for additional employment subsidies, in the NED Council.

4.13 As a first step in restoring regional policy, the 1984 cuts should be reversed and provision for regional aid *increased by £300 million.*

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Training

4.14 The TUC's long-term education and training policies are set out in the TUC-Labour Party joint policy statement *Education and Training.* This envisages a major increase in

adult training provision for the unemployed under the MSC's New Training Initiative. In the longer term this will require increasing provision by up to 300,000, but as a first step to assist industry the Government should increase the MSC's mainstream occupational training programme for adults. The number of places should be doubled to 100,000.

This would cost about *£170 million.*

Special employment measures

4.15 The TUC believes that the most effective way of reducing unemployment is to create permanent jobs. In addition, however, immediate help can also be given in the form of quick-acting special employment measures for unemployed people. The TUC is therefore calling for:

- expanding the Job Release Scheme to allow men aged 60 or over and women aged 55 or over to take early retirement with a guarantee of replacement by an unemployed person;

  Cost £63 million.
- the re-introduction of the Short-Time Working Compensation Scheme to prevent further redundancies thus saving tens of thousands of jobs at risk.

  Cost £52 million.

4.16 Manufacturing industry cannot be rebuilt overnight. The proposals in this statement are only what can be done immediately, with the prospect of having an immediate impact to help relieve the pressure and reduce job loss. National resources to rebuild industry will need to be sharply increased in subsequent years, reflecting the priority such policies will have in future economic policy. The TUC's immediate priorities include:

- immediate increase in ECGD provision: cost *£140 million*;
- increased resources for local authority assistance to local commerce and industry; including worker co-operatives and local Enterprise Boards, and local Enterprise Agencies: cost *£100 million*;
- immediate increase in adult skill training provision and the expansion of special measures: cost *£285 million*;
- restore cuts in regional industrial aid: cost *£300 million.*

Total cost of the above measures: ***£835 million.***

5: Benefits and taxes

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Introduction

5.1 This chapter sets out the TUC's proposals for increased social benefits for three priority groups: families, the unemployed, and pensioners. The TUC's proposals are based on the conventional assumption that benefits, tax thresholds and excise duties will be increased in line with inflation. It also sets out proposals for changes in taxation which, by sharing the tax burden more fairly, would pay for many of these benefits.

Social benefits

5.2 The Government's policies offer no encouragement to the poor. In his Autumn Statement, the Chancellor announced that spending on social security in 1987-88 would be increased by £1.7 billion compared with public expenditure plans published earlier in the year. This is yet another example of misleading presentation by the Government. It compares with previous unrealistic plans, not actual spending and the social security budget had by November, overrun by £1.6 billion. Whilst the Chancellor has sought to make a virtue out of necessity, the real reason for the increase in spending is the Government's failure to tackle unemployment. The TUC's own strategy for social security, explained in detail in the General Council's evidence to the Social Security Reviews, emphasises the need for adequate benefits for everyone unable to support themselves.

Families

5.3 Many of the poorest people are those with families to support. One of the most effective ways of countering family poverty is through the child benefit system. Because it is paid to those with day to day care of children, it also helps to alleviate the hidden poverty in families when the wage earner's income is not evenly shared by all members of the household. Yet the Government has regularly failed to increase child benefit in line with inflation and in 1986 child benefit was increased by only 10p a week. The TUC is also concerned about the large number of women who, because of responsibilities for caring for invalid relatives, are unable to take paid employment. Increasing invalid care allowance would be an important step towards fair valuation of the important contribution of women carers. The TUC is therefore calling for:

- an increase in child benefit by £3 a week;
- an increase in one parent family benefit by £2 a week;
- an increase in invalid care allowance by £8 a week (up to the rate of unemployment benefit);

These benefit increases could not take effect until July 1987, so the total cost would be about *£1,200 million* in 1987-88.

Unemployed

5.4 Unemployment is now admitted by the Government to be the biggest single cause of low income. Particularly hard hit are the 1.3 million long-term unemployed, most of whom rely on short-term supplementary benefit. All other SB claimants receive long-term rates after 52 weeks (or immediately for pensioners). A 1985 study published in the Journal of Social Policy found that, as a result, long-term unemployed families frequently borrowed money to pay for food, clothing, shoes, heat and rent. The MSC have reported that a number of long-term unemployed people were forced to sell possessions, and many were unable to meet their bills. Moreover, those unemployed who have taken a place on the Community Programme find their wage limits failing to keep pace with the rise in average earnings.

5.5 As a move towards giving unemployed people freedom of choice in part-time and full-time work, the Government should increase

the limit on the average wage limit on the Community Programme for the long-term unemployed from £67 a week to £80 a week to keep pace with rises in incomes since the Programme was established.

5.6 Another key area is the need to increase the YTS trainee allowances to £38.25 in the first year and to at least £47.80 for second year trainees to keep pace with inflation since youth schemes were introduced.

The TUC is therefore calling for

- extension of long-term supplementary benefit to all claimants after one year;
- increase in average wage limit on the Community Programme in line with the increase in earnings;
- increase in YTS allowances in line with inflation.

The cost of these measures would be about *£785 million* in 1987-88.

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Pensioners

5.7 Britain's pensioners fare badly compared with pensioners in other European countries. As a percentage of average earnings the British pension is a third compared with three quarters in Belgium and two thirds in Germany. One quarter of pensioners in Britain are living on or around the poverty line. Yet British pensioners have lost out even further as a result of Government policies. All pensioners have been hit by the Government's decision in 1980 to end the link between the State retirement pension and average earnings. The Government Actuary has estimated that the basic pension, as a proportion of average earnings, could fall by half in the long-term if the link is not restored. Under the changes in the 1986 Social Security Act, the long-term prospects for occupational pensions have also been hit.

5.8 Many pensioners also rely on the wider social security system to supplement their retirement pensions, and the latest housing benefit cuts, in November 1985, meant that 1.2 million pensioners lost some or all of their housing benefit. A further cut is planned this year. The inadequacy of current pensions and other benefits to meet the needs of pensioners has been tragically demonstrated each winter in recent years. Severe cold weather together with insufficient money to pay fuel bills has caused deaths among elderly people from hypothermia and other cold-related conditions, as well as widespread suffering from inadequate heating.

5.9 The TUC's target for pensions is one-third of average earnings for single people and one-half for married couples. In 1987 the Government should, as a first step, restore the link with earnings. This would increase single pensions by £5 a week and the pension of married couples by £8. According to the normal timescale for changing claimant's order books, this would have to take effect from July 1987. This would cost about *£1,450 million* in 1987-88.

5.10 Together, the TUC's proposals on benefits would cost around £3,400 million. However, over half of the increase in social benefits can be met by making the tax system fairer and raising extra revenue. The TUC's proposals for tax changes are set out below.

Taxation

5.11 Two key requirements of an effective tax system are that it should have clear rules and that these should be fairly enforced. The British tax system falls far short of this model. The Government has pursued a deliberately unevenhanded policy of tax concessions for the better-off, while cuts in Inland Revenue manpower have made it easier for tax payers to avoid or evade their tax obligations.

5.12 It will take time, political will, and technical expertise to deal with all these problems. The tax measures proposed by the TUC for 1987, like those for social benefits, will need to be followed up by a wider programme of tax reform. The TUC will for example, be examining ways of reducing the tax bills of the low paid and eliminating the poverty trap for example, by introducing a lower band of tax at the bottom end of the income scale. Nonetheless, immediate steps can be taken on taxation to help pay for improved social benefits.

Investment and capital taxes

5.13 Despite the vast inequalities in the distribution of wealth, taxes on capital amount to 5 per cent of Inland Revenue tax receipts. Capital gains tax is ineffective both because of its high threshold and large number of exemptions. As far as unearned income is concerned, the abolition of investment income surcharge has greatly benefited those with large Stock Exchange investments. The real bonanza has been for senior executives benefiting from

generous 'share option' schemes, operated by over 90 per cent of the UK's top 145 public companies. The Government's new Personal Equity Plans will give most to higher rate taxpayers and those who already have substantial shareholdings. PEPs offer little incentive to the small investor.

5.14 Inland Revenue statistics show that the top 1 per cent of wealth holders have 20 per cent of total wealth; equivalent to the entire wealth of the bottom 75 per cent. Since 1979, the wealthiest 10 per cent have increased their share from 52 per cent to 56 per cent of the total. There is no reason why people fortunate enough to have built up capital or to have unearned income should not pay their due share of taxation. The TUC proposes to review the overall balance of taxes on income and wealth, including the scope for introducing a wealth tax. However, this is not an excuse for delay. The TUC calls on the Government to take immediate action to restore existing investment and capital taxes to their former status and to ensure that they are effectively enforced. This would raise *£809 million.*

5.15 This would be done by restoring the investment income surcharge. This would raise £395 million at today's prices. In addition, the TUC is calling for a reduction in the threshold of capital gains tax in line with income tax thresholds; abolition of capital gains tax relief for gifts; and abolition of exemptions on life assurance policies. Together these will raise £320 million. In addition, inheritance tax on lifetime transfers would be introduced, and the tax itself would not be indexed. This would raise £95 million.

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Tax thresholds

5.16 The better-off have benefited since 1979 both from changes in taxation and from increases in real earnings which have widened the gap between rich and poor. The top 10 per cent of full-time male adult earners had by 1985, after accounting for inflation, enjoyed an increase in their earnings of more than one-third. By comparison, the bottom 10 per cent of male earners had an increase in real weekly earnings of just 3 per cent. The bottom 10 per cent of male manual workers did even worse, taking a real wage cut. Government taxation policies have had two major results. The share of national income taken by taxation has risen and the increase in the tax burden has been unevenly shared. Taxes which bear most heavily on the poor, such as

national insurance contributions and expenditure taxes have risen considerably. But tax cuts for people on top incomes began in 1980 when, in its first budget, the Government reduced the highest rate from 98 per cent to 60 per cent.

Mortgage interest relief

5.17 Mortgage interest tax relief, although providing a valued benefit to all owner-occupiers of houses, is of most benefit to the better-off. Government figures show that whereas nearly one tenth of people receiving mortgage interest relief in 1984 had incomes above £20,000, they accounted nearly a fifth of total tax reliefs. One effect of the higher rate mortgage tax relief has been to fuel the excessive rise in house prices in the south-east. The TUC would not wish to see mortgage interest relief abolished, but wants to ensure that the benefits go to the majority of taxpayers paying the standard rate of income tax. Abolishing mortgage interest relief at higher tax rates would save *£379 million.*

Corporation tax

5.18 British industry in 1985 was more profitable than at any time since 1960. Since 1982, gross profits have risen rapidly. Yet, as the *1986 TUC Economic Review* showed, investment has failed to follow this upward trend. Of particular concern is the fact that, despite large increases in dividends, advance corporation tax (ACT) the tax paid on distributed profit has declined as a share of total company taxation. In 1979-80, ACT brought in 39 per cent of total corporation tax receipts, but in 1986-87 it is expected to be 35 per cent. The TUC considers that the Government should amend the tax system in order to increase ACT as a share of total company taxation.

5.19 In calling for increased ACT, the TUC would clearly distinguish between profitable companies which do not re-invest, and those firms prepared to plough back an increasing share of profits in order to invest for the future. As Chapter 4 showed, British industry as a whole is highly profitable but investment has failed to keep up with the recovery in profits. The objective of increasing ACT, as a tax on distributed profit, is not to raise company's total tax bills but to help encourage firms to re-invest more of the profits

they currently distribute to shareholders.

5.20 The TUC is also concerned about the distorting effect of the tax system on company's investment decisions. Existing tax measures, such as the Business Expansion Scheme, rather than stimulating new investment, have been widely used for tax avoidance purposes. Similarly, recent large increases in dividends to shareholders reflect a priority of short-term interests over longer term needs. The TUC has no wish to see a net deterioration in the overall financial position of firms. However, assistance through the tax system should be firmly linked to industrial policy objectives. The criteria for tax incentives should therefore be reviewed and, as a first step, BES tax relief should be withdrawn.

These measures would raise *£535 million.*

Hidden economy

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5.21 The term 'hidden economy' covers tax evasion and avoidance, double job-holding, and unrecorded paid employment often 'bogus' self-employment. The hidden economy is, by its nature, difficult to measure but long-term trends show that it has grown over the last twenty years, and that this growth has accelerated since 1980.

5.22 Whilst it would be unrealistic to suggest that tax lost in the hidden economy is immediately recoverable, not least because of inadequate Inland Revenue resources, the TUC considers that action against the hidden economy will play an important role in the creation of a more equal society. The Inland Revenue's annual report shows that the yield from investigations is far higher than the cost of employing extra staff. In the 1984-85 tax year for example, tax recovered by PAYE audit staff exceeded costs by 5.5 times and the return from Special Offices was 27 times higher than staff costs. Despite this, staff cuts since 1979 have resulted in a 150 per cent increase in arrears of work, excluding outstanding Schedule E assessments. One effect of the long-term backlog of work is to further increase taxpayers' awareness of the scope for tax evasion. The TUC believes that a more sensible manpower policy for the Inland Revenue would eliminate arrears of work, lead to greater efficiency, improve compliance and reduce the size of the hidden economy. An effective recruitment and training programme would save £130 million in one year.

5.23 The TUC's proposals for increases in social benefits and changes in taxation are set

out in the Table below. They show that the benefit increases proposed would cost around £3.4 billion, but that £1.9 billion could be raised by making the tax system more equitable.

Figure 5.1: Tax and benefit changes 1987

Benefit	*Expenditure (£m)*	*Tax*	*Revenue (£m)*
Increase child benefit by £3; Increase 1 parent allowance by £2	1200	Investment income surcharge	400
		Capital gains tax	320
Increase invalid care allowance by £8	20	Inheritance tax	95
Extend long-term supplementary benefit rate	400		
Raise community programme wage limit to £80	170	Restrict mortgage interest relief to basic rate	380
Increase first and second year YTS allowances	215		
Increase state retirement pension	1450	Abolish BES reliefs	75
		Increase ACT	460
		Hidden economy	130
Totals	3400		1890

Sources: Financial Statement and Budget Report 1984-85 and 1986-87. Autumn Statement 1986. Department of Employment Gazette October 1986. Inland Revenue Statistics 1986. Inquiry into British Housing 1985. Board of Inland Revenue: Report for the Year Ended December 31, 1985.

Conclusions

5.24 The TUC has no illusions that the proposals set out in this Chapter will meet all the needs of people on low incomes. But they would make an important start to reversing the growing gap between rich and poor, they are all achievable by any government in a timescale of one year.

5.25 The joint TUC/Labour Party proposals for a statutory national minimum wage would further increase the benefits to the lower paid. However, there is much more than should be done both to alleviate hardship and to remove sex discrimination from the tax system. The TUC is undertaking a wider review of taxation in order to develop a fairer tax system from which the needs of the low paid and the poor would be equitably financed.

6: An Employment Strategy

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6.1 This chapter shows how this submission illustrates the central elements of a new employment strategy. The TUC Budget submission sets out the immediate first steps required to reduce registered unemployment by 1 million in two years. It indicates where further action is needed to achieve this aim, and to secure further reductions in unemployment in the longer term.

The TUC's priorities

6.2 The TUC has set out three clear priorities for future calls on national wealth. These are: firstly, to create jobs and increase growth; secondly, to help those in need; and thirdly, to increase living standards for the rest of the population. The TUC has said that discussions on these priorities should take place each year through a National Economic Assessment.

6.3 The TUC's Budget submission reflects these priorities. Nearly £5 billion extra should be spent on construction repair and maintenance work, on expanding the public services; and on assistance to industry. Nearly £3.5 billion should be spent on social benefits, but over half will be paid for from fairer taxation of the better-off and on company profits not used for re-investment.

6.4 The Budget submission therefore has two clear objectives. Firstly, it will create jobs and boost economic growth by raising both public and private capital investment, and by restoring vital public services. This will help correct the serious imbalance in the British economy, with private consumption roaring ahead with a

'consumer boom' while investment lags behind. Secondly, it will help those most in need – the old, families and the unemployed. This will in turn mean that the better off will have to accept a slower increase in their living standards.

6.5 The living standards of all those in work will still rise, and additional help for the low paid will come from the TUC's minimum wage strategy. But the TUC is prepared to make the hard choice between tax cuts which will increase take home pay; and more public investment and help for those in need. The economic situation demands that national resources must be shifted into investment in the infrastructure and into industry; into rebuilding vital public services, and in helping those in need. The Government must put aside short-term political considerations and the temptation to 'buy votes' by tax cuts, and act instead in the long-term national interest.

A New Employment Strategy

6.6 Yet if the Government maintains its medium-term financial strategy there is little hope of a significant fall in unemployment. It fails to take account of the enormous social and economic costs which are borne by the nation as a whole if resources are left idle. In its place should be put a medium-term employment strategy which places employment and production at the centre and not the periphery of government policy making. The strategy will also be concerned with the quality of jobs created, not only to promote equal opportunities but through technology development and training and industrial regeneration, create more skilled, higher productivity jobs.

The Budget submission

6.7 This submission is a first step in implementing that strategy. It shows the sort of measures needed if unemployment is to be brought down. It shows that even the current Chancellor can take immediate and effective action to stimulate growth and cut unemployment.

6.8 But far more needs to be done, through the Employment Strategy, if unemployment is to be significantly reduced within two years, and if further reductions are to be sustained in the longer term. Central to this longer-term aim will be the rebuilding of British industry, particularly

in the manufacturing sector, as shown in the *1986 TUC Economic Review*. These longer-term policies must be launched at the same time as measures designed to have a short-term impact. As the benefits from the initial stimulus to growth begin to run down, the effect of these longer-term policies will increasingly help sustain Britain's recovery.

6.9 That is why the TUC has recognised the need for further action beyond the proposals set out in this Budget submission. For example, the TUC is calling for increased spending on repair and maintenance work which can be started quickly, and has an immediate impact in terms of jobs. But a longer-term strategy needs to bring on stream a steady line of new building work in order to build up the construction programme in later years. Similarly, resources for industry will need to increase sharply, reflecting the priority given to rebuilding industry within the TUC's wider economic policies. This approach recognises the fact that investment cannot be turned on and off like a tap, and requires careful planning over longer periods than a single year.

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A Partnership Approach

6.10 The Government has a major responsibility to establish the climate in which employment growth on this scale can occur. The Government can exert a major influence on the overall level of activity in the economy through its spending and taxation plans, and its exchange rate and interest rate policies. However, it will not succeed unless it is able to mobilise the support of key partners in the economy: the unions and the employers. That is why the TUC has called for the establishment of a National Economic Assessment (NEA) to help decide on the distribution of national resources and the priorities for their use.

A national and local partnership

6.11 The present Government has launched a concerted attack on local government. It has abolished the metropolitan counties. It has prevented local authorities from providing for local needs by rate capping and cutbacks in rate support grants; and it is forcing local authorities

to put out to tender local services such as refuse collection and school cleaning.

6.12 This growing centralisation of control often means that local needs are ignored. It also paradoxically reduces the effectiveness of central government as local and regional authorities are often in a position to implement policy changes more quickly and more flexibly. That is why much of the TUC's submission is based on an increase in local authority spending, on housing, health and education and in providing assistance to local industry. In the longer term, local authorities will play a key role in the new employment strategy, particularly in the further development of local economic initiatives and in regional economic development.

An international partnership and the balance of payments

6.13 There has been a failure among the countries of the industrial world, including Britain, to agree on a co-ordinated strategy to bring down unemployment. The Government has in fact before it another chance in the form of the EC Commission's growth strategy proposal.

6.14 The Commission believe these proposals, which centre on an increase in private and public investment, could cut the average unemployment rate in the Community by nearly a third by 1990. The Commission has clearly identified Britain, along with Germany and France, as one of the Member States able to help expand the European economy.

6.15 The Commission lay great stress on the need for dialogue between the *"social partners"* — Government, trade unions, and employers — as essential for the growth strategy's success. All member states have been urged to start such dialogues as a matter of urgency, and to involve the social partners in their formal response to the Commission's proposals. Progress has already been made between employers and unions in building an economic policy consensus at the European level, and both the European trade union and employer organisations have endorsed the Commission's general approach.

6.16 The TUC has urged the Government to add its support to the Commission's proposal, and start national talks through the National Economic Development Council. The Government has so far turned its back on the TUC's offer, and shut its ears to the calls from other European Governments to establish such a

dialogue at national level between trade unions, employers and government.

6.17 Britain's future as an industrialised country depends in the long term on commencing the long-term task of correcting the trade imbalance on manufactured goods. It is unrealistic to believe Britain can sustain current living standards by relying on income from services such as banking, tourism, shipping; from rents and dividends from overseas investments; or from oil revenues.

6.18 The TUC has advocated a range of industrial and trade policies to correct the manufactured trade imbalance. Moreover, the balance of payments deficit would be further eased by adopting the Commission's growth strategy, whereby the economies of a number of countries expand together. This would reduce the deficit by a quarter. And by expanding through public investment and public services, the import bill can be kept down. This is because the public sector buys far fewer imports than either the private sector or industrial consumers. Nonetheless, the choice facing Britain is no longer between further strain on the balance of payments or lower growth at home. Growth in Britain in 1986 was among the lowest in the industrialised world, but the balance of payments deficit on manufactured trade deteriorated sharply.

6.19 The Government's neglect of industry has weakened the industrial base to the point that, without offsetting corrective measures, any increase in domestic growth can suck in imports faster than exports can be expanded. The decline in revenues from oil is another factor, the Government having squandered the benefits on paying for unemployment rather than regnerating British industry. That is why action will be required from day one of a Labour Government to start repairing the weaknesses in the British industrial base. Many of these policies will take years to work, but others can and must have a more immediate effect.

6.20 The recently launched NED Council initiative, for example, seeks to get British exporters to use the recent devaluation to increase sales and not, as in the past, boost profits. Firm and effective Government action to back up industrial action of this sort can have a significant impact on the balance of payments. Moreover, some initial deterioration in the balance of payments can be expected due to the fall in the exchange rate. This is because the value of exports in sterling drops immediately while the benefits from increased export volumes due to lower prices takes time to work through.

6.21 However, any initial deterioration in the balance of payments has to be seen in

context with the rest of the package, and the wider range of policies set out in the Medium Term Employment Strategy. It is one thing to run a deficit with the Government doing nothing to remedy industrial weakness, and quite another to consider what size of balance of payments deficit might be sustainable as part of a recovery programme.

Inflation

6.22 The second potential constraint is inflation, however, there are so many unused and underused resources in the economy that a major expansion can be undertaken with little change in the underlying inflation rate. Using the National Institute's computer model of the economy, the TUC estimates inflation will increase by less than 2 per cent if Britain expands alone, and by less than 1 per cent if part of a co-ordinated expansion. Nor is there any necessary link between low inflation and economic success. For example, in the late 1960s and early 1970s Japan had a similar inflation rate to the UK but three times the UK's economic growth rate. Nonetheless, it is clear that if the inflation rate were to accelerate again it would undermine growth in the longer term. Policies to deal with inflation in the long term will therefore be developed through the National Economic Assessment.

PAGE PROOF

Skill shortages

6.23 It has been claimed that an expansion would be constrained by serious skill shortages. However, it is clear that the overall position is not as serious as has been made out. Earlier this year, only 15 per cent of firms were reporting skill shortages as a potential constraint, far less than in the late 1970s and the lowest for many years.

6.24 More justifiable concerns have been raised about certain sectors, such as construction where the growth of self-employment has helped undermine the industry's training effort. That is why the TUC has urged complementary action, through contract compliance, increased training, and firmer action against 'bogus' self-employment to make sure any skill-shortage problems can be overcome. Constraints will also be eased by targetting the measures on high unemployment areas.

6.25 Skill shortages will emerge as a serious

constraint in the longer term if Britain persists in under-investing in training, and the complacency in some company boardrooms is not overcome. That is why in this Budget submission the TUC has called for increased adult training provision, aimed at a longer-term target of 300,000 adult training places within the MSC's New Training Initiative.

PAGE PROOF

Paying for the programme

6.26 The TUC Budget submission will mean an expansion of £6.5 billion. This will come from increased borrowing, but at least a third will be recovered from more tax revenues and fewer people claiming unemployment benefits as growth increases and unemployment falls. This would still have Britain as a low spending, low borrowing nation compared with the European average. Moreover, the borrowed money will be used to invest in the future, just as businesses borrow to invest in new machinery and the individual takes out a mortgage to buy a house.

Economic and Employment Impact

6.27 The package's structure relfects the TUC priorities, but also what could be put into effect quickly and be expected to have a quick acting impact on the economy. A further important consideration has been to strike a balance between the impact on the private sector and the public sector and between manufacturing and services, reflecting the structure and employment distribution within the economy.

Employment

6.28 The TUC has acknowledged that some jobs will be filled by the unregistered unemployed, particularly part-time jobs in the service industries. The growth of unregistered unemployment has in large part been because the Government has manipulated the unemployment register, but also because more workers are looking for part-time work. However, while the TUC favours the growth of part-time jobs, provided they are adequately protected, the economy also needs to generate full-time jobs.

6.29 The TUC has estimated the wider economic impacts of its Budget proposals, using computer models of the economy produced by the National Institute of Economic and Social Research (NIESR) and the London Business School (LBS). These models do not fully reflect how the economy works in practice, and they cannot capture all aspects of the TUC's policies, particularly those aimed at industrial regeneration. The TUC has therefore taken this into account in interpreting the results from the computer models.

6.30 The Budget package provides for a £2.4 billion increase in public investment, mainly on construction repair and maintenance work; £1.6 billion on expanded public services; and £0.8 billion on industrial assistance. In addition, there is a £3.4 billion increase in social benefits offset by £1.9 billion in tax increases and hence about half the increase in social benefits is financed by borrowing.

6.31 A major focus of the TUC's proposals will therefore be on creating full-time jobs in the construction and supplying industries, and in some sectors of manufacturing industry. These are far more likely to be filled by workers on the register, and at present claiming benefit. This will help ensure that the increase in employment is balanced between full-time and part-time jobs, and hence has a more direct impact on the unemployment register than the existing pattern of employment growth is having.

6.32 The TUC estimates that these measures will create 800,000 jobs over two years, rising to 825,000 if part of a co-ordinated expansion. Taking a balanced view of the number of jobs filled by the unregistered unemployed means that the impact on the register will be 550,000 if no further measures are taken in the second year with a domestic expansion, rising to 580,000 with a co-ordinated expansion.

6.33 Jobs will be created directly on site in the construction industry, and for administrative, technical, professional and clerical workers. They will also be created in the supplying industries to construction.

6.34 There will be similar impact from a revival of manufacturing. The TUC estimates that 250,000 jobs will be created in manufacturing with jobs in supplying industries, from suppliers of capital equipment to component manufacturers; and also in the service industries supporting manufacturing, such as transport and the business service sector.

6.35 Jobs will be created in the education services, both for teachers and non-teaching staffs, by restoring the cuts made since

1979; by increasing provision for the under 5s and for the over 16s; and by reducing class sizes and developing what is taught further. Jobs will also be created in the health and social services.

6.36 Jobs will also be sustained and created as those coming back into work are able to afford goods and services, providing continued employment in the private service sector industries such as retailing. The TUC's proposals will transfer income from the better off to the poor, who are less likely to buy imported consumer durables; and increase demand for UK products rather than foreign manufactures.

6.37 The TUC believes that the economic arithmetic shows that a *first* year expansion along the lines set out in this submission would, over two years, reduce registered unemployment by well over half a million. This is a substantial contribution to the reduction of registered unemployment by 1 million within the MTES. The MTES target will be achieved by continued expansion in the 1988 Budget; by introducing special employment and training measures; and by the TUC's supply side measures to regenerate British industry.

PAGE PROOF

National Economic Assessment

6.38 The TUC is fully aware of the dangers and pitfalls, unlike the Chancellor's rosy view of the world. The balance of payments deficit is an area of concern, and is a problem which must be acknowledged. But it is a problem which can and will be overcome if there is the national will to take the concerted action needed. This is unlikely without a change of Government given that the agreement on priorities in the use of resources entails a close working partnership between the government and industry in which the trade unions would play an indispensible part. This is incorporated in the plans of the TUC and the Labour Party for a National Economic Summit leading to a National Economic Assessment which would set out the creation and use of resources between public and private investment, public and private consumption and the balance of payments. It would need to spell this out in three categories namely output, incomes and expenditure, and including the relationship of these to the level of inflation.

6.39 Nevertheless the nation, and above all the unemployed, cannot wait for a General Election. This is a programme for immediate action, by Government in the Budget, but also by

industry to boost investment and exports and cut the UK's massive import bill. The TUC will be exploring all practical opportunities to boost the nation's economic and industrial performance in the weeks and months ahead.

4.00 pm?

C/ Wednesday 3 December is when you saw these people last year. With reference to x the Diary is clearer on Wednes. 9 December. Julie 3/8.

The Scotch Whisky Association

Limited Liability
Registered in Scotland No. 35148
TEL: 031-229 4383
TELEX: 727626
FAX No. 031-229 1989

20 ATHOLL CRESCENT · EDINBURGH EH3 8HF
REGISTERED OFFICE

HFOB/KPT/RCE

30th July 1987

C/ You saw these people last year with FST and PMG.

What date? OK

Diary can accomodate. Accept / Regrets? Julie 31/7.

The Rt Hon Nigel Lawson PC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1P 3AG

Dear Chancellor,

You have been kind enough each year to see a small delegation from my Council prior to your Budget and we would be very grateful if you could please agree to do so again this year.

I appreciate it may seem a touch early to fix a date but, knowing how diaries fill up, we wondered whether the week 7th-11th December might be convenient from your point of view. At the moment, our delegation can manage any day that week but we would have a preference for either 9th or 10th if either of those should be suitable to you.

If you should be agreeable to meeting us in December, nearer the time I shall send you our usual report on the various matters concerning the taxation of Scotch Whisky which we would hope to discuss with you.

Our delegation is likely to be the same as last year, namely Mr John Macphail, the Chairman of the Association; Mr David Connell, the Vice Chairman; Mr Ivan Straker, the Chairman of our Public Affairs Committee; Professor Donald MacKay, our Economic Adviser and myself but I shall also confirm this nearer the time.

With kind regards,

Yours sincerely

Bill Bewsher

H F O Bewsher
Director General

mjd 5/68J

MEMBERS OF SCOTCH WHISKY ASSOCIATION DELEGATION

Colonel Bewsher	-	Director General of SWA
Mr McPhail	-	Chairman of SWA, Chairman of Highland Distilleries Group, Chairman of Robertson and Baxter, Chairman of Northern British Distillery Company Limited.
Mr Connell	-	Vice-Chairman of SWA, Regional Marketing Director (International) of United Distillers plc.
Mr Straker	-	Chairman of SWA Public Affairs committee, Chairman of Seagram Distillers plc.
Professor MacKay	-	SWA, Financial Adviser, Free-lance Financial Consultant.

The Private Members bill on Scotch Whisky on Friday received its Second Reading and has now gone into Standing Committee.

Highland Distilleries Group - Famous Grouse
Cutty Sark
Lang

United Distillers PLC - Johnny Walker, ~~Black~~ White Horse
Crawfords, Dewers.

Seagram Distillers PLC. - Chivers Regal
Glenlivet, Queen Ann.

5320/022/NJ

FROM: MISS S WALLIS

DATE: 3 September 1987

1 MRS BURNHAMS
2 MCU
3. FST

cc PS/Chancellor
PS/CST
PS/EST
PS/Paymaster General
Mr A Wilson
PS/IR
Mr P Crabb

BUDGET DEPUTATION: THE ASSOCIATION OF CORPORATE TREASURERS

The Association of Corporate Treasurers have sent in a memorandum setting out their ideas for next years Budget, and are asking for an opportunity to discuss them with the Inland Revenue or Treasury Officials.

The Inland Revenue would be happy to meet with them. I attach a reply reflecting this point.

Suzanne Wallis
MISS S WALLIS

5320/022/NJ

Treasury Chambers, Parliament Street, SW1P 3AG

D G Jones Esq
Chairman - Technical Committee
The Association of Corporate Treasurers
Redland PLC
Redland House
Reigate
Surrey RH2 OSJ

September 1987

Thank you for your letter of 3 August which enclosed a memorandum setting out your Budget representations.

Inland Revenue officials would be pleased to meet with you and they will be in touch to arrange a suitable time.

NORMAN LAMONT

The Association of Corporate Treasurers

16 PARK CRESCENT REGENTS PARK LONDON W1N 3PA

Telephone 01-631 1991

3rd August 1987

DGJ/cg

Please reply to:

Redland PLC,
Redland House,
Reigate,
Surrey RH2 0SJ

Tel: 0737 242488

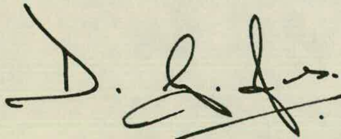
The Rt. Hon. N. Lamont, M.P.,
The Treasury,
Parliament Street,
London SW1

Dear Mr. Lamont,

On behalf of the Association of Corporate Treasurers, I am enclosing a copy of a memorandum indicating ideas the Association would wish to see included in the 1988 Finance Act. I have sent a copy of this to the Board of the Inland Revenue.

The Association would like to request a meeting with the Inland Revenue or your officials to discuss the content of this memorandum.

Yours sincerely,



D.G. Jones
Chairman - Technical Committee

Finance Bill Representation

HM TREASURY - MCU	
RECD.	10 AUG 1987
ACTION	IR
	cc Miss Sinclair FP.
SIGNATURE	FST
REF. No.	23200/87

enc

cc R. Plastow - A.C.T.
The Board of the Inland Revenue

A Company Limited by Guarantee in England under No. 1445322 at the above address

ASSOCIATION BUDGET SUBMISSIONS 1988

Corporate treasurers raise finance and manage investment and risk for their companies. Our main risk management functions are foreign exchange exposure, interest rate risk and maintaining corporate liquidity. The Association of Corporate Treasurers takes this opportunity, in advance of the 1988 budget, to make its submissions.

Foreign Exchange Gains and Losses

This is a particularly important area of the corporate treasurer's activity and one where the tax law is very unsatisfactory. The Association has previously made representations to the Treasury on this matter and is participating in further discussions to find an equitable solution to a longstanding problem.

Foreign Dividends

Many countries now have a tax rate higher than the U.K. U.K. companies are taxed on foreign dividends on a source by source basis. They may therefore be deterred from paying dividends from overseas subsidiaries because of the loss of double tax relief. We therefore repeat our submission that an overall limit be substituted such that excess double tax relief arising from such sources can be used as a credit against tax on dividends received from countries with a lower tax rate. Alternatively we would like assurances that the 'mixing' of income through intermediate foreign holding companies will not be blocked by interpretation of the controlled foreign corporation legislation.

Tax Rulings

Corporate treasurers frequently face uncertainty in the tax consequences of the transactions they undertake. This has become particularly significant with the development in recent years of increasingly sophisticated financial instruments. We believe there is a need for a system of binding rulings so that the tax effect of innovative transactions can be cleared with the Revenue in advance of their being undertaken.

Index Linked Bonds

Companies are permitted to issue index linked bonds. The inflation element is not tax deductible for the borrower. Normally both the inflation element of interest as well as the real rate is tax deductible. We suggest an annual tax deduction based on the retail price index should be given for the inflation element of the capital appreciation of index linked bonds. The present tax treatment for lenders should remain unaltered.

Withholding Tax

The application of withholding tax rules favours the raising of finance through banks rather than directly. Efficient fund raising requires that borrowers and investors are matched on an even handed basis. Withholding tax is a significant technical obstruction to the development of the corporate debt marekt. For example, a company contemplating a public debt issue has two choices:

- To make a domestic issue with withholding tax; or
- To make a Euro issue with no withholding tax.

If the company wants to issue in the domestic market then the application of the withholding tax rules will exclude foreign lenders (unless they can recover the withholding tax and even then they are usually unwilling to invest). The Association would welcome the opportunity to discuss with the Treasury how this issue can be resolved in such a way as to ensure that there would be no leakage of revenue.

Interest Rate Swaps

The incidental costs of swaps are not tax deductible although receipts and payments on the swaps themselves are. Such incidental costs do not fall within the Revenue's definition of the incidental costs of raising finance. The U.K. is unique amongst major countries for this tax treatment of incidental costs of swaps. We suggest tht suitable legislation is introduced to enable such costs to be deductible.

The legislation favours the arrangement of swaps through banks. Swap transactions between companies should be possible on an equal basis.

Interest Rate Instruemnts

A number of interest rate management techniques have been made available in recent years. These techniques enable treasurers better to control the risk their companies face from volatile interest rates. These instruments and agreements are generally for compensation to be paid or received related to interest rate movements. They have the effect of either fixing the future cost of a borrowing or the income on a deposit or to ensure that it does not exceed or fall below a particular rate. For technical reasons, the cost of these instruments does not generally qualify for a tax deduction. For example, they may not qualify as 'incidental costs of raising finance' under Section 38, Finance Act 1980.

The Association submits that where costs of interest rate management are incurred wholly and exclusively for the purpose of a trade, they should be allowed as a trading expense of a trading company and that they should also be allowable as a management expense of an investment company.

20th July 1987

3318/010/AC

FROM: MRS T C BURNHAMS
DATE: 24 September 1987

1. MISS EVANS
2. MISS SINCLAIR
3. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Scholar
Mr Culpin
PS/IR
Mr D Draper - IR
PS/C & E
Mr R Allen - C & E

BUDGET DEPUTATIONS AND REPRESENTATIONS

This submission seeks your agreement to guidelines for the handling of deputations and representations for the coming Budget.

BUDGET DEPUTATIONS

2. In recent years the practice has been to accept requests from those major representative bodies on a "core list" approved by Ministers. In addition, the former Financial Secretary proposed in 1985 that representative bodies from small businesses, the motor industry or petrol consumers, and the oil industry should generally be seen. Other requests for meetings have been turned down unless they were from an MP or there was another specific reason for the meeting. Annex A sets out last year's core list, and Annex B shows the bodies whose requests for a meeting were accepted.

3. Sir Peter Middleton enquired last year whether you and other Treasury Ministers were receiving more and more deputations in successive years. The table at Annex C shows that that has not been the case. We are therefore suggesting that you follow broadly last year's practice on this. Annex B shows that 29 bodies were seen before the 1987 Budget. These include

at least one representative of small businesses and the motor industry or petrol consumers. The list does not include a number of other bodies seen (mostly over lunch) which were not strictly Budget deputations, including some from the oil industry.

4. For the coming Budget round, we propose that requests from bodies on the core list - omitting the TUC and CBI if the Treasury's proposals for the January NEDC meeting are agreed - should be accepted. We would be grateful to know whether we should continue to assume that, subject to the merit of the individual case and the number of other approaches from similar bodies, representative bodies from small businesses, the motor industry or petrol consumers, and the oil industry will generally be seen; requests will also be accepted where an MP asks to bring a representative association; and that other requests be turned down, unless there is a specific reason for agreeing. The aim should be to see all deputations in time to allow a clear month before Budget day.

5. I attach at Annex D the standard format for briefing for meetings with Budget deputations. If you agree this format will continue. We will make a special effort to keep briefing as short as possible, seeking guidance from Private Secretaries on any supplementary briefing which may be needed (as agreed in exchanges we had with Private Offices earlier this year).

BUDGET REPRESENTATIONS

6. As last year, we propose that members of the public should receive an acknowledgment sent by FP. In response to letters requiring a Ministerial reply (eg from MPs), FP will provide a standard reply to be sent by the appropriate Minister. I attach at Annex D suggested all-purpose replies for Ministers, Private Secretaries and officials which follow those issued last year. There will, of course, always be some representations which need a non-standard response and these we will continue to provide as appropriate. But we hope that the vast majority of representations can receive a standard reply.

7. In the past there have been no arrangements for reporting to Treasury Ministers the contents of the correspondence from the public to which we will be sending standard acknowledgments. We propose to remedy this this year, and to let you have a short monthly summary of this correspondence, from December onwards. Last year 1300 representations were received: this was not heavy by comparison with, say 1985. The summary we can supply will of necessity be very brief. As previously, in conjunction with the Revenue Departments, we will provide a more detailed analysis of the main points made in representations from the more important organisations.

8. We will liaise with Private Offices to try to spread out meetings more evenly in the pre-Budget period. However, the timing of meetings largely depends on the receipt of Budget submissions and some degree of bunching in January/February is probably unavoidable.

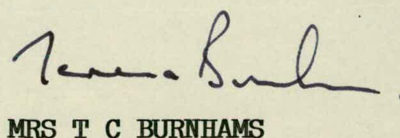
CONCLUSION

9. We would be grateful to know if you are content:

(a) that we should handle requests for meetings with Budget deputations as proposed in paragraph 4 above;

(b) that briefing for such meetings should be in the standard format used last year (paragraph 5);

(c) that written Budget representations should receive one of the standard acknowledgments set out in Annex D, unless it is clearly inappropriate, in which case an individual response will be drafted.



MRS T C BURNHAMS

3318/013/AC

ANNEX A

CORE LIST OF REPRESENTATIVE BODIES

(Confederation of British Industry) *

(Trades Union Congress) *

Association of British Chambers of Commerce

Institute of Directors

Country Landowners Association

Scotch Whisky Association

Tobacco Advisory Council

Brewers Society

* subject to decision on NEDC pre Budget meeting

ANNEX B

BUDGET DEPUTATIONS IN THE RUN UP TO THE 1987 BUDGET

Country Landowners Association 29.9.86 FST

Landowners Group 15/10/86 FST

Scotch Whisky Association 3/12/86 CHX, MST, FST

Food and Drink Federation 4/12/86 MST

Scottish Landowners Federation 9/12/86 FST

Confederation of British Industry 9/12/86 CHX, CST, FST, EST

Managerial, Professional and Staff
Liaison Group 15/12/86 FST

Small Businesses Committee 17/12/86 FST

British Venture Capital Association 19/12/86 FST

Society of Conservative Accountants 6/1/87 FST

Automobile Association 13/1/87 CHX, MST

The Jockey Club 20/1/87 MST

CBI Smaller Firms Council 21/1/87 FST

The Union of Independent Companies 22/1/87 FST

Jim Lester MP and Tobacco Industries 22/1/87 MST

Conservative Small Firm Committee 28/1/87 FST

Institute of Directors 29/1/87 CHX, FST, EST, MST

Tobacco Advisory Council 3/2/87 CHX, MST

National Union of Licensed Victuallers 4/2/87 CHX, MST

The Wines and Spirit Association of
Great Britain and Northern Ireland 5/2/87 MST

Brewers' Society 6/2/87 CHX, MST

British Greyhound Racing Board 10/2/87 MST

Society of Motor Manufacturers and Traders 11/2/87 MST

Scottish Conservative Back Bench Committee 11/2/87 MST

Trades Union Congress (TUC) 19/2/87 CHX, CST, FST, MST

Institute of Chartered Accountants in
England and Wales 24/2/87 FST

Unquoted Companies 24/2/87 FST

Freight Transport Association 26/2/87 MST

UK Offshore Operators Association Ltd 26/2/87 FST

The Association of the British Chambers of Commerce 4/3/87 CST

ANNEX C

BUDGET DEPUTATIONS - 1983-1987

MINISTER	CH/EX	CST	FST	EST	MST	TOTAL*
1983	7	4	8	8	4	28
1984	8	5	11	3	16	37
1985	6	2	2	-	13	22
1986	8	3	15	1	15	30
1987	8	3	16	2	14	29

* More than one Minister met same deputations

3100/05/sh

ANNEX D

BUDGET DEPUTATIONS: STANDARD BRIEFING FORMAT

Paragraph 1	Organisation. Description of Membership (where necessary). Brief biographical details of representatives attending meetings.
Paragraph 2	Object of meeting (either major body seen as a matter of course or being seen for some specific reason).
Paragraph 3	Summary of organisation's written representations.
Paragraph 4	Points likely to be raised together with a few lines of comment.
Paragraph 5	Any points that Ministers should put to the organisation.

ANNEX E

BUDGET REPRESENTATIONS: STANDARD ACKNOWLEDGEMENT

1 **MINISTERIAL**

a Thank you for your letter of [date] enclosing correspondence from [name and address].
I can assure you that [name] representations will be carefully considered in the run-up to the Budget. However, I hope you will understand that I cannot comment further at this stage.

[Minister's name]

b Thank you for your letter of [date] enclosing representations for the Budget from the [name of organisation].
I can assure you that your representations will be carefully considered in the run-up to the Budget. However, I hope you will understand that I cannot comment further at this stage.

[Minister's name]

2 **PRIVATE SECRETARY AND OFFICIAL**

The [Minister] has asked me to thank you for your letter of [date].
I can assure you that your comments will be carefully considered in the run-up to the Budget. However, I hope you will understand that it would be inappropriate to offer further comments at this stage.
Thank you for taking the trouble to write.

[Name]
[Private Secretary]

C/ Delegation from Scotch Whisky Association

I have moved this from 9 December because it clashed with TCSC Hearing.

4.00pm on Monday 14 December seem to be convenient for SWA FST & EST.

Are you content?

OK ✓ Julie 26/11.

OK

Jonathan.

Mr Cropper wants to come to the Scotch Whisky Ass. meeting on 9 Dec.

OK?

Julie
11/11.

MR 5/2

UNCLASSIFIED

BF2/12

FROM: MRS J THORPE
DATE: 30 September 1987

MR G McKENZIE

cc: PS/CST
PS/FST
PS/PMG
PS/EST
Sir P Middleton
Mr Scholar
Miss Sinclair
PS/C&E
PS/IR

BUDGET REPRESENTATIONS: THE SCOTCH WHISKEY ASSOCIATION

The Chancellor, the Financial Secretary and the Paymaster General will be meeting a delegation from the Scotch Whiskey Association, as they did last year, on Wednesday 9 December at 4.00 pm in HM Treasury about their Budget representations.

2. I would be grateful if you could coordinate briefing to arrive in this office by close of play on Monday 7 December.

Sir T. Burns + Mr Culpin (- Mr Allen) will also be present.

julie thorpe

MRS J THORPE
Diary Secretary

Activity Sports & Toys

Tube Plastics Limited
Severn Road . Stourport-on-Severn
Worcestershire DY13 9EX

Telephone: 02993 4516
Telex: 336559 TPTOYS

5th. October, 1987

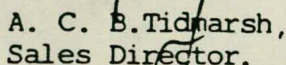
Mr. Peter Brooke,
H.M. Treasury,
London.

Imagine our distress and even anger when we find that the Inland Revenue, who have absolutely no knowledge of profit sharing schemes, are dictating how our scheme must work. Whilst, in theory, we could scrap our schemes (we have four different ones for different sections of our work force) and institute a revenue designed one, it would be such a retrograde step we would have to actually increase many staff members' basic salaries to compensate them, and this we would not wish to do. However, we all feel that providing schemes are fair and fixed in advance and are certified as such by the auditors, companies should be permitted to keep existing schemes and even devise their own. You stress in your leaflet the advantages of flexibility and so surely should not be introducing a straight-jacket in this area.

It is a great shame that a wonderful idea that could help transform attitudes in industry should be crippled by the Revenue's insistence on how the idea should be put into practice.

Should you need details of our schemes, examples of its effects on our wage costs over the years etc., we would be very glad to provide them.

Yours sincerely,
for TUBE PLASTICS LIMITED,



A. C. B.Tidmarsh,
Sales Director.

ps2/10R

UNCLASSIFIED

FROM: CATHY RYDING
DATE: 6 October 1987

MRS T C BURNHAMS

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Scholar
Mr Culpin
Miss Sinclair
Miss C Evans

PS/IR
Mr D Draper - IR
PS/C&E
Mr R Allen - C&E

BUDGET DEPUTATIONS AND REPRESENTATIONS

The Chancellor was grateful for your minute of 24 September.

2. The Chancellor is content with the proposals in paragraph 9, and also with the helpful suggestion in paragraph 7 that you will let him have a short monthly summary of correspondence from the public.

CR

CATHY RYDING

839/131/AC

FROM: MISS WALLIS

DATE: 6 October 1987

1. MISS EVANS 6/10

2. MCU

3. FINANCIAL SECRETARY

cc PS/CHANCELLOR 12/2
PS/CST
PS/EST
PS/PAYMASTER GENERAL
MISS SINCLAIR
PS/IR

BUDGET DEPUTATION : TONY SPELLER MP

Tony Speller's letter of 3 September to the Chancellor enclosed a letter from the National Federation of Retail Newsagents seeking an opportunity to discuss with Ministers the Federation's proposals for the 1988 Budget.

2. The letter explains that the Federation wish to reiterate their proposal to extend capital gains retirement relief for the self employed, which was included in their representations for the 1987 Budget, (copy attached).

3. The National Federation of Retail Newsagents are not on the "core list" of organisations that Ministers meet as a matter of course. But we understand that Tony Speller will be leading the delegation. On that basis, we suggest that you accept the National Federation's request for a meeting.

4. The Revenue agree.

5. I attach a draft reply.

S Wallis

MISS S WALLIS

839/127/AC

Treasury Chambers, Parliament Street, SW1P 3AG

Tony Speller Esq MP
House of Commons
LONDON
SW1A 0AA

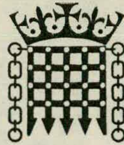
October 1987

Thank you for your letter of 3 September enclosing representations from Mr K L J Peters of the National Federation of Retail Newsagents.

I would be delighted to meet you and a delegation from the National Federation of Retail Newsagents. I have asked my office to be in touch with you to arrange this.

NORMAN LAMONT

From: Tony Speller, M.P. for North Devon



01- 219 4589

HOUSE OF COMMONS
LONDON SW1A 0AA

TS/87/573

3rd September 1987

Dear Nigel

? Nothing to do with attached letter

Sale of Cigarettes and Tobacco to Persons under the Age of Sixteen

I have been asked by my friends at the National Federation of Retail Newsagents, for whom I am Hon Parliamentary Adviser, to pass the enclosed letter to you personally.

Yours ever
Tony

Rt Hon Nigel Lawson MP
The Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG

147 CST
HM TREASURY – MCU
REC'D. - 4 SEP 1987
ACTION IR
SIGNATURE FST
REF No. 24231/87

National Federation of Retail Newsagents

Representing the Trade in England, Scotland, Wales and Ireland

Member International Distributors of the Press

HEAD OFFICE: YEOMAN HOUSE, SEKFORDE STREET,
CLERKENWELL GREEN, LONDON EC1R OHD.
Telephone: 01-253 4225 (6 lines)

24th August, 1987

The Rt.Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
The Treasury,
Parliament Street,
London, SW1P 3AG.

Dear Minister,

I have previously written to you on the subject of relief to the self-employed on retirement in the hope that the circumstances as set out in my letter of 29th January 1987 might have been incorporated in the last Budget.

I received a reply from Mr. Norman Lamont advising that the representations to re-introduce a sliding scale in respect of the application of Capital Gains Tax to seek to assist the self-employed who wish to retire before the age of 60, but would not wish so to do on the grounds of ill-health, would be given consideration.

It is recognised that the timing of the representation was rather close upon the Budget, bearing in mind all that has to be considered. We should therefore like to re-open this matter at the earliest possible date, with a view to changes being introduced in the 1988 Budget.

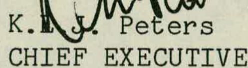
To this end, members of our Parliamentary Committee of which I am one, totalling four in number, are seeking a meeting with you so that we may put forward proposals in regard to the self-employed, whereby an individual may receive the amount of relief available in respect of gains accrued to him on the sale of his business at the age of 55 years or alternatively, that a sliding scale from the age of 55 to 60 be introduced whereby the self-employed may benefit to an increasing degree in respect of relief on Capital Gains Tax on the sale of their business commencing at age 55, and increasing to the maximum figure relevant at age 60.

We are aware that, in respect of pensions for the self-employed, the Finance Bill 1987 No. 2, provides for increased relief on contributions to individual pension schemes and that these are age-related. We feel that this has a relationship to that which we are seeking.

We look forward to a meeting with you.

Yours sincerely,

K.E.J. Peters
CHIEF EXECUTIVE



Treasury Chambers, Parliament Street, SW1P 3AG

K E J Peters Esq
The National Federation of Retail Newsagents
Yeoman House
Sekforde Street
Clerkenwell Green
London
EC1R OHD

26 February 1987

Dear Mr Peters

Thank you for your letter of 29 January to The Chancellor of the Exchequer enclosing representations for the Budget from The National Federation of Retail Newsagents.

I can assure you that your representations will be carefully considered in the run-up to the Budget. However, I hope you will understand that I cannot comment further at this stage.

Yours sincerely

Norman Lamont

NORMAN LAMONT

National Federation of Retail Newsagents

Representing the Trade in England, Scotland, Wales and Ireland

Member International Distributors of the Press

HEAD OFFICE: YEOMAN HOUSE, SEKFORDE STREET,
CLERKENWELL GREEN, LONDON EC1R 0HD
Telephone: 01-253 4225 (6 lines)

HM TREASURY – MCU
REC'D. - 2 FEB 1987
ACTION
SIGNATURE EST
1/531/87

29th January, 1987

The Rt.Hon. Nigel Lawson M.P.,
Chancellor of the Exchequer,
Treasury,
Parliament Street,
London, SW1P 3AG.

Dear Minister,

At the Annual Conference of this organisation which represents over 31,000 independent retail newsagents, a Resolution was passed, the effect of which was to seek to assist the self-employed on their retirement and the sale of their businesses, by substituting the age of 60 with the age of 55 to enable an individual to receive the amount of relief presently available in respect of gains accruing to him at 60, on the sale of his business at the age of 55 years in respect of Capital Gains Tax.

We are well aware that the Government, in amendments made in the 1985 Act, reduced the age from 65 to 60 at which point persons who fell within the scope of Sections 69 and 70 and Schedule 20 to the Finance Act 1985, would be entitled to the maximum relief on gains of £100,000 and agree that this concession was significant. Prior to that, of course, there was a sliding scale from 60 up to 65 whereby providing the persons had satisfied the requirements, they might benefit to an increasing degree in respect of relief on Capital Gains Tax up to the maximum figure at age 65.

In making this approach to you to reconsider the circumstances as they apply to the self-employed, and here we are not speaking purely of retail newsagents but any small independent business which we believe the Government recognises as being so essential to our economy, we ask that if the present qualifying age for the concessions as they stand cannot be reduced to 55 years of age, that careful consideration is given to re-introducing a sliding scale, as existed before, whereby self-employed persons who meet the requirements as presently set out, may benefit from tax reliefs on C.T.G. to the extent say, of £20,000 at 55, the amount increasing year-by-year until the figure of £100,000 is applicable at age 60.

I believe that to achieve such a change would require amending Section 69, 70 and Schedule 20 of the Finance Act, and one is aware that, as Chancellor, you have to consider the costs of the tax concessions being proposed to you in this letter in respect of the Exchequer.

However, we do feel that with the increasing trend to the general lowering of retirement age, our proposal is worthy of consideration and quite apart from this fact, we are aware that the Government has been giving some thought

..../2

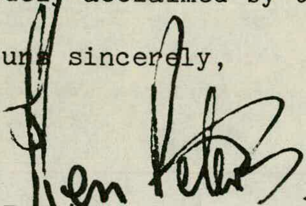
General Secretary K.E.J. PETERS *Administrative Secretary* E.D. McKINNEY *Commercial Secretary* D.G. CHERRY

to a joint retirement age, male and female, of 62/63 years. We do not wish to become involved in that area of discussion but, with the increasing trend to earlier retirement and the fact that the proposal made above would in many cases encourage early retirement, which in turn would create more opportunities for employment for others, we believe that the proposal has much merit and also would restore a degree of flexibility so that those who are obliged to retire, not necessarily through ill-health, because circumstances dictate that they have to sell their business within a year or so of their 60th birthday, already experience sufficient difficulties, particularly financial, that they should be relieved of, or at least in some degree, the burden of Capital Gains Tax.

I hope that this proposal will be given serious consideration and whilst realising that it is close to the time when decisions are made in respect of the 1987 Budget, there is still time for a decision in line with that which we propose here, to be announced in the Budget even although the necessary amending legislation would have to follow that announcement.

I can assure you, Minister, that such a decision on your part would be widely acclaimed by the independent business community.

Yours sincerely,



K.E.J. Peters
GENERAL SECRETARY

Confederation of British Industry
Centre Point
103 New Oxford Street
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Telephone 01-379 7400
Telex 21332
Facsimile 01-240 1578

Director-General
John M M Banham

Secretary
Maurice Hunt

CBI

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London SW1P 3AG

9 October 1987

Our Ref - 10/05

Dear Chancellor

Technical Budget Representations 1988

I have pleasure in enclosing our Technical Representations for the 1988 Budget.

In line with our aim of promoting the international competitiveness of British business these Representations have been drafted and assembled under the main theme headings of "Competitiveness" and "Burdens on Business". They comprise suggestions for dealing with aspects of the UK tax system which hinder British firms in competition with foreign businesses and for removing identified restraints on enterprise and employee participation. They also identify areas where unnecessary and onerous compliance and administrative burdens are imposed on business by the UK tax legislation, and where the tax system is out of line with the realities of modern commercial life. In addition we comment on the tax legislative process itself.

In order to assist you in your Budget planning we are forwarding these Representations for your early consideration. Copies are being sent to your colleagues at the Treasury and also to officials at the Inland Revenue and at H M Customs and Excise.

We would be very pleased to discuss these Representations with you or your colleagues and to learn of any comments you may have on our suggestions.

Yours sincerely

Alan Willingale

A E Willingale
Chairman
Taxation Committee

Encl.

BR
HM TREASURY – MCU
RECD. 13 OCT 1987
ACTION Mrs Burnhams FP
cc. CHX, CST, FST, PMG, EST, Sir P Middleton, Sir T Burns, Mr Cassell, Mr Monck, Mr Scholar, Mr Culpin, Miss Sinclair, PS/IR, PS/CE
CHX
25686/87

CBI CONFEDERATION OF BRITISH INDUSTRY

TECHNICAL BUDGET REPRESENTATIONS 1988

Confederation of British Industry
Centre Point
103 New Oxford Street
London
WC1A 1DU

October 1987

£5.00

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CBI TECHNICAL BUDGET REPRESENTATIONS 1988

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CONFEDERATION OF BRITISH INDUSTRY

TECHNICAL BUDGET REPRESENTATIONS 1988

INTRODUCTION

In September this year the CBI's ruling Council adopted a new strategy document entitled "An Era of Investment". It identified three main elements in the CBI's mission to promote the long-run international competitiveness of British business:-

* Minimising the direct and indirect costs imposed on business decisions by central or local government or the EEC Commission.

* Promoting policies to secure a strong and internationally competitive industrial base to complement strengths within other sectors of the economy and

* Seeking to remove those competitive handicaps which are outside the control of individual businesses.

In these Technical Budget Representations this year we follow up the themes of **Competitiveness** and **Burdens on Business** as they relate to taxation.

Within these themes there are new representations but we make no apology for repeating many previous items as we regard them as crucial if we are to encourage change and prevent loss of the UK's share of world markets.

There are many other items which we raised in previous years which are still relevant, but they have not been specifically referred to this year in the interest of reducing the size of the document to more manageable proportions for discussion with government. We may return to these items in detail in future years, and they therefore remain on the table. Similarly, in the interests of brevity we have omitted some of the points which we raised in respect of the two 1987 Finance Acts. Here again, these points are not withdrawn and we may return to them later.

We have added to this document in Appendix I a supplementary list of items which we would also like to discuss if time permits. A further Appendix (II) identifies a number of very important matters which do not otherwise appear in the document because they are each the subject of separate representations to government.

TAX LEGISLATION - GENERAL ISSUES

Reforms of Legislative Procedures

We recognise the difficulty of fitting all our suggested changes into a typically overcrowded Budget programme. We therefore urge a review of the procedures involved in tax legislation to avoid the problem of having to deal with so much new material over such a short period as the existing Parliamentary timetable imposes.

We have ourselves suggested in the past that a separate Technical Taxation Bill should be introduced from time to time to deal with the anomalies and inconsistencies with which the present tax laws are riddled. We are pleased to note that the idea of a separate Technical Taxation Bill together with wider reforms of the legislative process to give more time for the consideration of technical matters has received welcome support from Members of Parliament in recent Finance Bill debates[1]. Such reform would go a long way towards preventing the hurried passing of ill-considered tax legislation.

Subordinate Legislation

In the case of subordinate legislation we mentioned last year that evaluation of the Finance Bill was made more difficult by the inclusion of a number of enabling clauses leaving the details to be covered by regulations. The effect was that for the debates on the Bill itself Parliamentary scrutiny and business comment could not be based on the total package of legislation on the relevant topics since that was not available. This meant that the compliance burden on business was uncertain for two reasons, first, in that what the government had in mind was only partly known and second because, without the necessity of any further Parliamentary debate, the rules could at some future date be changed merely by administrative action.

We find it unfortunate that despite all the criticisms last year the same procedure was adopted this year. We therefore repeat our request that where it is proposed to produce a new regime of taxation in particular areas, subordinate legislation should not be used to make substantive changes in the law but should be strictly confined to administrative matters. Additionally, it would be helpful if the whole package of relevant legislation, draft clauses and draft regulations, could be made available at or before the date on which the Bill is published, on the understanding that the regulations might need to be amended in the light of the Finance Bill debates. Experience has shown that since scrutiny of subordinate legislation is severely constrained, the debates on the Bill provide the only opportunity for real discussion in Parliament.

---

[1] See the comments of Tim Smith MP, Hansard 20 July 1987 Columns 74 and 75.

We reiterate our eagerness to participate with Parliament, officials and other interested parties, in a general review of the legislative process on tax matters.

Retrospective Legislation

The CBI deplores in the strongest possible terms the principle of taxation by retrospective legislation. We therefore are very alarmed that this iniquitous process should have reared its head again in 1987, the more so in the light of the extensive debates on this topic during the Finance Bill 1978.

We must make clear at once that we, like other commentators, distinguish between legislation that is for the relief of the taxpayer and legislation that is for the burdening of the taxpayer. We quote from Hansard Standing Committee A, 6 June 1978 Column 703:-

"There is not the slightest objection, and there never has been, to this House taking steps to relieve the subject of what might otherwise have been the consequences of past Acts. What is objectionable is that the power of legislation is used to add burdens or to introduce criminality in respect of past events and to alter retrospectively to the disadvantage of the subject affected the law prevailing at the particular past time."

There are three points we wish to stress.

First, during those debates retrospective legislation in this sense was described as an affront to the rule of law and it was emphasised that a taxpayer is entitled to operate within the bounds of the law as he finds it at the time of his action.

Second, from the business viewpoint, also identified in the 1978 debate, retrospective legislation is undesirable because of the degree of uncertainty it introduces into business decisions.

Third, we have an objection relating to international tax principles. Section 63, F(No2)A 1987, overrode the provisions of a Double Taxation Agreement. This is objectionable in the international context as it tends to create a climate in which the overriding of the provisions of these Agreements would become internationally acceptable. As the UK has always vigorously opposed such action by other countries we should be doubly careful to ensure that we do not become offenders ourselves.

We therefore urge that the use of retrospective legislation in tax matters be halted. As was said in the 1987 Finance Bill debate:-

"....in no circumstances should we have an element of retrospection. If the Government or the Inland Revenue wish to change their minds, they should change the law, but they should not make the law retrospective...."[1]

COMPETITIVENESS

Government can influence the climate and environment in which business operates, and in this part of our paper we concentrate on aspects of taxation where Government can assist business to prosper by making necessary changes.

In identifying aspects of UK tax law which handicap UK business we have been concerned not so much with direct comparisons between the treatment of particular items in the UK and abroad, but with areas where we feel that, given the general structure of UK taxation and given the importance of international trade, the UK tax system hinders UK business in relation to that of its rivals.

This section covers two main areas: A. International Business and B. Corporate Finance.

A INTERNATIONAL BUSINESS

In previous years we have made the point that, for British businesses to function well in international markets and compete successfully as exporters, importers or traders overseas we need a taxation climate no less favourable than the best practice to be found abroad. So long as our competitors have tax advantages they will have an edge in the commercial market. We identified a number of areas last year where improvements could be made and this year we again draw attention to the following:-

---

[1] Hansard 16 July 1987 Column 1310, Sir William Clark MP

1 Pooling of Overseas Tax

Relief for foreign tax is often lost because the foreign tax on any particular source can only be set against the UK tax on that source in the same basis period. This increases costs and makes it difficult for UK companies, particularly construction and related companies, to secure internationally competitive contracts. This difficulty could be tempered if it were possible for such UK companies to pool overseas trading profits and the overseas taxation related thereto. We recommend that taxpayers should have the option of pooling foreign taxes from all trading sources each year and setting this against the aggregate UK tax on those sources.

Such pooling would not be a subsidy; it would merely even out tax payable by such companies, enabling them to secure overseas work, thus bringing foreign exchange and orders for plant and material to the UK. This would also accord with commercial reality in that companies generally carry on one business and are assessed on that basis.

We have set out this particular problem because it needs urgent attention but it is our opinion that the most satisfactory solution would be the pooling of foreign taxes from all sources.

2 Double Taxation Relief Available for Offset Against ACT

Where companies invest substantially abroad, incur large amounts of foreign tax on their income brought into the UK and have little or no mainstream corporation tax payable after double taxation relief, the main UK tax charge is the ACT on their dividends to shareholders. The failure to give double taxation relief against this ACT increases the total tax burden on the company and so inhibits investment overseas.

We propose that there should be complete set-off of DTR against ACT but leaving the tax credit and any payment thereof to the shareholder unaffected.

Failing this, we have two alternative proposals which are intended to let the benefit of DTR flow through the company to shareholders without causing the Revenue to repay more in tax credit than they receive in ACT:-

i Net UK Rate

To operate this the ACT would be calculated as at present on the dividend but the company could choose how much DTR to set against that ACT, only the residue being payable to the Revenue. This residual amount would then become the set-off against the company's liability to mainstream corporation tax.

The recipient of the dividend would receive the tax credit as at present and this would satisfy his basic rate tax liability. For repayment purposes, however, the credit would carry a net effective rate so that the amount of any tax repaid in respect of the dividend would not exceed the amount of ACT paid to the Revenue on that dividend.

ii Offset of Withholding Taxes

Under this proposal all withholding taxes on dividends received would be available for set-off against the ACT liability. The tax credit on dividends paid and any payment of that credit to the shareholder would not be affected.

3 Double Taxation Relief - Tax Paid by Foreign Legal Entities Deemed to be Partnerships

Where a foreign legal entity itself pays overseas tax but is deemed for purposes of UK taxation to be a partnership, UK double taxation relief will be denied to the UK parent of an overseas partner company because that partner has not itself paid the overseas tax.

We recommend that where a foreign legal entity is deemed for UK tax purposes to be a partnership, any overseas tax paid by that legal entity should be followed through to the partners and deemed to have been paid by them.

4 Double Taxation Relief - Payments from Abroad for Technical and Advisory Services

In general, double taxation relief is not available for the foreign tax charged on income from technical and advisory services where the source of those payments is regarded by the Revenue as being in the UK.

However, the justification for double tax relief in this area seems to be accepted by the Revenue but it appears to be being used as a bargaining counter in Tax Treaty negotiations. On this basis, unless double tax relief is given in a treaty it will not be given unilaterally. This is a rather narrow view, especially since it is based on a disputed theory of sourcing.

In most modern double taxation relief agreements the definition of "Royalties" is broad enough to encompass payments for technical and advisory services. The problem exists where there is no agreement or where an up-to-date treaty has not yet been negotiated. The effect is that when tendering for third party contracts in these circumstances it is necessary to gross up for the withholding tax, thus rendering the tender less competitive and risking the loss of the contract.

We recommend that the Revenue should reconsider the position.

5 Underlying Tax On Pre-Merger Profits

In certain overseas jurisdictions the concept of "merger" permits all the assets, liabilities and reserves of one company to be combined with those of another under a merger agreement; distributable profits retain their characteristic and are distributable by the surviving company.

Where a dividend is paid to a United Kingdom parent company by, for example, a United States company resulting from a merger and such dividend is derived from pre-merger profits transferred to the surviving company, the Inland Revenue practice is understood to be to deny double tax credit relief in respect of the underlying foreign tax paid on those profits. The argument is that the dividend in question is paid out of profits the tax on which has not been "borne by the corporate body paying the dividend" (Section 506, TA 1970) and that the extension of relief to dividends from second tier companies under Section 508 (2) is not permissible because the transfer of profits was not by way of "dividend".

This is a real problem for which legislation is the only solution. We have been informed of specific examples relating to companies in Belgium, Canada and South Africa as well as the United States.

The inequity could be solved by adding a fourth subparagraph to Section 506, TA 1970, as follows:-

> '(4) For the purposes of subsection (1) above, foreign tax borne on the relevant profits shall be deemed to have been paid by the company paying the dividend where the dividend is paid out of profits acquired in a merger'.

6 Capital Injected by way of Capital Contribution

Where a UK company has an existing US subsidiary which requires further capital it is an acceptable practice under US commercial law to inject this as a capital contribution without going through the formalities necessary for the issue of further shares. This is acceptable in the same way as equity capital for the US equivalent of UK solvency tests for insurance companies. It is a cheap and relatively simple way in which to inject capital.

However, on disposal of the shares in that subsidiary company the contributed capital is not regarded in UK law as part of the base cost of those shares for the purpose of calculating any capital gain because, under Section 32 (1) (b), CGTA 1979, it fails to rank as enhancement, not having been expenditure wholly and exclusively incurred on the shares. Hence, the contributed capital, which will be reflected in the value of the company and therefore of its shares on disposal, will suffer UK tax as a capital gain.

In the USA the tax code specifically allows voluntary capital contributions, made to a company by its shareholders pro-rata to their shareholdings, to be added to the base cost of the shares. The situation is similar to that of a further call on partly-paid shares.

We recommend that for the purposes of UK taxation the applicable foreign company law should determine whether a contribution is a capital or a revenue item. Where it is capital it should be regarded as part of the base cost of the shares in issue for the purposes of calculating any UK capital gain or loss on disposal.

7 Dual Resident Companies

Sections 63 and 64, F(No2)A 1987, impose limitations to prevent double group relief for losses and other reliefs in relation to investing companies which have dual residence.

Similar legislation is in preparation in the USA, where most of the dual resident companies are incorporated, and until the US regulations are published it will not be known whether there will be a mismatch between the rules in the UK and the USA.

We are anxious to ensure that the relevant reliefs remain available in at least one of the two jurisdictions.

We are also anxious that companies wishing to reorganise themselves or their group structures to comply with the new rules should be able to do so without attracting any additional tax burdens or restraints as a result of the operation of, for example, Sections 278 and 482, TA 1970.

8 Foreign Employees Working in the UK

The provisions in FA 1986 reflect only a small part of the problems facing foreign employees working in the UK. As well as the domestic and social upheaval of coming to work in the UK for a temporary period, there is unavoidable additional expenditure on housing and education. We regret that even the limited relief suggested by the Government in the Second Consultative Document issued by the Inland Revenue on 25th January 1985 has not been implemented and we urge further consideration of this matter.

We recommend that, in the case of short term employments in the UK - say, up to three years - there should be special relief for additional housing and education costs; in particular, the additional charge imposed by Section 33A, FA 1977, (where the cost of providing accommodation exceeds £75,000) should not apply.

We further recommend that Section 37(6), FA 1986, should be amended to cover three journeys per year in each direction and Section 37(10), FA 1986, should be amended to include any child aged 18 or over who is still undergoing full time education at a school or college.

There are other tax aspects of international employment not touched on in FA 1986, for example, the question of pension contributions. When a foreign national is seconded here from overseas and becomes an employee of a UK company within an international group he will most likely remain a member of the pension fund of the overseas company. In this circumstance he will be denied tax relief for his pension fund contributions and risks being taxed on contributions made on his behalf by his UK employer.

This is completely at variance with the treatment of the foreign national who, although working in the UK, remains employed by an overseas company. He will get relief for his pension contributions under Schedule 2, FA 1974, on the grounds that his contributions "correspond" with contributions to an approved fund in the UK.

We recommend that the same treatment should be accorded to the foreign national who is seconded to and employed by a UK company.

B CORPORATE FINANCE

Suitable financial arrangements are vital for satisfactory manufacturing and commercial operations, and for the winning of orders in the competitive world in which British business operates. In this regard there are areas of tax law which could sensibly be amended to remove unnecessary constraints on the free flow of funds.

The treatment for tax purposes of profits and losses arising from exchange rate fluctuations is a matter which we, together with a number of other representative bodies, are considering separately. We hope that legislation will be enacted at least to allow relief for exchange losses in respect of loans used to finance business.

All businesses require ready access to sources of funds and the ever-changing types of financial instruments available in international money markets. At present, UK tax law inhibits corporate treasurers from tapping these sources.

Our further suggested amendments to the tax legislation which would assist the making of suitable corporate financial arrangements are set out below.

1 Incidental Costs of Raising Capital

The old restriction on allowing tax relief on the incidental costs of obtaining finance by means of loans or the issue of loan stock, on the grounds that the expense was related to capital, was partly overcome by Section 38, FA 1980. This relief should now be extended to the incidental costs of raising all types of finance. We have in mind particularly equity and short term note issue programmes in the UK or elsewhere. The relevant fees etc. are expenses of the companies concerned in raising finance just as much as are the costs of raising longer term loan capital. There is no good reason for continuing to penalise these other forms of finance. Both loans and new equity capital may be provided by existing shareholders or from outside the company by new participators. This tax bias against equity capital should now be removed so that all the costs of raising finance are deductible. Lack of deductibility is a deterrent to raising more capital, thus leaving businesses under-capitalised. We also have in mind that the deductibility of the costs of raising capital is one of the considerations in choosing the method of financing, and consequently it can bring about distortions in capital markets.

2 Short Interest

The rules regarding the deductibility for tax purposes of interest are too restrictive to permit a free use of all the facilities available in present-day financial markets. For example, no deduction would appear to be available for short interest paid on funds borrowed for use on fixed capital projects, other than interest payable to a UK bank, discount house or member of a UK stock exchange. Also, in the case of investment companies and other non trading companies, short interest which is not payable to a UK bank, discount house or stock exchange is not allowable as a deduction, either as a charge on income or as an expense of management.

This can be unnecessarily restrictive to the activities of a parent company which is a true holding company and to financing subsidiaries and intermediate holding companies in a group. Also, it is frequently desirable that surplus funds in operating companies should be lent short-term to the holding company of the group or sub-group, but for the absence of tax relief. Furthermore, holding companies would like to issue sterling commercial paper at interest rather than at a discount but they are prevented from doing so by this legislative restriction. In view of the Government's encouragement of the issue of sterling commercial paper a restriction of this nature should be removed, and we would like to know what justification is advanced for its retention.

We recommend that subsection (3) of Section 248, TA 1970, should be amended to include as a charge on income all short interest payments which are not deductible in computing profits.

3 Group Income - Section 256 (3), TA 1970

Another hindrance to a group's management of its finances is Section 256 (3) which specifies that an election to pay interest without deduction of tax between group companies does not apply to interest received by a company on any investments if a profit on the sale of those investments would be treated as a trading receipt of that company. This makes more difficult the use of in-house finance companies which would otherwise be a valuable aid to efficient management of corporate finance.

We find it difficult to understand the reason for the existence of Section 256 (3), and if the Revenue still think that it should be retained we would like to know the mischief to which it is directed.

4 Stamp Duty - Intra-Group Transfers

As proposed in the consultative document "The Scope for Reforming Stamp Duties" issued by the Inland Revenue in March 1983, the 90 per cent ownership required to obtain relief from transfer duty for intra-group transfers should be reduced to 75 per cent to bring it into line with the normal corporation tax definition of a group rather than have yet another additional and arbitrary burden on business.

5 Deep Discount Securities

Since the introduction of legislation to deal with deep discount securities in Section 36, FA 1984, the use of these financial facilities has been disappointingly small. One reason for this is the inflexibility of the rules contained in Schedule 9, FA 1984, and in particular the requirement that these securities must be redeemable in a lump sum.

Partial redemption of a deep discount issue is not possible and therefore, in order to spread the burden of repayment evenly over a number of years, it is necessary to issue several deep discount securities each with a different issue price and redemption date. This multiplication of documents only adds to the administrative costs both for the taxpayer and the Inland Revenue.

This defect in the legislation could deter prospective borrowers. Amendments to remedy the rules would encourage the wider adoption of these new financial facilities to the benefit of the cash flow of many borrowers and of the London market.

BURDENS ON BUSINESS

It is the Government's declared aim to remove unnecessary restrictions and inhibitions on business activity so as to leave businesses free to get on with the job of making profits to create wealth for the country and enhance employment prospects.

In this section we have attempted to identify areas where unnecessary and onerous compliance and administrative burdens are imposed on business by tax legislation or where the tax system itself is out of line with the realities of modern commercial life.

A THE SCHEDULAR SYSTEM

Many of the cases where the British tax system imposes anomalies and unnecessary burdens on business arise from the continuance of the schedular system. The continued use of this system seems unnecessary wherever audited accounts are available and form the basis for the tax computation.

We have addressed ourselves to this subject on many occasions, notably in our reply to The Green Paper on Corporation Tax (CBI October 1982). What we advocate is legislation which will permit all bona fide business expenses to be deductible in computing business profits.

Typical items of expenditure which we have in mind are the costs of raising equity capital (already referred to earlier in our representations), the cost of abortive capital projects or feasibility studies, payments to terminate onerous contracts, relief for capital expenditure on intangibles such as franchises and publishing rights, and the business expenditure of investment and certain insurance companies which may at present fall foul of Section 304, TA 1970.

One important problem is that some expenditure, although clearly for legitimate business purposes, is not relieved as a business expense or as a cost for capital gains purposes or as being available for capital allowances. We refer elsewhere in these representations to the difficulty of establishing that certain expenditure is "enhancement expenditure" on shares for capital gains purposes. We believe that it is anomalous that what is clearly business expenditure should not be relieved either as a revenue or as a capital outgoing.

The archaic distinction between interest which is a business expense and interest which is a charge on income, and between trading income and interest or rental income, should be brought to an end. Also, capital losses should be made available for off-set against trading income, or for group relief.

As a start in eliminating some of the worst anomalies of the schedular system we advocate the following:-

1 **Set Off of Losses Brought Forward Against Income Under Schedule A or Case III or VI of Schedule D or Capital Gains**

Under present law interest receivable may be taxed under Schedule D Case III (Section 109, TA 1970) whereas interest payable may be a trading expense and come within the Schedule D Case I computation. Where the company has trading losses brought forward therefore, its tax position can be significantly affected by the distinction between interest which is a trading expense and interest which is a charge on income. For this reason as well as because of our belief that interest income should not be distinguished from trading income we propose that losses brought forward should be available for set-off against interest income and other profits.

Similar considerations apply to rent received.

Now that the same rate of coporation tax will be applicable to trading income and company capital gains, we further propose that trading losses brought forward should be available for set-off against capital gains.

2 **Set Off of Capital Losses Against Trading Income or Group Income**

We also propose that current capital losses should be available for offset against profits from whatever source for the same period, or as group relief, and unrelieved capital losses brought forward should be available for offset against profits of the same company from whatever source the taxpayer chooses.

3 **Excess Charges or Management Expenses**

Section 248, TA 1970, should be amended so as to make excess charges available for relief against profits arising in the preceding accounting period or against profits of whatever nature of that company arising in succeeding accounting periods. There should be similar relief for excess management expenses of an investment or insurance company.

4 Schedule A

Many companies receive rents in the context of their business as a whole. Expenditure relating to rental income is not obvious to the ordinary bookkeeper and is often part of larger items of expenditure. The time consumed in education and motivation of bookkeepers and the subsequent analysis of expenditure is a significant irritant and burden on business. Little tax is involved for a great amount of effort. Separate Schedule A computations should not be required for trading companies.

B CLOSE COMPANIES

Dividends from Trading Subsidiaries

Since 1980 the trading income of a close company has been excluded in determining whether any of the undistributed profits should be apportioned to, and taxed as the income of, the shareholders. There remains the anomaly that the trading income of the subsidiary of a close company may be subject to apportionment if paid over to the parent company as dividends. Dividends from the subsidiary are regarded as the parent's investment income whether they have been paid out of trading or investment profits.

We believe that trading income should not lose its identity as trading income when it is paid as an intra group dividend and that this anomaly should be rectified.

C TIME LIMITS

On several occasions in the past we have advocated a uniform time limit of six years for the making of claims, seeking reliefs and exercising options.

The greatest problem with time limits, however, is concerned with group relief. Sometimes with small groups of companies, and almost invariably with larger groups, it is not possible to agree the tax computations of the loss making companies and all the possible claimant companies within the period of two years from the end of the accounting period, which is statutorily allowed for group relief claims. Hence, use has to be made of provisional and protective surrenders of group relief. This causes unnecessary administrative burdens both to the taxpayer concerned and to the Revenue.

Furthermore, the practice with these arrangements shows inconsistency between Districts, and the Revenue Head Office instructions are too strict. The result is that taxpayers may have to commit themselves to a pattern of grouping before all the relevant facts have been established.

The position is further exacerbated by the official Revenue policy that group relief claims must be submitted in final form before the due date for the payment of tax in order for the tax assessed to be held over.

We recommend that the time limit for the claim to group relief should be extended to six years, the same as that for the surrender of ACT. This will normally have to be considered at the same time.

Unnecessary difficulty and hardship may sometimes be caused by the insistence of the Revenue that claims to surrender ACT must be made on a final and non provisional basis within the statutory six-year time limit. This takes no account of the practicalities of the situations which can arise.

Consequently, we further recommend that there should be an automatic extension of that six-year period for both group relief claims and the surrender of ACT when the relevant profit and loss figures have not by then been agreed because of factors outside the control of the taxpayer, for example, the outcome of an appeal before the Courts is awaited, or relevant overseas tax liabilities have not been settled.

In addition, we think that it should be possible to reopen without time limit, claims for group relief and ACT surrenders when increased foreign tax makes this desirable.

D ADVANCE CORPORATION TAX

1 Restrictions on Advance Corporation Tax

There are a number of restrictions on the utilisation of ACT which are both inequitable and illogical.

Where it is necessary to write off ACT in company accounts this has a harmful effect on performance and possibly on the company's rating on the Stock Exchange and with its bankers. A more flexible utilisation of ACT could therefore have a beneficial impact.

ACT was intended to be an advance payment of corporation tax not a separate tax in its own right. A company should not have to bear the additional cost of ACT which it cannot utilise when it has a current Corporation Tax liability. Nor should there be additional liability when an enterprise chooses to organise its businesses through subsidiary companies rather than use a divisional structure.

We strongly urge that the following points be given early attention:-

a ACT payments should be set off in full against the next available corporation tax liability of the companies making the payments, instead of being deferred as at present.

b Groups of companies are unfairly discriminated against by the inability to carry back surrendered ACT. An organisation having all of its activities in a single corporate vehicle is able to carry back ACT for a period of six years, yet an organisation which for commercial reasons has included different activities in different corporate vehicles is unable to carry back surrendered ACT. We recommend that the facility to carry back for six years should be available for ACT surrendered within a group. In order to prevent possible abuse the utilisation of ACT could be restricted to periods when the surrendering company and the receiving company were both members of the same group.

2 Advance Corporation Tax - Change of Rate

Section 103(5)(b), FA 1972, provides that, when the rate of ACT changes, an accounting period straddling that change date is deemed to be divided into two separate periods for the purposes of applying the ACT and franked investment income rules.

The necessity for this restriction is understood in the context of the present system whereby set-off to give relief for tax credits is effected by relating franked investment income (i.e. distributions received plus the tax credits thereon) to franked payments (i.e. distributions made grossed up by the rate of ACT).

The effect, however, is that a company cannot set franked investment income received after the date of change against franked payments made before that date even though the income is received and the payments are made within the company's same accounting period.

This restriction causes unnecessary cash flow loss because the tax credit relevant to that franked investment income cannot be used until ACT becomes payable in respect of a later distribution.

We recommend that this anomaly be removed and suggest that the above - mentioned Section be amended as follows:-

In line three of sub-section (5) (b) delete from "... the company's liability..." to the end of sub-paragraph (b) and insert "... the franked investment income received after that date shall be recalculated as follows:-

i the tax credit relating to that franked investment income shall be ascertained,

ii the franked investment income shall be recalculated assuming that the tax credit was ACT paid in respect of a dividend paid before 6 April in that period".

For example, franked investment income of £100 with tax credit of £27 becomes franked investment income of £93 with tax credit of £27 (29% of £93 = £27).

E VAT

As last year, we commence by expressing our concern at the extent to which major changes in VAT are introduced by way of a statutory instrument subject only to the negative procedure in Parliament rather than by way of primary legislation through the provisions of the annual Finance Bill. The new partial exemption rules illustrate this.

We repeat the view that the various VAT regulations should now be codified as part of a Value Added Taxes Act and that the powers of H M Customs & Excise to make regulations should be substantially reduced. The present system creates a considerable burden on commerce and industry which is unjustified. Having made the above general point, we continue with specific items.

1 VAT on Imports - Guarantees

We are convinced that the requirement to provide a guarantee against payment of deferred VAT is an unwarranted and costly burden on businesses in all normal cases. It bears particularly harshly upon those small and medium sized businesses which frequently have difficulty in obtaining adequate finance and if H M Customs & Excise require a guarantee from the trader's bankers, those bankers will normally reduce the trader's credit facilities by an amount equivalent to the guarantee.

Some larger companies have a credit rating superior to that of the bank which is giving the guarantee and in this circumstance a guarantee would appear to be pointless.

Obviously, we accept that there must be cases where H M Customs & Excise feel that on the history of tax payments or for other good reasons a guarantee is necessary. We suggest that instead of a standard guarantee being required in all instances H M Customs & Excise should be required specifically to notify those traders for whom they wish to obtain a guarantee and the trader should have the right of appeal to the VAT Tribunal against the decision of H M Customs & Excise. In this way, the guarantees would be related to the real needs of H M Customs & Excise without burdening business.

2 New Penalty Rules: Mitigation and Appeals

We have previously expressed our concern about the practical operation of the new VAT penalty rules and the antagonism that these may create between the public on the one hand and H M Customs & Excise and the Government on the other. We are currently responding separately to further Customs & Excise consultations on these rules.

Customs are the Executive arm of the State, and it has been suggested that the 1985 legislation fails to maintain the separation of the Executive from the Judiciary, and leaves the citizen bereft of a primary protection of the Treaty of Rome 1950 Convention for the Protection of Human Rights and Fundamental Freedoms, namely the right to full judicial review of sentences.

We ourselves remain of the opinion that the VAT penalty system should, like the time-proven regime applied for direct taxes, contain the following essential features:-

First, it should have penalties which are specified only by their maximum, leaving the actual penalty in particular cases to be fixed at between zero and the maximum. In other words, it should enable the penalty to fit the offence having regard to all the circumstances of the particular case.

Secondly, failing settlement between Customs and the taxpayer, there should always be a right of appeal by the taxpayer both as to the quantum of the penalty and on the question of whether any penalty at all is appropriate. The existing all or nothing right of appeal as to whether the taxpayer had a reasonable excuse for his action or inaction is not sufficient to cover the multitude of different circumstances which crop up in practice.

3 Relief for VAT on Bad Debts

This is a subject on which we have been making representations for many years. The scope of relief has been increased from time to time and we acknowledge and welcome that the bad debt problem will now no longer exist for small businesses when accounting for VAT on a cash basis. For all other businesses, however, the problem remains and we still consider that the VAT regulations should be brought into line with the Income Tax rules thus giving relief for VAT on bad debts where on normal commercial criteria the debt is regarded as irrecoverable.

4 Preservation of the National Heritage

The construction of new buildings is zero-rated for VAT purposes but all the work done to existing buildings, including the cost of conversion, is subject to VAT at 15%, except for alterations to listed buildings, these being zero-rated. When a converted but unlisted building is sold the sale is an exempt supply and consequently the person responsible for the conversion has to bear the VAT on the conversion costs. The effect of this is that demolition and building anew is often the only cost-effective way of reversing inner city decay. In order to preserve an important part of our national heritage, zero-rating should be extended to all building conversions and sales of converted buildings by the person converting them, particularly where demolition is prohibited by Local Authorities.

5 Inward Processing Relief

Regulation 44, SI 1985 No.886 gives relief from the charge to VAT if goods are imported solely for repair or other treatment, do not become the property of a person in the United Kingdom and, when re-exported, are identifiably the same goods. We consider that this relief should be extended to bring it in line with the provisions of inward processing relief available for other duties. As we have said before, the relief

would benefit United Kingdom exports and we are not aware that it would harm United Kingdom producers, since it is a basic requirement for the purpose of Inward Processing Relief that comparable and suitable goods are not available from within the EEC.

6 Partial Exemption and Prescribed Accounting Periods

The Regulations require that traders account for VAT on a periodic basis and if the exempt outputs in any period exceed the de minimis level there is a restriction of the input tax so that an additional amount has to be paid to (or a reduced amount claimed from) H M Customs & Excise.

This procedure is repeated each period and after the end of the year there is an annual review and adjustment. The present system can result in substantial restrictions of allowable input tax in any period when none is due on an annual basis. Traders should be given the facility to work on a cumulative basis. The problem is particularly acute where there is bunching of exempt outputs in the early quarters of the year but it becomes quite clear in the third and fourth quarters that there will be no partial exemption restriction for the year overall.

7 Issue of Securities

Section 18, FA 1987, is an unsatisfactory attempt to palliate a central defect in the new regulations on partial exemption. Because the test for obtaining relief for input tax is now that it should have been incurred in making taxable supplies, instead of the previous requirement that it was incurred for the purpose of making them, the input tax on the issue of shares and debentures ceases to be recoverable. To correct this, Section 18 exempts underwriting commission but it takes no account for other issue expenses such as the legal, accountancy and advertising expenses.

Failing correction of the regulations (which we regard as the better solution) we recommend that Section 18 be amended to render recoverable the VAT on all the expenses of the issue of shares and debentures.

8 **Transactions in Property**

Article 13(c) of the Sixth EEC Directive on VAT permits Member States to grant an option for taxable status for transactions involving the letting and leasing of immovable property. The present rules treating all letting and leasing as exempt have the effect that there is no relief for VAT paid by the landlord on repairs, alterations and management. These charges are effectively passed on to the tenant of commercial property and become part of his costs. They are therefore detrimental to United Kingdom exports. An option should be granted under which both Parties to any property transaction may jointly elect that the transaction is to be treated as a standard rated supply. Provision for such an election is common in other EEC countries.

9 **Supplies to Groups**

When a business is transferred as a going concern to a partly exempt VAT group the chargeable assets comprised in that business are treated, as a result of Section 15, FA 1987, as being both supplied to and supplied by the representative member of that group.

a In notice BN 3/87 issued by the Commissioners of Customs and Excise it states that the above treatment does not apply to goodwill. There is, however, nothing in Section 15 to that effect and we recommend that the Section be appropriately amended to put the matter beyond doubt.

b Section 15 does not apply provided that the Commissioners are satisfied that the transferor acquired the assets more than three years before the date of the transfer. In any case of doubt we feel that the arbiter should be a VAT Tribunal not the Commissioners.

10 **Due and Prompt Payment of Taxes**

Where there is delay in accounting for taxes but no fraudulent intention, the correct remedy is to charge interest at a commercial rate on the tax outstanding in restitution of any loss suffered. Such an approach has been proven effective in operation by the Inland Revenue for many years, is simple, inexpensive and readily understood, and preserves as far as possible good relations between the public and the taxing authorities.

The system of more or less automatic penalties, surcharges and Tribunal appearances now coming into operation, on the other hand reduces good relations to an irrelevance. It is incomprehensible to the majority of taxpayers, inexplicable in its complexity, and arbitrary and capricious in its incidence.

We understand that H M Customs & Excise are inhibited from calculating interest by problems in computer programming. If that is so, it is not acceptable and the highest priority should be given to resolving these problems. If necessary, the system should be extended by the use of private contractors.

There is concern that these aspects of VAT are not treated even-handedly. Where a firm is in a constant repayment position there is an inspection of its books by Customs every six months, with consequent delay to the repayment. This also is unacceptable and Customs should aim to make repayments on time.

11 Registration of Two or More Persons as One Taxable Person

Section 40, VATA 1983, sets out the matters on which an appeal against the decisions of the Commissioners of Customs & Excise can be made to a VAT Tribunal.

Section 10, FA 1986, is designed to enable the Commissioners to counter the avoidance of VAT through the artificial splitting of a business by deeming the business to be carried on by a single taxable person. Any appeal against this decision, however, encounters the restriction in subsection (3) of Section 10 that the Tribunal is not to consider all the circumstances of the case and if appropriate substitute its own decision for that of the Commissioners, but is to confine itself to deciding whether the Commissioners could reasonably have been satisfied as to certain matters set out in the Section.

This limits the Tribunal in the exercise of its judgement by preventing any challenge to the Commissioners' decision in all cases except those in which that decision is plainly unreasonable.

This restriction and departure from the normal rules for tax appeals is unwarranted.

We recommend that subsection (3) of Section 10, FA 1986, should be repealed.

F CAPITAL GAINS TAX

1 Enhancement Expenditure

We have referred earlier to the problems associated with Capital Contributions and with payments which fall between the two stools of capital and revenue. We are also concerned about the narrow way in which Section 32(1) (b), CGTA 1979, is drawn particularly in respect of assets other than physical assets, especially shares.

A parent company may incur expenditure which enhances the value of the assets owned by a subsidiary company - eg on assessing and planning the development of a mineral asset - which, especially where overseas subsidiaries are concerned, it may not be possible to charge to the overseas subsidiary and which does not qualify as management expenses. We suggest that in such circumstances the expenditure should be added to the cost price of the shares in the subsidiary for capital gains tax purposes.

2 Indexation against Inflation

Despite the improvements made by Section 68, FA 1985, the inflation element for the period before 1982 is still within the capital gains tax net. This major problem is one to which we have consistently referred in our Budget Representations over many years, and we are still anxious to discuss possible solutions, for example, the proposal for revaluation at 1982.

In many industries the rollover claims dating from the high-inflation years are now beginning to crystallize, and the injustice of taxing pre-1982 paper capital gains will be exacerbated by the provision in Section 74, F(No 2)A 1987, to tax company capital gains at the full corporation tax rate.

3 Indexation: Rollover on Business Assets and Gifts

Roll-over relief on business assets (Section 115, CGTA 1979) is intended to help a business that sells a capital asset and uses the proceeds to buy a replacement. Instead of having to pay tax at the time of selling the first asset, the business is treated as if it had owned a single asset throughout, equal in cost to the first and having the same sale proceeds as the second.

The arithmetical method of the Section is to treat the first asset as sold for a price producing no profit or loss, and to treat the excess of the real sale price over that deemed price as reducing the cost of the second asset. The indexation rules in Section 68, FA 1985, now create an anomaly. Had there in fact been a single asset throughout, indexation on the 1982 market value would span the entire period from 1982 to the sale of the second asset; but on an asset that is replaced that indexation only applies up to the date of the first sale.

It is true the indexation allowance on the first asset has the effect of increasing the indexation on the second asset, since the first indexation increases the deemed sale price of the first asset and, by reducing the excess that is deducted from the cost of the second, increases that cost. However, that increase in the second indexation is less than the detriment suffered as regards the first indexation. The discrepancy is considerable for any asset such as farm land which has greatly increased in value over the past couple of decades.

Similar difficulties in the operation of Section 68 are met if relief on gifts is claimed under Section 126, CGTA 1979, or Section 79, FA 1980.

The solution we suggest (but we are very willing to discuss any others) is that the provisions of Section 68 (7) and (8), FA 1985, should be extended to roll-overs on business assets and gifts. This would have the effect of treating these roll-overs in the same way as assets transferred within a group on a no gain/no loss basis.

4 Rollover Relief

i Classes of Asset

The classes of asset to which rollover relief applies are restricted by Sections 115-118, CGTA 1979.

There should be a further class added for Trade Investments, including shares in subsidiary companies, so that rollover relief is available against gains on the sale of these investments when the proceeds of sale are applied in the purchase of other business assets.

ii <u>Trade Use within a Group</u>

Where assets have been owned in turn by more than one company in a group of companies but they have not been used for the purposes of a trade throughout the whole of the period of ownership by the group, the apportionment to arrive at the amount of the gain available for rollover on disposal should take into account the trade use in the group as a whole.

G OTHER BURDENS ON BUSINESS

1 The Pay and File Scheme

We do not think that the answers given in the course of the Parliamentary debates on the 1987 Finance Bills met the points which we had raised in our representations on those Bills. We therefore repeat those points below. We are responding separately to the other parts of the Revenue's consultative paper following the Keith Report and are already engaged in discussions on aspects of the pay and file proposals:-

i <u>Revenue Power to Call for Information</u>

Section 82, F(No2)A 1987, in its amendments to Section 11, TMA 1970, gives power to the Revenue to require companies by notice served on them to deliver returns of profits and losses containing such information and accompanied by such accounts, statements and reports as may be required in pursuance of the notice. Apart from the explanation that for a UK company the reference to accounts is a reference only to such accounts and documents as are required to be prepared under the Companies Act 1985, there is no indication of the compliance burden which this requirement will impose on companies.

As indicated in the Introduction to this paper we do oppose provisions of this nature which can by administrative measure lead to increased compliance burdens and which can be instituted and changed without full debate in Parliament.

Furthermore, it would be wrong if administrative powers were to be used in such a way as to bypass or circumvent such statutory information gathering powers, with the concomitant taxpayer safeguards that they contain, as already exist in the Taxes Acts.

ii **Mitigation of Penalties and Appeals**

We are unhappy about the mechanical nature of the new penalty rules for failure to make a corporation tax return, as set out in Sections 83 and 84, F(No2)A 1987. We have consistently argued in relation to both the Customs and Excise and the Inland Revenue penalty rules that penalties should be based on the existing Revenue formula of specifying only the maximum and not the minimum award.

At present a typical formula might be a penalty of a sum "not exceeding £x" or, expressed as a daily penalty, "not exceeding £x per day" for the period a failure continues. The lump sum might also be formulated as a sum "not exceeding £x and a sum equal to the total amount of relevant tax (lost)".

On this basis we believe there is scope for bringing the relevant monetary values of £x up to date and simplifying the procedure for claiming penalties, for instance by using the assessment procedure contemplated in Section 84, without destroying some essential features of the present system.

Under the present regime, the maximum penalties are rarely applied because the Revenue reaches a negotiated settlement of tax, interest and penalties with the taxpayer. There is full flexibility to negotiate a penalty settlement between zero and the maximum. The system is thus conducive to both sides reaching such a settlement. Only where the Revenue and the taxpayer cannot reach agreement does the matter proceed to the independent appeal commissioners (or the higher courts) for them to fix the penalty award. Since both the Revenue and the appeal commissioners (and the higher courts) are free to use their own judgement in fixing the relevant penalty award - up to the maximum - they can take full account of all the circumstances of the case in arriving at the penalty award. The appeal commissioners may of course award more or less than the Revenue would have settled for in negotiations, a feature that also encourages settlement.

We believe that this ability of the taxpayer ultimately to be able to rely on the fairmindedness of the appeal commissioners using their unfettered discretion is a valuable protection and conducive to good taxpayer relations, the benefits of which outweigh administrative convenience. It also reflects the proper role of commissioners.

We do not believe that the reasonable excuse concept as adopted for VAT purposes (or even a restricted power of mitigation) is an adequate substitute for

this discretion. Indeed, we are not at all clear what would constitute a reasonable excuse for these purposes or how it is intended that adequate taxpayer protection would be achieved in practice. The Revenue will of course be receiving the tax due and interest on it regardless of the quantum of the penalty.

It will be clear from what we have said above that we do not believe that the discretion of the appeal commissioners and higher courts should be restricted in the ways outlined in Section 84. They should retain their existing and valued discretion to assess degrees of culpability and make the punishment fit the offence. We believe that the recent decisions of the VAT Tribunal in the Geary, Jackson and Pook cases reinforces our view that the approach we suggest is the better way of handling these matters.

This is a subject which cannot properly be discussed in relation to companies alone since it affects all penalties and therefore we shall be referring to it more fully in our separate response to the Revenue's consultative paper which we mentioned above.

iii <u>New Penalty Procedure - Burden of Proof</u>

We understand that the penalty assessed under Section 84, F(No2)A 1987, is to be subject to the existing rule that the burden of proving that there is a penalty offence should rest with the Revenue, thus differing from the ordinary tax assessment rules where the burden of displacing the assessment falls on the taxpayer. To make the position crystal clear we would like to see an express statutory provision to this effect introduced into the legislation.

Presumably, Inspectors of Taxes will still be able to make settlements whereby any penalty element can be entirely quashed without the need to incur the cost of a hearing before appeal commissioners.

iv <u>Payment of Interest to the Revenue on Tax Overdue and Payment of Interest by the Revenue on Tax Overpaid</u>

The question of the symmetry of interest arrangements is one to which we hope to return in further discussions with the Revenue. In relation to Section 87, F(No2)A 1987, (interest on tax overpaid) we believe it is inequitable that where a company has received income under deduction of tax at source there should be a delay of the sort envisaged by the definition of "material date" before it becomes entitled to payment of interest. Ideally, there ought not to be a gap between the date when the tax is actually paid or deducted and the deemed date. A possible improvement would be to bring the qualifying time forward to the end of the receiving company's accounting period.

Where groups of companies are concerned, and in the absence of symmetry of interest arrangements, underpayments by one company in the group should be set against overpayments by other companies in the same group before the calculation of interest on the residual position.

As mentioned above and indicated in Appendix II, further aspects of the implementation of the Pay and File Scheme will be the subject of future discussions with the Revenue.

2 Disallowance of Trading Losses on Change in Ownership

In 1985 we commented on the Inland Revenue's draft of the proposed statement of practice on the operation of Section 483, TA 1970. We now have a revised draft statement of practice.

Section 483, in its present form and application, is a deterrent to the making of the business changes which good management requires. A company which has been making losses will inevitably need changes in the way it is run in order to make it profitable, and there is frequent doubt as to whether these changes constitute "major changes" within the terms of Section 483, thus preventing relief for the past losses. Indeed it is difficult to see why major changes should be the cause of a penalty, if these changes are designed to make the acquired business profitable and to secure employment, rather than divert profit from existing businesses to mop up past losses.

This Section has given rise to business uncertainty and in some cases companies have desisted from making changes which are desirable on commercial grounds for fear that tax penalties would be incurred.

It remains our view that the best way to tackle the problem would be by the introduction, through new legislation, of a motive test which would go a significant way towards reducing that uncertainty. The test should be that Section 483 would apply only in those cases where the primary purpose of the acquisition was to obtain a tax advantage.

Bearing in mind wider economic aims, takeovers which would preserve employment in loss-making companies should be encouraged and not impeded by this Section or the uncertainty it creates.

3 Approved Share Option Schemes: Part-timers

The detailed rules as set out in Section 38 and Schedule 10, FA 1984, are too restrictive as regards part-time staff.

We believe that the schemes should be available to any staff at the choice of the company. To this end the restriction to "full-time" directors and other staff working at least 20 hours per week should be removed. Since there is a restriction by reference to remuneration, we wonder why it is also necessary to have a restriction with regard to the number of hours worked. It should be possible to enable part-time staff, who may be long-serving and who may have made significant contributions to the company, to participate. In those firms which employ a relatively high proportion of part-timers, ruling them out from the benefits of Approved Share Option Schemes can have a very damaging effect on morale.

4 **Share Option Schemes: Delay in Obtaining Approval**

We understand that there is at present considerable delay before final approval is granted by the Board of Inland Revenue to a share option scheme.

This unnecessarily inconveniences the companies concerned and although this is not strictly a technical point, the CBI urge that measures be taken to speed up the procedure for granting approval.

5 **Relocation Expenses**

Payments made by employers to their employees to reimburse the expenses of transferring their residences at company request to higher cost housing areas within the UK are, within limits, regarded by the Inland Revenue as non-taxable. This follows Statement of Practice 1/85 but it does not extend to payments made to new employees on joining a company. As a result, these payments to newly joining employees must be grossed up, at great expense to the paying company, in order to counteract the effect of their being taxable in the hands of the recipients.

To remedy this inequitable result we recommend that the Inland Revenue should extend their present concessional arrangements to cover the relocation expenses of newly joining employees. This would be an encouragement to the mobility of labour, and it would bring the matter into line with Extra-Statutory Concession A5(a) which deals with removal expenses and applies to both new and existing staff.

We further recommend that the Inland Revenue should reconsider its views on the need for the employee to dispose of his old place of residence before he can obtain any tax relief on his relocation expenses. This requirement can cause hardship on transfer within the UK, the more so if the transfer is from abroad. It should not be necessary for the employee to give up his home in the old location if he plans to return to it eventually.

6 Leased Motor Cars

Paragraph 12, Schedule 8, FA 1971, as amended, restricts the deduction of the hiring costs of a motor car used for business purposes if the retail price of that car when new exceeded £8,000.

We believe that all the leasing charges on a motor car used for business purposes should be allowable and that the restriction in respect of cars costing over £8,000 is inequitable. Furthermore, the costs of administering this restriction far outweigh the benefit to the Exchequer.

We recommend that this paragraph be repealed.

7 Diesel-Engined Company Cars

For the same type of motor car a larger cubic capacity engine is required for diesel power than for the petrol equivalent. This has the effect that an employee having private use of a diesel-engined company car is in many cases placed in a higher bracket in the table of scale charges both for the car benefit and for the car fuel benefit. This in itself is inequitable considering that the employee would still be using basically the same type of car and the cost of the benefit to the employer both for the car and for the fuel would be less.

The result is that many employers are reluctant to change to diesel-engined cars, even where they would like to do so, because of the increased tax burden they would be imposing on their employees.

We therefore recommend that in the tables of flat rate cash equivalents in Part 1, Schedule 7, FA 1976, and in Section 64A, FA 1976, there should be separate sections for diesel-engined cars, to take into account their higher cylinder capacity.

We recommend that to this list there should be added loans, including intra-group loans, but with the same exception as above for creditors carrying on a trade of lending money.

3 Capital Allowancs - Capital Expenditure on Mineral Extraction

Section 55, FA 1986, and its attendant Schedules 13 and 14 modernising the code of capital allowances for expenditure on mineral extraction are welcomed, but the following matters still give concern:-

i Restriction of Allowances for Assets Purchased "Secondhand"

Schedule 13, at paragraphs 19, 20 and 21, applies where there is a purchase of mineral assets from a person who incurred, or whose predecessor incurred, relevant expenditure on those assets in the course of a mineral trade. It has the effect of restricting the expenditure on which the purchaser can get allowances by reference to the previous trader's qualifying expenditure.

We can see no justification for this artificial restriction. Whatever may be the tax arrangements of the predecessor the purchaser should rank for allowances by reference to the full expenditure incurred by him.

We therefore recommend that the above-mentioned paragraphs of Schedule 13 be repealed or amended as appropriate, so as to give a purchaser of mineral assets relief by reference to his actual expenditure, subject to the normal restrictions in the case of sales between connected persons.

ii Restoration Costs

The provisions of paragraph 8, Schedule 13, FA 1986, which bring certain expenditure on restoration within the category of qualifying expenditure are broadly welcomed. It is regretted, however, that only expenditure incurred within three years of the last day of trading by a taxpayer who has ceased the trade of mineral extraction will be eligible for this relief.

This is a matter which primarily concerns the smaller single site operator and the three year period specified is far too short.

APPENDIX I

ADDITIONAL ITEMS FOR DISCUSSION IF TIME PERMITS

1 Expenses Connected with Work Done Abroad

The provisions in Section 34, FA 1986, amending Section 32, FA 1977, are welcome but the latter section is applicable only to an employee who is resident and ordinarily resident in the UK. This has the effect of excluding employees who are resident in the UK but not here long enough to become ordinarily resident.

We recommend that residence alone should be sufficient to qualify for relief under the section.

Where relief is given for the travelling expenses of the employee's children we recommend that the definition of "child" in Section 32, FA 1977, should be widened to include any child aged 18 or over who is still undergoing full time education at a school or college. A similar amendment is necessary to Section 35(9), FA 1986.

With modern communications and the ease and speed of travel it is to be expected that schoolchildren will want to visit their parent(s) overseas at the end of each school term. We therefore recommend that the wording of Section 34(3)(c) and of Section 35(6), FA 1986, should be amended to extend relief to three journeys per year in each direction.

Where relief is not given in any of the circumstances envisaged above the additional cost falls upon the UK employer.

2 Company Reconstructions: Restriction of Relief

The amendments introduced by Section 42 and Schedule 10, FA 1986, apply when a trade is transferred from one company to another in common ownership and the transferor company is insolvent. They have the effect that any tax losses which are available for transfer are restricted if the successor company does not take over all the transferor company's liabilities and the latter has insufficient assets to cover them.

The liabilities taken into account for this purpose, however, do not include the items listed in Schedule 10, FA 1986, namely the transferor company's share capital, share premium account, reserves or loan stock the creditor for which was not carrying on a trade of lending money at the time when the loan was made.

5 Indexation

The principle of indexation of monetary amounts which already applies automatically to personal allowances and is annually applied to, for example, the capital gains exemption limit, should apply to other monetary limits in the Taxes Acts. Examples are to be found in Section 188 and Schedule 8, TA 1970, concerning payments made for loss of office, in Schedule 20, FA 1985, concerning retirement relief, in Section 14(5), F(No2)A 1979, concerning more expensive motor cars, in Section 61(1) FA 1978, concerning profit sharing schemes, and in Sections 23 and 58, F(No2)A 1987, concerning pension scheme lump sum payments.

We recommend that the period during which relevant expenditure can qualify should be extended to bring it into line with the after-care obligations laid down in the Town and Country Planning (Minerals) Act 1981, namely five years from the time when restoration has been completed.

iii Rate of Writing-down Allowance

The rate of writing-down allowance specified by paragraph 9 (5), Schedule 13, FA 1986, is 10% for mineral rights and deposits and 25% for other assets, applied on the reducing balance basis.

We believe that this 10% rate is too low and as the cost to the Exchequer of increasing this rate would not be excessive we recommend that it be increased to 25%.

4 Costs of Tax Appeals

The decision of a taxpayer whether or not to appeal to the Courts against a tax assessment is made even more difficult by the consideration that if his appeal fails he will have to bear a substantial proportion of the costs. This is particularly so where the amount of tax involved is small, however good his case may be.

In addition, although costs are sometimes awarded at VAT Tribunal decisions and sometimes not, there is no way by which the taxpayer can recoup his costs of an appeal before the General or Special Commissioners. This is particularly onerous because a large part of the costs of fighting a tax case is borne at the Commissioners' or Tribunal level. This results because litigants have to do a great deal of preparatory work which is not repeated at the High Court level and there are also the costs incurred in producing witnesses.

We therefore recommend that, prior to a hearing before the Commissioners or a VAT Tribunal, the taxpayer should be given the option of electing for costs to be awarded. If he does so elect then, of course, the award of costs will work both ways and the taxpayer will have to pay the Revenue or Customs costs if he loses.

We further recommend that if, at any stage in the determination of a particular issue, the taxpayer succeeds and the Revenue or Customs appeal to a higher authority, the taxpayer's costs on a solicitor and client basis should be borne by the Revenue or Customs whether or not their appeal succeeds.

APPENDIX II

The following items are the subject of separate discussions or representations -

a with the Inland Revenue

Exchange Rate Fluctuations

The exchange fluctuations on foreign currency borrowings should be recognised for tax purposes.

Section 482, TA 1970

This Section, which concerns the migration of companies, should now be repealed following the abolition of exchange control.

The Pay and File Scheme

A number of aspects of the implementation of the scheme for filing returns for and making payments of corporation tax are creating concern for business.

Part Two of the Revenue's response to the Keith Report

Aspects of the Revenue's proposed new enforcement powers additional to the pay and file scheme.

Groups of Companies

Many of the points in our paper entitled "The Tax Treatment of Groups of Companies" which we submitted to the Revenue in December 1983 have not so far been dealt with.

b with HM Customs & Excise

VAT: Partial Exemption: Deductible Input Tax

The origin and scope of the right to deduct input tax, and the revised schemes.

VAT: Tour Operators

Compliance with Article 26 of the Sixth EEC Directive on VAT by travel agents and tour operators.

VAT: Penalties

A review of the system of civil penalties, default surcharge and repayment supplement introduced by the Finance Act 1985.

PS/CHX
12/2
(for information)

Treasury Chambers, Parliament Street, SW1P 3AG

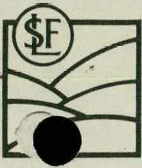
P C Macdonald Esq
Convenor
The Scottish Landowners' Federation
18 Abercromby Place
Edinburgh
EH3 6TY

October 1987

Thank you for your letter of 12 October enclosing representations for the Budget from the Scottish Landowners' Federation.

I can assure you that your representations will be carefully considered in the run-up to the Budget. However, I hope you will understand that it would be inappropriate for me to comment further at this stage.

NORMAN LAMONT



The Scottish Landowners' Federation

President:
The Duke of Atholl

Convener:
P. C. Macdonald

Director:
D. J. Hughes Hallett, F.R.I.C.S.

Our Ref: BR/87

BR

Your Ref:

HM TREASURY – MCU
RECD. 14 OCT 1987
ACTION Mrs Evanhams FP
cc IR
PST
25816/87

Date: 12th October 1987

The Rt Hon Nigel Lawson MP
The Chancellor of the Exchequer
House of Commons
LONDON
SW1A 0AA

Dear Chancellor,

BUDGET REPRESENTATIONS 1988

I enclose a copy of our Budget Representations for 1988 which I hope you will take into account when preparing your Budget for 1988.

At a time when landowners and farmers are under severe financial pressures, a fact of which I am sure you are well aware, the need to have in place a tax system which will encourage, and act as an incentive to, the development and maintenance of a stable rural economy, in particular agriculture and associated rural activities, must be paramount.

Our Representations have accordingly been framed with this objective in view, and in particular, the need to maintain, and increase, rural employment and to provide a firm base for the encouragement of investment in the countryside, to the benefit of all. This can only be achieved where there is confidence in the future.

We have frequently in the past expressed concern at the adverse effect which the existing Capital Gains Tax (CGT) regime has on investment in the rural economy as a whole, tying up much needed capital which can only be released with serious tax implications. We have studied with great interest the recent paper on Reform of CGT which has been prepared by the Country Landowners Association (CLA), in which radical reform is proposed, returning to a system for the taxation of short term gains, tapered over a 5 year period. We would lend our support to the principles contained in this paper, as a major reform of CGT is long overdue. The proposals have the merit of simplicity, and should reduce the Inland Revenue's staff costs both of which would appear to fall very much into line with your Government's intentions for the U.K. tax system as a whole, and the scheme for taxing short term gains would appear rightly to be targetted on the "short term speculator" rather than, for example, on the average landowner who holds land long term as an essential element of his business. He is one of the main sufferers under the present CGT system which still retains an element of tax on past inflation. We would therefore wish to be associated with the CLA in supporting their proposals for reform.

We are also concerned as to the tax treatment of the disposal or transfer of milk quotas, and we have included our detailed views on this matter in our technical representations.

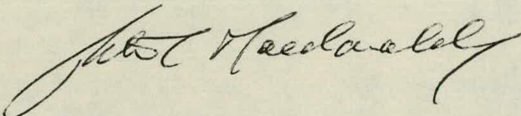
With regard to Inheritance Tax we are particularly concerned as to the likely tax implications for the average small family farming business of the Reservation of Benefit provisions. It will be much more difficult, than under the previous CTT regime, to make dispositions of property within the family and this could have serious effects on the agricultural industry in Scotland. The ability to transfer property within a family should not be inhibited in this way.

Alhtough we welcomed both the increase in the nil rate threshold and a widening of the rate bands, introduced in the Finance Act 1987, it is our view that the bands require further increase and widening and the effective rates require to be reduced as the highest rate is still reached very quickly.

It is our intention to respond in detail to the Inland Revenue's paper on Disincorporation and we therefore consider it sufficient to say here only that we welcome the proposed reforms as introducing a greater element of flexibility to the choices available as to the methods of carrying on a business.

I hope you will take account of our Representations when framing your Budget for 1988 as all the matters referred to we consider of importance for the maintenance and stability of a viable rural economy.

Yours sincerely



P C Macdonald
Convener

Enc

TECHNICAL REPRESENTATIONS FOR THE 1988 BUDGET

SUBMITTED BY SCOTTISH LANDOWNERS' FEDERATION

CAPITAL GAINS TAX

(i) We support in principle the recommendations contained in the CLA Working Party's report on reform of Capital Gains Tax and in particular, the proposals for the abolition of the present system and the introduction of a tax on short term gains;

(ii) Milk quotas, under EEC law, cannot be separated from the land and are assets of the trade of farms. Milk quotas should therefore be considered as part of the land or as goodwill and thus "qualifying assets" for the purposes of roll-over relief;

(iii) The present discrimination against landowners as regards the tax treatment of their assets should be brought to an end as outdated and unfair. This treatment is highlighted by the non-availability to tenanted land of either roll-over or retirement relief. It seems illogical for such reliefs to be denied them and we accordingly would wish to see the practice ended by the introduction of such reliefs for tenanted land. We have previously suggested that equity and simplicity would result if estate ownership were to be regarded as a business for tax purposes.

(iv) The anomaly whereby only one spouse is entitled to an annual exemption is outdated and unreasonable, particularly as similar reliefs ie. IHT annual exemption are presently available to both spouses. We recommend that each spouse should be entitled to his/her own full annual exemption. This is also in line with current thinking regarding the taxation of spouses generally;

(v) The present monetary limit of £20,000 for small part disposals is unrealistic when looked at in the context of the indebtedness of the average farmer. We therefore recommend that the limit be increased to £75,000 which would provide useful assistance to a farmer in reducing his indebtedness by deferring, rather than releasing, the charge to tax.

INHERITANCE TAX

(i) We view with concern the implications of this tax, in particular the Gifts with Reservation of Benefit ("GWR") provisions, for the average small family farming business, as its effect is likely to inhibit the free disposition of assets, particularly houses and land, within a family. This could have serious effects on agriculture in Scotland. The adverse effects of this area of IHT should be limited by the removal of the present uncertainty as to the law and how the GWR provisions are to be operated in practice.

(ii) The 60% rate of IHT is reached at £330,000 which, as dwellinghouses and land are involved, is reached very easily. It is therefore now a tax on persons of modest means. We therefore recommend that the rates and bands should be increased and widened respectively.

.../2

(iii) A & M SETTLEMENTS AND LOSS OF BUSINESS/AGRICULTURAL RELIEF

The Capital Taxes Office have confirmed that agricultural and business reliefs will be lost if a donor who has settled property which, at the time of the transfer, would attract such reliefs dies within 7 years of doing so and either:-

(a) the trustees advance a share to a beneficiary absolutely

or

(b) vesting takes place automatically under the Trust Deed

or

(c) the trustees give a beneficiary an interest in possession. In each case relief would be lost pro tanto. The effect is that there will be some A & M Trusts which are vulnerable to loss of relief and others which are not, depending entirely on whether the beneficiaries are within 7 years of vesting in capital. It could not have been the intention of the legislation to create this anomaly which should be remedied by amending legislation.

(iv) The Capital Taxes Office have confirmed the existence of another legislative anomaly, relating to deferred Estate Duty on timber, which again could not have been the intention of Parliament. The CTO have confirmed that if there is a deferred Estate Duty liability on woodlands on any part of the land which is transferred then that transfer will not be a Potentially Exempt Transfer (PET). It had been thought that this would apply only to the timber and land on which it is growing but it is apparently the case that the whole transfer will be so tainted, even if it involves land unrelated to the timber concerned. This result cannot possibly have been intended and we therefore recommend that the law be amended to remedy the anomaly so that only that land with the relevant timber growing on it shall not be a PET.

INCOME TAX

(a) Section 180 of the Taxes Act 1970 should be abolished in light of the present agricultural recession in Scotland. Far from penalising those who finance their agricultural operations from other sources, Government should encourage them.

(b) There should be greater flexibility in the ability to carry forward losses - the present restrictions on carry forward losses to be set against profits of the same trading enterprise are likely to operate as a disincentive to diversification from agriculture into other rural enterprises.

(c) Relief on overdraft interest for agricultural estate owners should be restored.

(d) The new Community Charge is to be introduced in Scotland in April 1989 and will replace domestic rates presently chargeable on residential property. It is a "personal", as opposed to a "property"

.../3

tax and all adults resident in a particular area will be obliged to pay the charge, with no specific reference to the accommodation occupied by them. At present the income tax treatment accorded to the payment of Domestic rates by an employer for his employee living in tied accommodation is favourable but it seems likely that such treatment will not be accorded to payments by an employer of the community charge on his employee's behalf. The employee will be liable for such payment but if it is paid by the employer it will be treated as a cash benefit and therefore taxable in the hands of the employee. This will result in the unsatisfactory position where employees in Scotland will be worse off than in England, as the favourable tax treatment presently accorded to payment of rates will be available in England but not in Scotland. This situation will exist until similar legislation comes into force in England - an inequitable state of affairs and such discrimination in the tax systems was clearly not intended to operate.

12th October 1987

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NOTE OF A MEETING IN THE FINANCIAL SECRETARY'S ROOM, TUESDAY 13 OCTOBER 1987

Those present: Mr Cropper, Miss Hay, Miss Feest, Mr Cayley) Mr Gordon) IR, Mr Lester)

MILK QUOTAS

Present Position

1. The Financial Secretary asked whether there was really a case for extending rollover relief to milk quota. It was explained that substantial gains could and did arise - in some cases the quota could be more valuable than the cows. Relief was generally available to farmers on their other major assets: land, barns etc and Representations suggested that non-availability on milk quota significantly inhibited expansion.

2. The recent extension of relief to satellites had set a precedent which made pressure for further extensions that much more difficult to resist. Of the other agricultural quotas identified only potato quota - which generally involved smaller sums - was considered relevant. (The Revenue had established that EEC fishing rights - about which there had been similar representation - already qualified for rollover relief.)

3. The Financial Secretary asked if the extension of relief to milk quota would substantially increase the pressure for yet further relief in other areas. Although the general view was that there were no obvious assets of a similar nature, there might be increased pressure from,

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for example, agricultural landlords who continued to seek rollover relief on the land which they let. However, it was also felt that such cases could be distinguished from milk quota. The Financial Secretary pointed out that there were industrial quotas on, for example, steel and textiles. Although no representations had been seen on these, unlike the very many on milk quota, the Revenue would look at these to ascertain the present position and see if there was likely to be further pressure in these areas if relief were to be extended to agricultural quotas.

4. It was generally agreed that there would be no implications for the oil industry with whom, it was understood, discussions on rollover relief - particularly on production licences - were continuing.

Retrospection

5. The possibility of retrospection was discussed and it was decided that if relief was extended to milk quota the most suitable approach - as with satellites - would be to give relief for future acquisitions and disposals only.

Cost

6. The likely cost of extending relief to agricultural quotas on this basis was thought to be in the region of £10m.

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Conclusion

7. The Financial Secretary indicated that provided there would be nc major implications for industrial quotas he would be prepared to see relief extended. The Revenue agreed to establish the position of the other quotas as quickly as possible.

C. D. Lester

C D LESTER
13.10.87

cc PS/Chancellor
Mr Scholar
Mr Cropper
Miss Sinclair
Mr Jenkins – Parly Counsel
Mr C. Gordon IR
Mr Cayley IR
PS/IR

Inland Revenue

Policy Division
Somerset House

FROM: M F CAYLEY
DATE: 13 OCTOBER 1987

Ch/ Content to write as proposed? (The FST has now discussed with officials - note attached - but I do not think this should change us to write in a different sense)

PS/CHANCELLOR OF THE EXCHEQUER

OK (draft amended).

MILK QUOTA : LETTER FROM MR MACGREGOR

1. Mr MacGregor's letter of 8 October (copy below) suggests extending CGT rollover relief to milk quota. The policy issue is under consideration with the Financial Secretary, following Mr Gordon's minute to him of 23 September.

2. In the circumstances, a fairly formal reply seems appropriate. I attach a draft.

Michael Cayley

M F CAYLEY

---

cc PS/Financial Secretary
Mr Scholar
Mr Cropper
Mr Isaac
Mr Pitts
Mr Beighton
Mr Cayley
Mr C Gordon
PS/IR

The Rt Hon John MacGregor OBE, MP
Minister of Agriculture, Fisheries and Food,
Whitehall Place,
LONDON
SW1A 2hh

You wrote to me on 8 October suggesting that CGT rollover relief should be extended to milk quota. I have read your comments with interest, ~~but I know you will not expect me to say more at this stage than that~~ and I will bear them carefully in mind when considering what proposals to bring forward in next year's Finance Bill.

NIGEL LAWSON

Another way of looking at the matter is this. Milk quota is in effect a right to produce milk and seems tantamount to a measure of the goodwill attaching to the value of a dairy farm. The value of goodwill in any business now benefits from roll-over relief but milk quotas are not presently regarded as coming under this heading. Yet had milk quotas not been imposed, a farmer would have been able to move from his dairy farm to another holding and "rolled-over" gains arising on the sale of the dairy business. Treating quotas as goodwill, or by some other means you judge appropriate, so allowing them to attract roll-over relief, would be a return to the status quo ante.

In the correspondence on this matter between officials, the question of precedents has arisen, such as for potato, hops and fish quotas. I do not see that there should be any real difficulties of this kind. Hop quotas were abolished several years ago, fish quotas are not for re-sale and whilst potato quotas are traded, the individual area quotas sold are usually very small indeed.

Peter Walker, Malcolm Rifkind and Tom King have also received many representations on this and are convinced that the present position inhibits just the kind of diversification of farming that we are now exhorting upon farmers. They fully support the line I am taking. I am copying this letter to them.

Yours Sincerely

JOHN MacGREGOR

(Approved by the Minister
and signed in his absence)

Budget Reps

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

CH/EXCHEQUER
REC. 08 OCT 1987 8/10
ACTION PS/IR
COPIES TO CST FST SIR P. MIDDLETON MR CASSELL MR SCHOLAR MR BONNEY

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Parliament Street
London
SW1P 3AG

8 October 1987

Mr Gayler
cc Mr Isaac
Mr Houghton
Mr Beighton
Mr Gordon
Mr Shaw

Dear Chancellor

I shall shortly be letting you have my suggestions on changes which I would like you to consider for next year's Finance Bill. But there is one issue which I think is worth sending to you early on so that it can be explored at an early stage as I am now convinced that the case for it is overwhelming.

This concerns the case for roll-over relief against CGT to be granted when the proceeds from the realisation of milk quota are re-invested in another business. The present position is anomalous and exposes us to the justifiable criticisms that the absence of roll-over relief stands in the way of enterprise and good commercial practice, restricts the ability of the industry to diversify, and runs counter to what we are trying to achieve in the dairy industry.

As you know, milk quotas are being steadily reduced and production is falling. Many dairy farmers are finding that their quotas are too small to allow their enterprise to be viable and are seeking to move to larger farms. Some are abandoning milk with the aim of diversifying on another, larger holding. When they move, and given that the value of the quota can amount to as much as half the value of their dairy farms, the CGT charge can be considerable. Of course, if a farmer sells his quota and retires then a capital gains charge will arise as it would for any other business, and that is fair. But the absence of roll-over relief for milk quotas means that a farmer must pay such a charge when he moves from one farm to another in order to develop his business. This inevitably inhibits sensible decision-taking and mobility, in a way that does not apply to the sale and re-use of any other business assets. I have a number of specific practical examples of the unjustified deleterious effects this is now having.

/ Another way of ...

ps2/37R

cc PS/Financial Secretary
Mr Scholar
Mr Cropper
Mr Caylor - IR
Mr Isaac - IR
PS/IR

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

15 October 1987

The Rt Hon John MacGregor OBE MP
Minister of Agriculture, Fisheries and Food
Whitehall
LONDON SW1A 2HH

Dear John

You wrote to me on 8 October suggesting that CGT rollover relief should be extended to milk quota. I have read your comments with interest, and I will bear them carefully in mind when considering what proposals to bring forward in next year's Finance Bill.

Yours
Nigel

NIGEL LAWSON

Inland Revenue

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Policy Division
Somerset House

FROM: C GORDON
DATE: 19 OCTOBER 1987

PS/FINANCIAL SECRETARY

MILK QUOTAS

1. Following our meeting on 13 October the Financial Secretary asked us to look at the position of industrial quotas.

2. Officials in the Department of Trade and Industry advise us that only steel quota is of a similar nature to milk quota - textile quota is an annual import quota and like other import quotas can already benefit from rollover relief where appropriate.

3. We have looked at steel quota which is generally short term in nature and consequently will commonly be dealt with as part of the computation of income rather than capital gains. Where transactions in the quota do give rise to capital gains, we can confirm that - as with EEC fishing rights - the nature of the quota is such that it already qualifies for rollover relief as goodwill.

4. There thus seems to be no reason why extending relief to milk and potato quota need have knock-on effects for industrial quotas.

---

cc PS/Chancellor
Mr Scholar
Mr Cropper
Miss Hay
Mr Jenkins
(Parliamentary Counsel)
Miss Sinclair
Mr Isaac
Mr Pitts
Mr Beighton
Mr Cayley
Mr Hamilton
Mr Gordon
Mr Lester
PS/IR

5. If the Financial Secretary considers it appropriate to extend the relief, one question which arises is when the extension should be announced. One possibility - as with satellites - would be an immediate announcement. This would have the advantage of preempting what is likely to be a sizeable campaign over the next few months to get the relief extended. On the other hand Ministers may feel it appropriate to hold back any announcement until Budget Day when it could form a useful sweetener in any wider package of reforms. We would welcome guidance.

C GORDON

Job Ownership Ltd

9 Poland Street London W1V 3DG
Telephone: 01-437 5511

FINANCIAL SECRETARY
REC. 20 OCT 1987
MR PRESCOTT - IR
PPS CST PMG EST
Sir P. Middleton
MR Monck MR Cassell
MRS Lomax MR Burgner
MR Scholar MR Ilett
MR Neilson
MR Call
PS/IR

The Rt. Hon. Norman Lamont MP
Financial Secretary,
The Treasury,
Parliament St
London SW1

October 19 1987

Dear Mr Lamont

I am writing this letter to you with the knowledge and encouragement of your colleague, Kenneth Clarke, the Chancellor of the Duchy of Lancaster.

Mr Clarke was kind enough to have a meeting last week with two of my colleagues, John Nelson Jones, whom you know and who is an unpaid director of J.O.L. and Robert Oakeshott, its chief executive. From J.O.L.'s point of view the meeting was to enlist the support of the Department of Trade and Industry behind the inclusion in next year's finance bill of a more or less substantial package of employee ownership reliefs, based on the ESOP legislation in the United States.

For obvious reasons Mr Clarke was in no position at the meeting to commit the DTI to supporting all or any of our proposals. Nevertheless I know from talking to them that John and Robert were struck by the notably positive response of the Chancellor of the Duchy of Lancaster and his officials. At the end they sought Mr Clarke's advice about whether to seek a meeting with you. The answer was an unqualified 'yes'.

So the chief purpose of this letter is to do just that - to ask whether you would be willing and able to see me, with a small J.O.L. delegation, at an early date.

Naturally if you agree to meet us, you will want to know in advance precisely what it is that we are seeking to achieve. I therefore enclose a copy of the letter which I wrote to Mr Clarke in advance of last week's meeting. Our position has not been materially modified since then.

I hope I have made myself clear and I look forward to hearing from you

Yours sincerely

Philip Baxendale

Chairman: Philip Baxendale; Executive Director: Robert Oakeshott
A Company limited by guarantee - Reg. No. 1419899

Job Ownership Ltd

9 Poland Street London W1V 3DG
Telephone: 01-437 5511

The Rt Hon Kenneth Clarke M.P.
Chancellor of the Duchy of Lancaster
Department of Trade & Industry
1-19 Victoria Street
London SW1

18.9.87

Dear Mr Clarke,

You will remember that in your letter of July 27 you welcomed a proposal of mine that you should be supplied, in advance of our meeting which has since been fixed for October 5th, with a 'detailed statement of the package of ESOP reliefs' which we are seeking. What follows is designed to meet that request. However before plunging into the details it makes sense to introduce a number of more general and preliminary points.

If only in the name of realism, it seems correct to start from JOL's failure, following Senator Long's visit towards the end of last year, to convince Government of the case for a set of measures in this country similar to the ESOP legislation in the US. No doubt the timing was against us, with the Chancellor already committed to Profit Related Pay in the run up to what, even a year ago, seemed likely to be the last Finance Bill of that Parliament. All the same, it seems to us now that an ESOP package submitted for consideration in advance of next year's budget is almost certain to fail unless it has the strong backing of your department. It follows that our first objective at the October 5th meeting will be to enlist your support-in-principle for an advance, embodied in a set of provisions, in next year's finance bill, towards a British counterpart of the ESOP legislation in the U.S. But it also follows, I think, that our second objective, when we meet with you and your officials, will be to listen and to seek your advice. In particular we will want to know what, in your view, the Treasury might realistically be persuaded to accept.

My second preliminary point is designed to ensure that, this time round, those who are advocating a package of ESOP reliefs in next year's finance bill should speak with one voice and not with more than one. As you and your officials may well be aware the professional firm of New Bridge St consulants went public, earlier this year, with a detailed and carefully integrated set of ESOP relief proposals and with a text which, given the necessary Government support, could almost be introduced into next year's finance bill as it stands. Essentially that New Bridge St package is a more detailed version of what we submitted, following Sentaor Long's visit, last year and one that has been converted into the language which legal draughtsmen understand. It is true that our own

legal advisers have some minor reservations about it. It is also true that JOL and New Bridge St Consultants, though they share a common objective in the promotion of employee ownership, are rather different animals. But my main point in this context is a positive one. I feel entitled to be sure that if the project of securing an advance towards a British counterpart of the American ESOP legislation can secure the backing of your department, then you can be confident that we and New Bridge St consultants can agree a common position and a common text.

My final introductory point is a more obvious one. There is clearly a spectrum of possibilities. Easily the best result from our viewpoint would be a major package of ESOP reliefs, basically derived from the American model, but, of course, buttressed by appropriate anti-avoidance provisions and protected from those abuses - like the conversion of pension funds into ESOPs - which have flawed the American experience. If it is realistic to suppose that the Treasury might be persuaded to accept such a major package, so much the better. Given the work which has already been done by New Bridge St and ourselves, the text of such a package could, I think, be quite rapidly agreed. I will not attempt to reproduce all its features here. But the package would:

- confer a complementary set of powers on the trustees of a properly constituted ESOP trust, namely the power a) to borrow money and b) to apply pre-tax contributions passed to them by their sponsoring company to pay off those loans and to meet interest charges on them.
- permit such trustees to warehouse shares purchased by them with borrowed money and not to allocate them to individual employees except pari passu with the repayment of their borrowings.
- grant limited tax reliefs to banks and other approved financial institutions which lent money to trustees of these schemes.
- allow an appropriate set of inheritance tax reliefs to owners of privately held companies which used these ESOP mechanisms to transfer the ownership of their businesses to employees.
- allow an appropriate roll-over-relief from capital gains tax for the owners of family businesses who decided to dispose of them in this way.

Those would be the main features of any major ESOP package. They have the merit of being based on American experience. If it is realistic to suppose that the Government could be persuaded to accept such a package then it should be a realitively simple matter, drawing upon the American evidence, to forecast the likely take-up rates and thus the likely gross revenue cost which would be involved.

But I need hardly say that JOL's position is not one of all or nothing. There is a maximum package at one end of the spectrum. But we would certainly not affect to despise a more modest set of provisions. Moreover, given the almost inescapable complexity of legislation of this kind, we would be happy to accept some sort of commitment in principle by Government in next year's finance bill - to be followed by a consultation exercise and a debate which would lead on to the inclusion of the best attainable package in the 1989 finance bill.

A more modest set of proposals are discussed in an appendix to this letter, 'Obstacles to the Transfer of Family Companies to their Employees', which has kindly been drafted by John Nelson Jones. He will be at our meeting on October 5th and will be able to speak with the professional authority of a lawyer.

At this stage I will confine my observations about a more modest package, tailored to the situation of family businesses, to just one additional point. As you and your officials are doubtless aware, there is case law support for the deductibility of contributions made by companies to employee benefit trusts (EBTs) provided that various conditions are satisfied. I have been advised that if this case law support could be supplemented by a 'clearance procedure' then a significant number of family businesses which are now inhibited by uncertainty from following this path to employee ownership, would decide to do so.

You will clearly expect me to say something about the likely tax costs of either a full-blooded or more modest package. Obviously that is going to depend on take-up rates and on the limits of tax deductibility which are decided upon. Given our knowledge of the American experience we will be well placed to prepare a set of estimates once, assuming a successful outcome of the October 5th meeting, we have reached agreement about what to go for. But it makes sense to say a word about take-up rates already at this stage. I believe that even a modest package would substantially increase the present trickle of private companies which are attempting to introduce employee ownership in a substantial or full-blooded way. But I do not foresee an annual take-up rate running into thousands or even hundreds of companies. The corresponding revenue costs are likely to be similarly modest. That is broadly confirmed by the Amerian evidence. The latter also shows that, for 'leveraged ESOPs', there is a specially favourable relationship between the amount of revenue foregone and the value of shareholdings eventually acquired by employees.

In conclusion I would like to answer one objection which was evidently voiced aginast our ESOP proposals last year. The objection was that our proposals, if accepted, could have been applied across a range of situations. Quite frankly I see that as a virtue rather than the reverse. For the 'leveraged ESOP' is, I believe, potentially a most flexible instrument. In this country it could, for example, be used I believe, in any of the following circumstances:

- when a family business is faced with a succession problem
- when state owned or local authority owned undertakings are privatised
- when a large conglomerate disposes of a profitable but peripheral subsidiary
- when a loss making but potentially profitable business faces what would otherwise be liquidation
- when a profitable business, particularly a privately held one,wishes its employees to participate rapidly in ownership and to a degree which can only be achieved rather slowly using the existing provisions of the 1978 Act
- when a profitable business wishes to raise finance for new investment and to associate its employees in the ownership of the new assets.

The first prize, in my view, would be a major ESOP package which would encourage the use of the leveraged ESOP in any or all of the above situations. But, to repeat, my enthusiasm for the package does not blind me to the benefits of a more modest set of measures - tailored specially to meet the needs of family businesses.

I hope I have made myself clear and I greatly look forward to our meeting on October the 5th.

Yours sincerely

Philip Jarndale.

APPENDIX

Obstacles to the Transfer of Family Companies to their employees

1. Many proprietors of family companies would be willing to transfer their shares to their employees or a trust for their employees. This paper considers the tax factors which deter them from doing so.

2. Broadly speaking, UK tax legislation is helpful to individuals who wish to give shares to their employees/an employee trust, but not to individuals who wish to sell them. Because the employees cannot normally afford to buy other shares, any sale by the proprietors normally has to be to an employee trust or to the company itself. If the sale is to an employee trust, it should be possible to structure matters so that no IHT is payable by the transferors even though the shares are sold at an undervalue. But if a company buys its own shares from a number of shareholders with widely differing percentage shareholdings, serious IHT problems may be experienced if, as will usually be the case, all of them receive the same price. This is because the value for IHT calculation purposes of a small block of shares is much less than that of a large block. Accordingly, the same price for both causes the Inland Revenue to argue that the large shareholder(s) has made a gift to the company which attracts IHT. Also, the company may be treated as having made a gift to the small shareholders, which if it is a close company, can be related back to the large shareholders under the IHT legislation.

3. These problems would not arise if the proprietors sold their shares to a competitor or other outside bidder. This represents an artificial obstacle to the transfer of shares to employees. It should be eliminated by legislation which exempts sales of shares to a company which is controlled by its employees/an employee trust from the scope of IHT so long as appropriate anti-avoidance conditions are satisfied.

4. As an alternative to purchasing its own shares, a private company whose shareholders wish to transfer it to employee ownership can make loans to an employee benefit trust so that it can purchase them. This is rendered unnecessarily difficult by close company tax legislation. From the time when the employee benefit trust first acquires shares in the company, any such loans would attract ACT under section 286 of the Taxes Act 1970. And it seems, though this is not entirely clear, that the Inland Revenue would treat as a distribution for tax purposes a purchase of shares by an employee benefit trust which is financed by a loan from the company.

5. Legislation should be introduced to eliminate these anomalies and uncertainties. It would of course be necessary to incorporate appropriate anti-avoidance conditions.

6. Proprietors of a family company who sell their shares to a listed company in return for shares or debentures qualify for capital gains tax roll-over relief. If instead they sell their shares to their employees/an employee benefit trust, no such relief is available even though they immediately reinvest the proceeds in listed shares or securities. This is another factor which discourages the spread of employee ownership. The position is different in the USA, where rollover relief is available provided that the proceeds of the sale of shares to an ESOP are reinvested in listed shares or securities within a reasonable time. Similar legislation is recommended for this country.

4476/33

CONFIDENTIAL

CE 20/10

FROM: D I SPARKES
DATE: 20 October 1987

1. MISS EVANS ✓
2. MR SCHOLAR / MUS 21/10
3. FINANCIAL SECRETARY

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Paymaster General

Mr Walker - IR
Ms A French - C&E

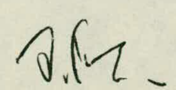
BUDGET REPRESENTATIONS: COUNTRY LANDOWNERS ASSOCIATION

The Country Landowners Association (CLA) have sent in their representations for the 1988 Budget. The letter from the President draws attention to their proposals for changes to CGT in particular. The CLA have asked to meet the Chancellor to discuss them.

2. Last year, for the first time, the Chancellor declined to meet the CLA in the run-up to the Budget because it was felt that their importance no longer warranted it. The CLA did however have the opportunity of airing their views when the Financial Secretary lunched with them shortly after their representations were received.

3. The CLA are on the core list this year and in the Revenue's view they should be seen by a Minister. Since the CLA's main concern is CGT, we recommend that they be seen by the Financial Secretary again. We shall of course arrange briefing.

4. I attach a draft letter to the CLA for the Financial Secretary's signature, if he agrees to meet them.



D I SPARKES

4476/35

DRAFT LETTER FROM FINANCIAL SECRETARY TO COUNTRY LANDOWNERS ASSOCIATION

Thank you for your letter to the Chancellor of 1 October to which he has asked me to reply. He is grateful to you for sending us your detailed Budget Representations and for letting us see your proposals for reform of capital gains tax. The measures which your Association are recommending will of course be considered very fully in the run-up to next year's Budget.

If you would like to discuss with me any of your proposals in greater detail my office would be happy to arrange a meeting. In the time available I imagine that you will wish to concentrate on your CGT proposals; if there are in addition a few of your more detailed representations which you want to raise, please let me know in advance of our meeting.

COUNTRY LANDOWNERS ASSOCIATION

The Rt. Hon. Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
LONDON SW1P 3AG

1st October 1987

Dear Chancellor,

Your Government's re-election to office for an historic third term allows you to conclude the radical reform of capital taxation you have already embarked upon.

Without doubt the major concern of small family businesses remains the pernicious effect of the present capital gains tax. The CLA has recently studied this tax in great detail and has produced radical and innovative proposals for reform which I enclose with this letter. I would very much welcome the opportunity of discussing these proposals with you.

You will see that from the statistical evidence available to us you could abolish capital gains tax and introduce a tapered income tax charge on capital gains whilst retaining more than two-thirds of the present yield.

I also enclose our detailed Budget Representations and would equally welcome the opportunity of raising the more far-reaching of them at a meeting with you.

Yours sincerely,

John Norris

President.

16 Belgrave Square, London SW1X 8PQ Tel. 01 235 0511

President: John Norris Deputy President: Gordon Lee-Steere Director General: James Douglas CBE

3369/41

CONFIDENTIAL

FROM: J J HEYWOOD
DATE: 23 October 1987

MR GORDON IR

cc PS/Chancellor
Mr Scholar
Mr Cropper
Miss Hay
Miss Sinclair
Mr Jenkins OPC
PS/IR

MILK QUOTAS

1. The Financial Secretary was grateful for your minute of 19 October.

2. He suggests that we should extend the relief and that this should be announced immediately.

JEREMY HEYWOOD
Private Secretary

rec on 22/3 86

With the Compliments of
the Director

The National Gallery
TRAFALGAR SQUARE : LONDON WC2N 5DN
Telephone 01-839 3321

NATIONAL ART-COLLECTIONS FUND

20 John Islip Street, London SW1P 4LL Telephone 01-821 0404 Patron: Her Majesty the Queen

PWP
BUDGET REPS

? Why have we suddenly received a copy of this?

The Rt. Hon. Nigel Lawson, MP
Chancellor of the Exchequer
H.M. Treasury
Parliament Street
London SW1P 3AG

23rd October 1987

The National Art-Collections Fund is the most experienced charity supporting the museums and art galleries of this country.

I am writing to recommend two measures in the 1988 Finance Act to help the public art collections in this country.

We understand from ministerial statements of Government policy toward the arts that there are unlikely to be greater financial provisions in the coming year. We understand that the Government is hoping that the arts organisations can increase their earnings and that there will be a larger contribution from the private sector to fill the gap.

We agree that museums and art galleries can find opportunities for greater self-help: but in our view the opportunities under the present tax system are very limited. They are unlikely to be enough. The financial squeeze to which these organisations have been subjected over the past few years is taking its toll in shut galleries, reduced research and poor displays. As for their purchasing grants, they have been reduced in market terms to a half or a quarter of the far from generous provisions of five years ago.

The NACF has recently increased its support and its income quite rapidly, and has been giving many more grants for the acquisitions of works of art. But, as you can imagine, the requests for help far out-run our resources. The prices of works of art have leaped, reflecting world demand.

May I revert, therefore, to the taxation measures which were advocated in our joint letter to you of 20th February 1985, from the Chairman of the Museums and Galleries Commission and the NACF. You have put into effect two out of the seven recommendations. I should like to advocate the introduction in the coming Finance Bill of at least two further measures:

/...

Chairman:
Sir Nicholas Goodison

Honorary Treasurer:
Lord Faringdon

Director:
Sir Peter Wakefield, KBE, CMG

../

1) A change in the division of advantage in the case of Art in Lieu acceptances from 75/25 to 50/50 between the owner and the Revenue.

2) The extension of tax relief to one-off donations to arts charities, or to charities in general.

The first measure would do much to reinforce the working of the A.I.L. system which has such importance for the retention of works of art in this country. The second would encourage giving to art charities and tax-exempt organisations and, with effort on the part of the trustees and administrators of art galleries, could transform both their collections and their display.

I am sending a copy of this letter to Richard Luce at the Office of Arts and Libraries.

Sir Nicholas Goodison
<u>Chairman</u>

[co]st to the Exchequer from United Kingdom companies and individual residents moving to Jersey, Guernsey and the Isle of Man.

Mr. Norman Lamont: I regret that it is not possible to provide such an estimate.

Personal Credit

64. **Mr. Battle:** To ask the Chancellor of the Exchequer what are the latest figures he has for the growth of personal credit over the last three years.

86. **Mr. Martlew:** To ask the Chancellor of the Exchequer what are the latest figures he has for the growth of personal credit over the last three years.

Mr. Lilley: Over the three years to the end of 1987, consumer credit has grown at an annual rate of about 18 per cent.

Investment Statistics

66. **Mrs. Clwyd:** To ask the Chancellor of the Exchequer what are the latest figures that he has for the current level of investment in *(a)* manufacturing industry and *(b)* the service sector.

Mr. Major: Investment in manufacturing in 1987 is provisionally estimated to be 3½ per cent. higher than in 1986. Investment in the construction, distribution and financial industries is estimated to be 10 per cent. higher in 1987 than a year earlier. For these industries as a whole the volume of investment in 1987 was the highest level yet recorded.

International Debt

68. **Mr. Skinner:** To ask the Chancellor of the Exchequer if any further meetings are planned with other Finance Ministers regarding world debt; and if he will make a statement.

Mr. Lilley: I refer the hon. Member to the reply I gave on 11 February at column *337*.

74. **Mr. Gerald Howarth:** To ask the Chancellor of the Exchequer if he will make a further statement setting out the Government's policy on international debt.

102. **Mr. Nicholas Baker:** To ask the Chancellor of the Exchequer if he will make a further statement setting out the Government's policy on international debt.

Mr. Lilley: We are continuing to press the initiative which my right hon. Friend announced last spring for the poorest, most heavily-indebted countries by the easing of terms of official debt in the Paris club. In addition, we have agreed to make a large contribution, by way of subsidy, to the enhanced structural adjustment facility at the IMF.

We warmly welcome the recommended increase in the capital of the World Bank of US$74·8 billion which will enable it to increase its annual lending level from around $14 billion to $20 billion by 1992. This will benefit in particular the middle income debtors.

Labour Statistics

69. **Mr. Sumberg:** To ask the Chancellor of the Exchequer in how many regions adult unemployment has fallen over the past year.

70. **Miss Emma Nicholson:** To ask the Chancellor of the Exchequer in how many regions adult unemployment has fallen over the past year.

97. **Mr. Wolfson:** To ask the Chancellor of the Exchequer in how many regions adult unemployment has fallen over the past year.

Mr. Major: Over the past year, unemployment has fallen in all regions of the United Kingdom.

82. **Mr. Couchman:** To ask the Chancellor of the Exchequer for how many successive quarters total employment in the British economy has risen.

Mr. Major: Employment in Great Britain has risen for 18 successive quarters since March 1983, the longest period of continuous employment growth for nearly 30 years, and by over 1½ million in total.

Personal Ownership

71. **Dr. Goodson-Wickes:** To ask the Chancellor of the Exchequer if he will make a statement on the growth of personal ownership in Britain since 1979.

Mr. Norman Lamont: I refer my hon. Friend to the answer which I gave to my hon. Friend the Member for Darlington (Mr. Fallon) on 29 October, at column *435*.

Supplementary Benefit

72. **Mr. McLeish:** To ask the Chancellor of the Exchequer what representations he has received concerning income tax reductions and the level of public expenditure on supplementary benefits.

Mr. Norman Lamont: My right hon. Friend has received a large number of representations concerning income tax reductions but very few which mention supplementary benefits.

Works of Art (Fiscal Allowances)

75. **Mr. Rathbone:** To ask the Chancellor of the Exchequer what submissions he has received concerning fiscal allowances for donations of art works to the nation.

Mr. Norman Lamont: My right hon. Friend has received none.

National Debt

78. **Mr. Chapman:** To ask the Chancellor of the Exchequer if he will make a statement on the changing level of the national debt, and the interest payable on it as a proportion of total public expenditure.

Mr. Major: The stock of public sector debt has declined as a share of GDP in recent years. This has reduced the burden of debt interest payments, enabling more expenditure on priority programmes while still reducing public spending as a proportion of GDP. Latest estimates of debt interest payments and public expenditure in 1987-88 will be published in the financial statement and Budget report on 15 March.

Small Landlords

83. **Mr. Bowis:** To ask the Chancellor of the Exchequer what tax incentives are available to encourage the small landlord; and if he will make a statement.

PO

FROM: Diary Secretary
DATE: 26 October 1987

MR JEFFERSON SMITH - C&E

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Mr Scholar
Miss Sinclair
Mr Michie
Mr Cropper
PS/Customs & Excise
PS/IR
Miss Rhodes

BUDGET DEPUTATION: AUTOMOBILE ASSOCIATION (AA)

The Paymaster General has agreed to a meeting with Sir Ralph Carr-Ellison, Chairman of the AA and Mr Simon Dyer, the AA's Director General on Thursday, 3 December at 4.45pm in the Treasury to discuss motoring taxation including VAT and excise duty on petrol.

The Paymaster would be grateful for briefing and official support please.

J. Daly

MRS J DALY
Diary Secretary

MR 2/38

CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 27 October 1987

PS/FINANCIAL SECRETARY

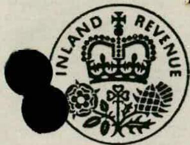
cc: Mr Scholar
Mr Cropper
Miss Hay
Miss Sinclair
Mr Jenkins - OPC
Mr Gordon - IR
PS/IR

MILK QUOTAS

The Chancellor has seen Mr Gordon's minute of 19 October, and yours of 23 October. He has commented: "Good".

CR

pp J M G TAYLOR



CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: C GORDON
DATE: 27 OCTOBER 1987
EXT: 6739

1. MR ISAAC

2. PS/FINANCIAL SECRETARY

MILK AND POTATO QUOTA

1. The Financial Secretary has indicated - your note of 23 October - that the capital gains rollover relief is to be extended to milk and potato quota and that there is to be an immediate announcement.

2. Accordingly I attach a draft Parliamentary Question and Answer together with a draft Inland Revenue Press Release.

3. If the Financial Secretary is content with these we would be grateful if you could arrange for the Question to be put down and let us know the date for answer so that we can arrange the issue of the Press Release.

C GORDON

---

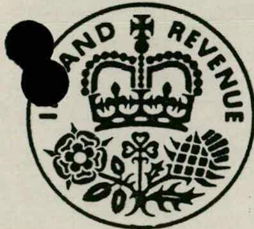
cc PS/Chancellor
Mr Scholar
Mr Cropper
Miss Hay
Miss Sinclair
Mr Jenkins
(Parliamentary Counsel)

Mr Isaac
Mr Pitts
Mr Hamilton
Mr Cayley
Miss McFarlane
(Press Office)
Mr Gordon
Mr Lester
PS/IR

DRAFT PARLIAMENTARY QUESTION AND ANSWER

Q. TO ASK Mr Chancellor of the Exchequer if he has plans to extend the capital gains rollover relief to milk and potato quotas.

A. Legislation will be introduced in next year's Finance Bill extending the rollover relief to milk and potato quotas. The relief will be available where there is a disposal or acquisition of milk or potato quota after midnight tonight.



INLAND REVENUE
Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01–438 6692 OR 6706

[3x]

CAPITAL GAINS ROLLOVER RELIEF:
MILK AND POTATO QUOTA

1. In response to a Parliamentary Question the Chancellor of the Exchequer the Rt Honourable Nigel Lawson MP today made the following statement:

> "Legislation will be introduced in next year's Finance Bill extending the rollover relief to milk and potato quotas. The relief will be available where there is a disposal or acquisition of milk or potato quota after midnight tonight".

NOTES FOR EDITORS

2. Rollover relief allows tax on capital gains to be deferred where there is a disposal of certain types of business assets and a new business asset is acquired within a period running from twelve months before the disposal to three years after it. Relief is confined to specified types of assets including land and goodwill.

3. Milk quota is the right to produce a particular quantity of milk on a particular piece of land without incurring a financial levy on sale of the milk. Potato quota is similar: in effect it represents the right to produce potatoes on a particular area of land without having to pay a financial levy. In both cases the land itself already qualifies for rollover relief but under present rules the quota - the right to produce milk or potatoes without incurring a levy - does not qualify. The relief will now be available where quota (or an interest in quota) is acquired or disposed of after midnight tonight.

4. There has been some uncertainty as to whether UK fishing licences qualify for rollover. These licences (granted to enable the UK to conform with European Community legislation) represent the right to catch a certain quantity of fish. They take a different legal form from milk and potato quota and are treated as goodwill for capital gains tax purposes, and hence already qualify for rollover.

28/4372

FROM: MISS S J FEEST
DATE: 28 October 1987

MR HUTSON
(Parliamentary Section)

cc PS/Chancellor
Mr Scholar
Mr Cropper
Miss Hay
Miss Sinclair
Mr Jenkins
(Parly.Counsel)
Mr Isaac
Mr Pitts
Mr Hamilton
Mr Cayley
Miss McFarlane
(Press Office)
Mr Gordon
Mr Lester
Mr C Gordon
PS/IR

MILK AND POTATO QUOTA

With reference to Mr Gordon's (IR) minute of 27 October 1987 and our conversation today, I understand that you have arranged for the draft Parliamentary Question and Answer therein to be put down.

2. As discussed, the Answer should be attributed to the Financial Secretary, not the Chancellor as stated in the draft press release.

3. Please will you tell Mr Gordon the date of the Answer so that the press release can be issued.

Susan Feest

SUSAN FEEST

29/4372

FROM: MISS S J FEEST
DATE: 28 October 1987

MR C GORDON - IR

cc PS/Chancellor
Mr Scholar
Mr Cropper
Miss Hay
Miss Sinclair
Mr Jenkins (Parly.Counsel)
Mr Isaac
Mr Pitts
Mr Hamilton
Mr Cayley
Miss McFarlane (Press Office)
Mr Gordon
Mr Lester
PS/IR

MILK AND POTATO QUOTA

The Financial Secretary was grateful for your minute of 27 October 1987.

2. I understand that the Parliamentary Question and Answer will be put down, but would point out that the Answer will be given by the Financial Secretary and not the Chancellor, as stated in your draft Press Release.

3. I will advise you regarding the date of the Answer so that the Press Release can be issued.

Susan Feest

SUSAN FEEST

7-13

cc Mr Monck
Mr JG Taylor (personal)

1. ~~PS~~ ~~PSA~~
2. pmp

Miss Evans

I take it from Mr Caff's recent discussion with me that the CBI will not be pressing for a separate formal meeting on the Budget – except that they will want to use one of their regular Nickson/Banham meetings with the Chancellor to say what's on their mind. Mr Caff spoke of expanding the Nickson/Banham meeting somewhat. I spoke discouragingly of this.

MCS 4/11

FROM: MRS T C BURNHAMS
DATE: 30 OCTOBER 1987

1. **MISS SINCLAIR** 30/10
2. **CHANCELLOR OF THE EXCHEQUER**

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Monck
Mr Scholar 30/1
Mr R I G Allen
PS/IR
PS/C&E

CBI: TECHNICAL REPRESENTATIONS FOR THE BUDGET

The CBI have sent you their Technical Representations for the Budget and Mr Willingale's letter of 9 October requests a meeting to discuss them.

2. Inland Revenue officials will be meeting the CBI on 9 November in the usual way, to discuss the Technical Representations, and we share the Revenue's view that there is no need for Ministers to meet the CBI.

3. We have not yet received the main Representations from the CBI, but these are expected shortly. There has been some discussion about whether the January NEDC meeting should replace your normal meetings with the CBI and TUC on their Budget representations (Mr Monck's minute of 27 July refers). It has now been agreed that you will attend the January NEDC. It remains to be seen whether the CBI will press, in addition, for some more informal meetings with you to discuss their main Budget representations. The attached reply is silent on this point.

MRS T C BURNHAMS

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

A E Willingale Esq
Chairman
Taxation Committee
CBI
Centre Point
103 New Oxford Street
LONDON WC1A 1DU

November 1987

Thank you for your letter of 9 October which enclosed your technical representations for the Budget.

I understand you will be having your usual discussion of the technical representations with the Inland Revenue Deputy Chairmen on 9 November. In the circumstances, I do not think a separate meeting with Ministers is necesary on your technical representations, but I can assure you that they will be given careful consideration.

I look forward to receiving your main Budget Representations in due course.

NIGEL LAWSON

TOBACCO
Advisory Council

Glen House, Stag Place, London SW1E 5AG. Telephone: ~~01 828 2041/2803.~~ ~~Telex:~~ 8953754 TOBCOM. Facsimile: 630 9638.

BR

HM TREASURY — MCU
RECD. - 2 NOV 1987
ACTION Mrs Brenhans FP
CC. ~~CHX, CST, FST, PMG,~~ EST, SIR P MIDDLETON, SIR T BURNS, MR CASSELL, MR MONCK, MR SCHOLAR, MISS SINCLAIR, MR RIG ALLEN, MS BOYS, CE
SIGNATURE CHX

BH - wait advice FP

The Rt. Hon. Nigel Lawson, MP,
Chancellor of the Exchequer,
H.M. Treasury,
Parliament Street,
London.

2nd November 1987

Dear Chancellor,

I have pleasure in enclosing the Tobacco Industry's submission in relation to 1988 Budget considerations.

The nil increase on tobacco goods in the 1987 Budget was greatly welcomed by the Industry for all the reasons which we explained to you a year ago. We stressed that duty increases in the current market conditions had far greater impact on the mix of smoking between British-made cigarettes and low priced, marginally costed imports than on the overall consumption of cigarettes; and we stressed that any further significant increase in duty would lead to the already worrying high level of import penetration continuing its inexorable upward trend.

In the event, the absence of a duty increase brought the growth trend to a complete standstill to the benefit of British-made cigarettes, but without increasing overall consumption and, indeed, our current estimates for 1987 are that consumption will again be down.

We remain, therefore, extremely grateful to you for the decision that you took in March 1987 and our plea now is that you do not reverse the policy which you embarked upon at your last Budget. The situation is still extremely fragile and any significant increase in duty would simply undo the good that was done this year. Having said that, we did recognise that 1986 was a very exceptional year for us in terms of the damage that had been done to the market of British-made cigarettes and the implications on our factories. This year, therefore, in asking for the good work not to be undone, we are recognising that the application of the current annual rate of inflation to the specific tax element in the cigarette structure might be necessary; but our plea remains that this level of increase (approximately 4p per 20) should be the absolute ceiling and, indeed, should only be applied to cigarettes on a non-discriminatory basis, i.e. only if similar increases are being applied to all other excise duty bearing goods.

We are, of course, aware of the arguments put forward by the B.M.A. for substantial duty increases on cigarettes. The above arguments are the best response that we can give to the B.M.A.'s views, but more specific comments are briefly outlined in a separate document attached.

I would greatly value a brief meeting with you along with two or three of my colleagues from the Industry not only to discuss some of the major points in our submission in detail, but more specifically to re-emphasise our very deep concern over the continuing nature of the threat from imports.

Yours sincerely,

Bill Owen.

W.C. Owen
Chief Executive

CHANCELLOR'S BUDGET 1988

TOBACCO INDUSTRY SUBMISSION

TOBACCO ADVISORY COUNCIL
NOVEMBER 1987

TAXATION OF CIGARETTES

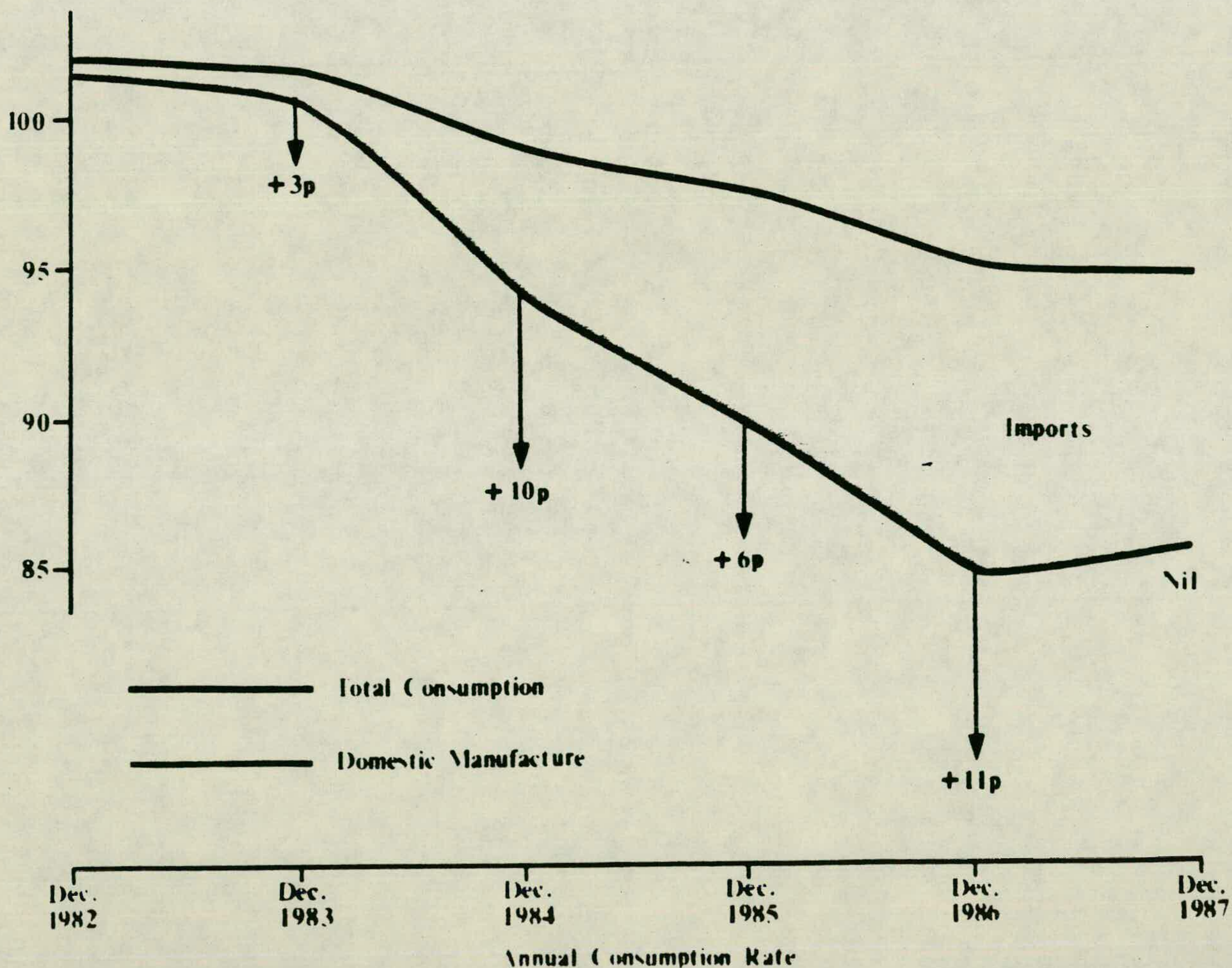
1. Chancellor's Budget - March 1987

In our submission for the 1987 Budget we highlighted, with regard to market trends,

- the growth of the low price imported sector which had increased from 0.5% to 10% of market in only 3 years;
- how excessive taxation increases provided a stimulus to this growth;
- how, because of this trend towards low price brands, cigarette consumption no longer declined rapidly in the face of excessive duty increases; and
- that such a fiscal policy, therefore, resulted in little more than a move away from domestically produced brands to the lower priced imported sector.

Such was the industry's concern over this import growth that, in spite of rising unit costs, UK manufacturers did not increase retail prices in early 1987 as might have been expected.

Clearly it was of considerable relief to the industry that the Chancellor, in recognising these acute problems, saw fit not to increase cigarette duty at the 1987 Budget; and this action complemented the industry's already ongoing initiatives, the result of which was that the average 'over-the-counter' price of non-low priced cigarettes was lower in the post-Budget period than it was at the end of 1986. The effect of this combined effort has become quickly apparent as the following chart shows -



It can be seen from the foregoing chart that -

- although after the 1986 Budget increase (+11p/20), the market share held by low priced imported cigarettes increased substantially;

- in the post-Budget period 1987, this sector share actually declined, albeit marginally, but for the first time since 1983;

- and with the total UK cigarette market continuing to contract, this reversal of a previously strong upward trend in the imported share is obviously particularly welcome.

It cannot be stressed too strongly, however, that the situation is still very fragile and that the structure of the cigarette market will continue, at least for some while, to be particularly sensitive to price changes. Certainly, excessive increases such as that experienced in 1986, when cigarette duty was increased by almost two and a half times the level justified by inflation, can only serve to undo the benefit now accruing from the 1987 Budget standstill.

2. <u>Principal Government Policies</u>

In their election manifesto the Conservative Party outlined the main policy objectives for their now present term of office. These included -

(i) the continued fall and ultimate eradication of inflation;

(ii) further reductions in unemployment; and

(iii) lower personal taxation and a continuation of the transfer from direct to indirect taxation.

Clearly, the Chancellor's fiscal policy for tobacco products in general, but cigarettes in particular, will impact upon each of these objectives as follows -

(i) <u>Inflation</u>

- In spite of the standstill in cigarette duty at the 1987 Budget, taxes have been increased substantially since the election of the Conservative Government in 1979 and the cigarette element of the RPI remains considerably above the All Items index viz -

	June 1987 cf. May 1979
All Items Index	186.2
Cigarette Index	262.7

- independent research, the results of which have been confirmed by Government officials, illustrates that raising additional revenue from cigarettes has a greater upward effect on the RPI than the effect would be of raising revenue from VAT or almost any other major source of excise taxation;

- any increase greater than that required by inflation is inflationary; and any increase which simply matches inflation cannot have the effect of achieving a lower level of inflation.

(ii) Unemployment

- Although direct employment in the UK tobacco industry stands at only some 20,000 jobs, total employment, i.e. including associated industries, is of the order of 185,000;

- this is some 70/80,000 lower than the 1980 level - a reduction of almost 30%;

- furthermore, cigarette manufacture is concentrated in areas of already high unemployment (North, North West, N. Ireland) where the consequences of further factory closures would be particularly far reaching;

- in this context it should be noted that rationalisation is carried out retrospectively and the standstill at the 1987 Budget, although very welcome, was too late to stop factory closures which had become inevitable (e.g Swindon);

- the historical linkage between market decline and lower employment levels is now being exacerbated by import penetration; and

- anything other than the most sensitive fiscal handling at the 1988 Budget will result in significant job losses within the cigarette and associated industries.

(iii) Lower Personal Taxation

- A policy to lower direct taxation need not and should not result in higher levels of indirect taxation;

- but any transfer from direct to indirect taxation which occurs should, at the very least, be spread proportionately over the various indirect taxes;

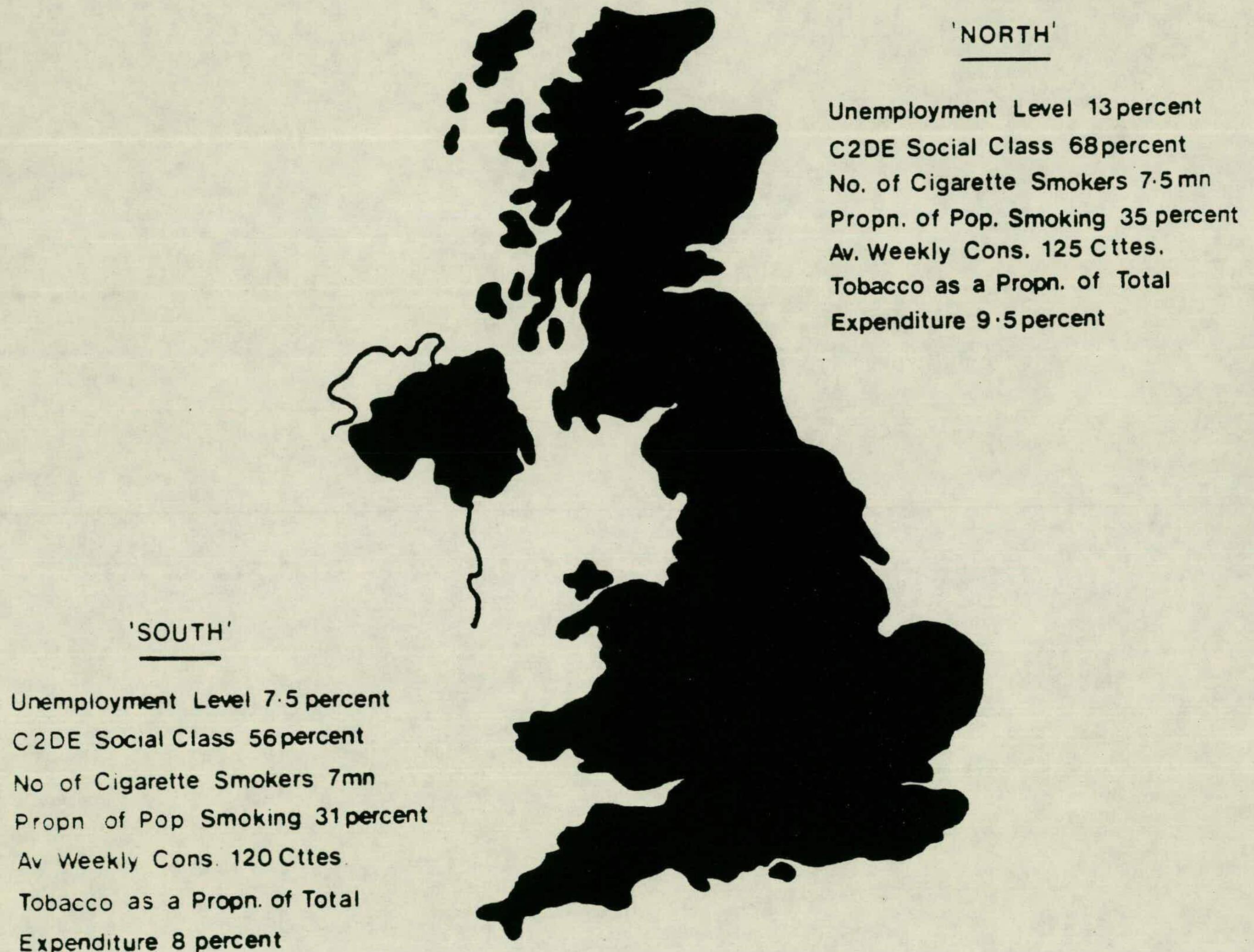
- indeed, because of the already punitive duty incidence on tobacco products, there is a strong argument that any increased emphasis on indirect taxation should fall with less severity on tobacco product groups;

- additionally, the vast disparity which currently exists between UK cigarette duty and the lower levels prevailing in almost all of the other EEC member states must suggest that UK smokers should not be further penalised. (Only 2.5% of total EEC cigarette sales are at tax levels higher than that prevailing in the U.K.)

From the above it is clear that the effect of excessive increases in cigarette duty would run totally counter to the Government's objectives regarding inflation and unemployment. It is also clear that such fiscal measures, as part of a policy to reduce the level of direct taxation, cannot be justified either in the domestic or European context.

3. Public Perception - "The North-South Divide"

A further area of Governmental concern is the representative imbalance in voting patterns which became readily apparent after the last General Election. There are obviously many factors which contribute to this imbalance although two stand out as being of particular significance - the higher level of unemployment in the 'North' and the consequently lower standard of living - and in these respects the following chart is important -



In view of the higher proportion and number of smokers in the 'North', the Government's policy towards cigarette taxation is of far greater significance to this sector of the population because -

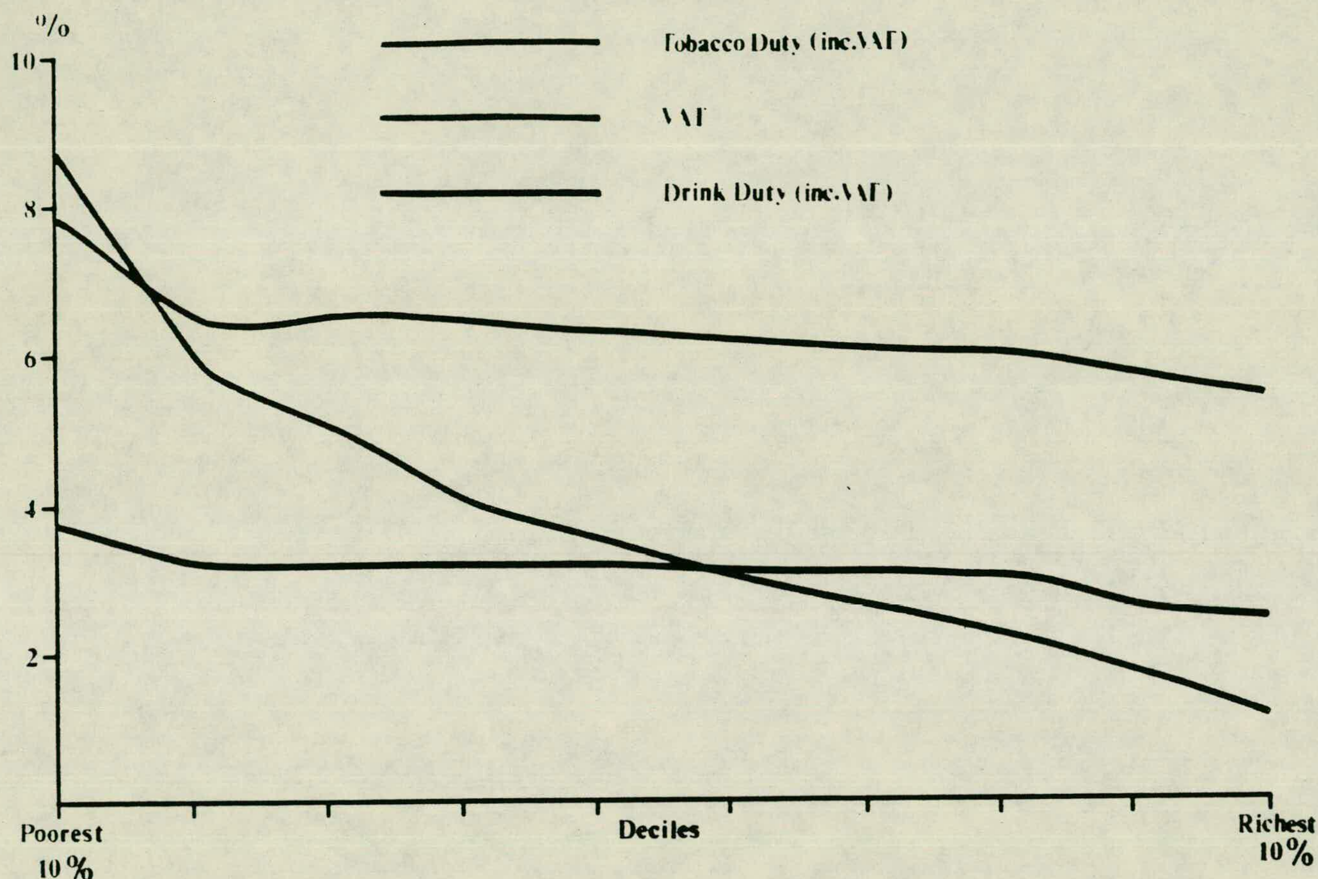
- tobacco taxation is the most regressive of all central Government taxes;

- the degree of regressivity has worsened considerably over the period of this Government;

- the poorest 35%/40% of householders pay more in tobacco taxes than in income tax;

- indeed, for the poorest households, expenditure on tobacco taxes is much the same as total expenditure on VAT. This and the degree to which tobacco taxation is particularly regressive, can be demonstrated as follows -

TAX EXPENDITURE AS A PROPORTION OF INCOME



An additional but very significant consideration is the geographical location of cigarette manufacture which is such that over 60% of all UK cigarette production occurs in the 'North' and is concentrated in relatively few manufacturing centres. Consequently the sociological implications of factory closures are indeed serious and will occur in precisely those areas for which the Government is, at present, displaying most concern.

It is clear that, if this Government intends to redress this present imbalance between 'North' and 'South', fiscal policies must not impact with disproportionate severity on the 'Northern' population. Such will be the effect, however, of excessive increases in cigarette duty and overtly so.

4. Long Term Industry Objectives

Clearly the emergence of cheap imported cigarettes is the single biggest commercial threat to the UK industry whose most important objective must, therefore, be to ensure that it competes effectively in order to reduce, or at least contain, the market share held by this sector.

However, almost regardless of any competitive activity which UK manufacturers might undertake, further growth in this sector will be inevitable if smokers are faced with fiscally-induced price increases of such magnitude that trading down to these often marginally-costed products becomes an overwhelmingly attractive proposition.

For this reason it is imperative that any benefits accruing from industry strategies are not negated by fiscal policies which force smokers away from domestically manufactured products. The industry firmly believes that the upward sales trend experienced by imported cigarettes over the past 3/4 years is not irreversible; but an essential pre-requisite of effecting such a reversal is a considerable period of relative price stability, the beneficial consequences of which are potentially very great, viz -

- a less volatile market for domestic cigarettes thus facilitating better planning for UK manufacturers;
- a more stable sales level clearly will offer greater protection for employment levels;
- it will contribute towards export objectives which have suffered significantly over recent years as rapidly falling home sales have too quickly increased unit costs, thus affecting our competitiveness in already very difficult overseas markets; and
- also offers greater protection and predictability for the Revenue.

5. Conclusion

The nil increase at the 1987 Budget was greatly welcomed and the beneficial effects of this policy are already becoming evident in the market-place. But the arguments in support of a continuation of such a fiscal policy are compelling, viz -

- current market trends, although more stable, are still very fragile and in need of consolidation if this is to be anything other than short term;
- a moderate fiscal policy will complement the strategies presently pursued by UK manufacturers;
- the avoidance of excessive duty increases will not increase the already considerable problems associated with excise rate approximation as defined by the EEC;
- a moderate fiscal policy towards cigarettes can assist towards the Government's central economic policy objectives of reducing both inflation and unemployment; and

- such a fiscal policy will be seen as a contributory step towards some alleviation of the 'North-South Divide'.

- it would seem strange and indeed contradictory to reverse the course adopted at the 1987 Budget by compensating, in 1988, for the nil increase in 1987.

It must be clear, therefore, that a continuation of the fiscal policy adopted at the 1987 Budget of no increase for any tobacco products is in the best interests of both the UK industry and the Government. But at the very worst, cigarettes and handrolling tobaccos should not be subjected to any increase greater than that justified by inflation. Above all we must not be faced with a large increase at the 1988 Budget which, in addition to being overtly politically inconsistent, will cause an immediate reduction in the industry's level of competitiveness thus, once more, increasing the vulnerability to import penetration with inevitable consequences for employment etc.

November 1987

TAXATION OF PIPE TOBACCOS AND CIGARS

Pipe Tobaccos

Although pipe tobacco duty has been held at each of the last five Budgets, consumption continues to decline and currently stands at only 75% of the 1982 level. However, this market contraction has occurred at a much slower rate than would have been the case had the duty level been increased and it is imperative therefore that this fiscal policy is continued, the arguments in support of this being -

- almost 50% of pipe tobacco consumption is accounted for by smokers aged 60+;
- over half of smokers are in the C2DE social groups;
- pipe tobacco manufacture is concentrated in areas of already high unemployment - Belfast 18%, Liverpool 20%;
- relative to cigarettes, UK pipe tobacco prices are still amongst the highest in the EEC.

Cigars

Over the period 1979-1984 the fiscal policy towards cigars was such that the duty incidence on this product group increased from 43% to 52% of retail price. Not surprisingly this action reversed the upward sales trend we had experienced since 1974 to such an extent that, by 1984, the cigar market stood at only 85% of its 1979 level.

Since 1984 the Chancellor has not increased cigar duty and, as a result, the market has recovered slightly, although total sales still represent only 90% of their 1979 level. Furthermore, it is our belief that this recovery remains fragile and can only be protected by a continuation of current fiscal policy which can be justified by the following reasons -

- over 50% of cigar smokers are in the C2DE social groups;
- about three-quarters of UK cigar production is located in areas of above average unemployment - Glasgow 17.5%, Glamorgan 14.5%;
- the duty incidence on cigars is still higher than in all bar two other EEC countries;

TAXATION OF CIGARETTES
British Medical Association Demands

1. In August 1987 the British Medical Association called for the Chancellor to increase cigarette prices by 30p per 20 at the 1988 Budget (+21%) and by 6% in real terms at each subsequent budget of this present Government. The rationale for this fiscal policy, in terms of the objectives which might be achieved, is based on statistical research papers written by Townsend, an economist at the Medical Research Council.

2. The U.K. tobacco industry questions the qualifications of the BMA to advise the Chancellor on fiscal matters of any kind. But it positively challenges certain important statements and assumptions contained in the Townsend papers as being either misleading through selective use of data, or ill-founded in the light of more soundly based independent research.

3. Townsend claims that, since the 1947-50 period, cigarette taxes and prices have generally fallen in real terms. The tobacco industry would argue that using this base period is to take, as one's standard of reference, conditions of post-war economic austerity that were quite abnormal and included a duty increase of over 55% in 1947 - proportionately the largest there has ever been. More meaningfully, based on the period 1952-86, cigarette prices currently are higher in real terms regardless of which base year is chosen.

4. It is hardly a revelation that increases in tobacco duty usually produce additional revenue. But the formula used by Townsend in this connection is an over-simplification and certainly takes no account of the way in which the UK cigarette market has changed over the past 3 or 4 years with the development of the low priced imported sector. At the 1986 Budget, cigarette prices rose by over 8% but, because the opportunity existed for smokers to downtrade into low priced imported cigarettes, consumption fell by little more than 2%. But within the total market, the swing to imported brands was substantial and would inevitably be repeated if another excessive duty increase was imposed.

5. Tobacco taxation is the most regressive source of central Government taxation in the United Kingdom; and any increase in tobacco tax rates is likely to make it even more so. Townsend suggests that, at least for male smokers, demand for cigarettes becomes much more price-elastic as one moves down the social scale; and, indeed, Townsend reaches the paradoxical conclusion that, if cigarette prices rose, male smokers in social class 1 - professional - would actually smoke more! In this respect, it would not be surprising if price elasticity for tobacco products among poorer smokers was somewhat higher than for the more affluent social classes. But it does not follow that these differences are sufficient to neutralise the regressive effects of tobacco tax increases and, in fact, the recent study carried out by London Economics - "Who Pays Tobacco Tax?" - shows quite clearly that the tax increases that have taken place since 1978 have markedly increased the regressiveness of tobacco taxation.

6. The basis for the BMA's proposed fiscal policy appears therefore to be questionable, viz -

(i) using any year between 1952-1986 as a base shows the current price of cigarettes to have increased in real terms;

(ii) excessive duty increases no longer significantly reduce total consumption but merely accelerate the swing from domestic to cheap imported cigarettes;

(iii) tobacco duty is regressive with the degree of regressivity increasing significantly since 1978; and there can be little doubt that the BMA's proposed policy would impact with most severity on those in the lower income groups.

7. The BMA proposal therefore is ill-conceived in almost every respect. Obviously an increase of 30p per 20 at the 1988 Budget would achieve some reduction in total cigarette consumption, but nowhere near the magnitude suggested by the BMA. And the downside of such an increase would be immense in that -

- UK domestic production would decline dramatically at the hands of cheap imports;

- employment levels would, consequently, come under great pressure;

- some smokers in the lowest income groups eg. pensioners, unemployed etc. would be denied the choice of whether or not to smoke while others who continued would suffer inordinately.

- because of the disproportionate upward effect which tobacco tax increases have on the RPI, the inflationary effects would run totally counter to the Government's objectives.

November 1987

UK OFFSHORE OPERATORS ASSOCIATION LIMITED

3 Hans Crescent, London SW1X 0LN
Telephone: 01·589 5255
Telex: 938291

ECONOMIC SECRETARY
REC'D - 3 NOV 1987
ACTION Mr Johns - IR
COPIES TO PS/Chancellor
PS/FST
Sir P Middleton
Mr Cassell
Mr Moore
Mr M Williams
Ms Leahy
Mrs Hubbard - IR
Miss Hill - IR
Mr Kuczys - IR
PS/IR

3 November 1987

P. B. Lilley, Esq.
Economic Secretary
H. M. Treasury
Parliament Street
LONDON SWIP 3AF

Dear Mr Lilley,

Our President, Carl Burnett, Executive Officers, and I would much appreciate a short meeting with you at your early convenience. The purpose would be two-fold :

- To discuss with you our Members' proposals for fiscal amendments in the Chancellor's next Budget in March 1988. They are designed to enhance confidence - particularly in the contracting and services sector which has been badly hit by the fall in oil prices - and restore a climate conducive to risk-taking. Our proposals, which would help maintain and hopefully increase the momentum of industry investment in UK offshore oil and gas, are particularly directed towards extending the productive life of existing fields and encouraging full evaluation and development of the Southern Gas Basin. The details are given in the enclosed letter and paper which we have just sent to the Minister of State for Energy, Mr Peter Morrison.

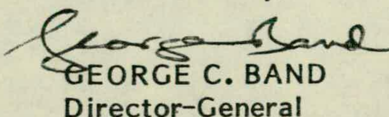
- Following the passage of the Petroleum Act, to apprise you of the considerable work done in UKOOA over recent months on the fiscal aspects of abandonment. We are glad to report that this has led to a consensus among our Members to request various amendments to the existing regime which will provide more equitable fiscal relief for the enormous costs involved. We will also in due course be submitting a paper on this subject.

When your officials have had an opportunity to study the enclosed paper, we would like our representatives to discuss it in further detail with a team drawn from the Department of Energy, the Inland Revenue and the Treasury, as has been the case in previous years.

May our secretaries be in touch to arrange the initial meeting with you at a mutually convenient date?

We look forward to seeing you.

Yours sincerely,



GEORGE C. BAND
Director-General

UK OFFSHORE OPERATORS ASSOCIATION LIMITED

3 Hans Crescent, London SW1X 0LN
Telephone: 01·589 5255
Telex: 938291

GCB/SLP

3rd November 1987

The Hon. Peter Morrison MP
Minister of State
Department of Energy
Thames House South
Millbank
London SW1P 4QJ

Dear Minister,

Fiscal Representations

We attach representations on three major fiscal matters which we would like to see taken up in the 1988 Budget and Finance Act. The first two represent our Members' views on the steps required to extend the life and increase the ultimate recovery of existing fields. This additional oil would benefit both Government and the industry. The third proposal would encourage the full evaluation and development of the Southern Gas Basin, defer the need for additional substantial imports and thereby assist the balance of payments.

The three proposals are summarised as follows :-

1. Incremental Investment Incentives

   In come cases this problem could be resolved if the criteria for determining separate field status were more flexibly applied. Where separate field status cannot be granted there should be an incremental investment allowance to ensure maximum economic recovery of reserves.. We are therefore proposing in our paper a PRT Incremental Investment Allowance of either 25% immediately, or 50% spread over 10 years. This would apply in each field after expiry of Safeguard.

2. Royalty

   Our Members would strongly prefer the abolition of Royalty for existing fields to help extend field life. We appreciate however, the large cost that total abolition of Royalty for existing fields would be for Government, especially in the first year. We are therefore proposing that there should be a Royalty Free Allowance of 20,000 b/d, similar to the oil allowance for PRT for new fields in the 1983 Finance Act.

3. Southern Basin

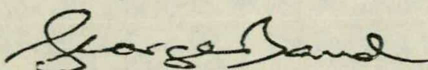
   We continue to feel strongly that there should not be a separate tax regime in the Southern North Sea, and thus our paper argues that this area should receive the same tax treatment as the rest of the UK Continental Shelf. Just as for oil, this would stimulate the development, by satellite or stand-alone techniques, of both the smaller and the more complex gas accumulations.

We trust that our paper makes a convincing case for fiscal change. This would help to enhance confidence - particularly in the contracting and services sector, which has been badly hit by the fall in oil prices - and restore a climate conducive to risk taking.

Our Executive Officers and I look forward to an early discussion with you on the above at our meeting already arranged for 10.00 a.m. on Friday 6th November. Then, when your Officials have had a full opportunity to study the paper, we would like our representatives to discuss it in further detail with a team drawn from your Department, the Inland Revenue and the Treasury, as has been the case in previous years. We are therefore also taking the opportunity to copy this letter to Mr Peter Lilley, the Economic Secretary to the Treasury.

We look forward to seeing you.

Yours sincerely



G C BAND
Director-General

FISCAL REPRESENTATIONS

A Memorandum Submitted to Government by the
UK Offshore Operators Association

November 1987

I. INTRODUCTION

I.1 As a result of the fiscal changes introduced in 1983 and 1987 it is generally recognised that the UKCS fiscal regime facilitates the development of new oil fields. However, fields developed before 1982 and all Southern Basin fields were excluded from the benefits of these fiscal changes, so that falling prices have had a disproportionate impact in these areas.

If the UK is to arrest the projected decline in oil and gas production and extend self sufficiency to the 21st Century, then the existing producing fields and the Southern Basin will need to play a key role. The purpose of this paper is to outline the case for three fiscal changes specifically designed to regenerate both confidence and activity in these important areas. They are:

- Incentives for incremental investments in PRT paying fields.
- Reduction of royalty on existing fields.
- Elimination of the Southern Basin fiscal differential.

The 1983 fiscal changes led to a marked resurgence of exploration, appraisal and, eventually, new development activity. It is striking that, while some of these developments could have been anticipated, many were not accurately foreseen. This highlights the danger of resting decisions about desirable fiscal changes too heavily on aggregations of anticipated case-by-case results. The case for fiscal change must take into account the effect on confidence and the creation of a climate conducive to risk taking.

I.2 Background

Figure 1 illustrates how the UK fiscal regime has evolved for producing fields over the past 15 years in relation to crude price developments. The key feature is the significant increase in the PRT burden as oil prices increased (1979-1981), with no corresponding relaxation as real oil prices fell.

- real oil prices are now significantly lower than the level in the mid-1970's when most producing fields were committed
- marginal Government take is significantly higher
- allowances protecting fields from PRT have been eroded (oil allowance halved, safeguard truncated)
- investment relief has been eroded (uplift truncated)

The combined impact of these developments on industry cash flows has been dramatic. Although oil companies have taken strong measures to adapt to the new environment by cutting costs on existing fields and new developments, and have slashed exploration budgets, some £3 billion was wiped off the internally generated cashflows of the upstream oil industry in 1986. (See Table 1). Taking into account the cost of servicing debt the overall cashflow position of the industry is almost certainly negative. Government cash flows, while much diminished, remain positive. The impact of the industry's cash squeeze has already been felt by the support industries, but the effects on total oil recovery from the UKCS will only become apparent in the longer term.

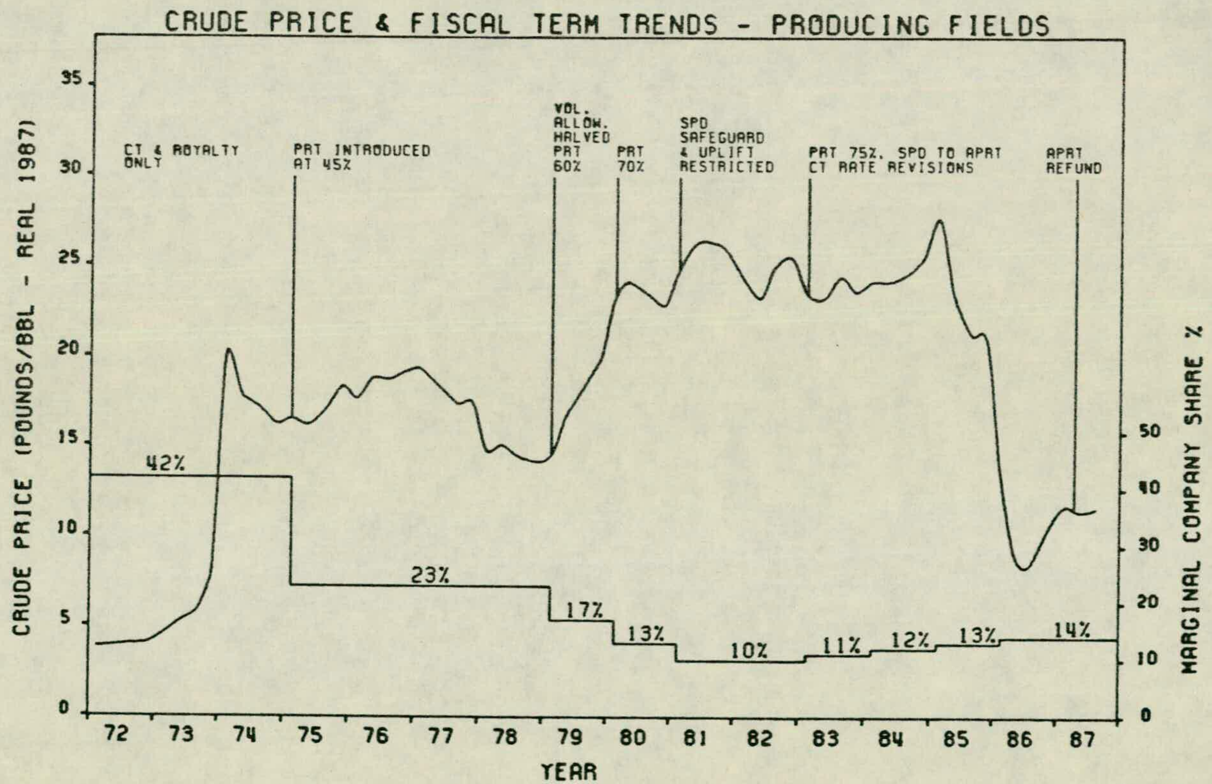


Table 1

UK PETROLEUM INDUSTRY: 1985-87

(£ Billions)

Average realised price	£20.6/bbl	£9.8/bbl	£11.0/bbl
	1985	1986	1987
Value of Sales (Oil and Gas only)	21.4	11.2	11.5
of which oil	19.7	9.3	9.5
gas	1.7	1.9	2.0
Total Operating Costs	2.2	2.1	2.3
Government Take	12.0	6.2	5.9
After Tax Income	7.2	2.9	3.3
Exploration Expenditures	1.5	1.0	0.8
Development Expenditures	2.8	2.3	1.8
Funds Flow before interest, Dividends and outstanding Loan Repayments	2.9	(0.4)	0.7

Note: 1987 Government take is estimated net of early repayment of some £300 million of APRT.

UKOOA members believe that there is a strong case for reversing some of the previous increases in the taxation of existing fields to ease the strain on cash flow with well targeted measures to encourage new investment and maximise recovery of UKCS reserves.

II. INCREMENTAL INVESTMENT ALLOWANCE

II.1. The Problem

Incremental investments within the ring fence of a PRT paying field suffer two major economic debits due to the fiscal regime:-

i) the DCF return after tax is some 10-15% points below the pre-tax level

ii) Government take is typically above 85%

In this fiscal environment there is clearly a risk that projects which are attractive before tax will be unattractive after tax. More damaging, however, is the "climate of inhibition" which prevents a variety of economically viable ideas which could add to reserves and extend the life of fields, from ever reaching the project stage because of the high fiscal hurdle which they have to jump.

Two distinct approaches to a solution are available. The incremental investment fiscal problem disappears if the incremental reserves are deemed to be outside the existing PRT boundary. For other investments an incremental investment allowance may be the only solution.

II.2. Background

Through 1984-5 Government and Industry held extensive discussions on the incremental investment problem, with UKOOA publishings its proposals in an Information Paper dated January 1985: 'Getting the Most out of the North Sea.' Whilst there was apparent acceptance of UKOOA's analysis of the problem, Government expressed doubts about the cost effectiveness of fiscal relief for incremental investment and concluded that the time was not yet ripe for action. Yet relief for incremental investment remains a strong priority for UKOOA members.

Earlier this year, when UKOOA, Brindex and all the major oil companies made submissions to the House of Commons Energy Select Committee, all recommended that Government implement an incremental investment allowance.
The Select Committee backed the industry view. They stated:-

"The present situation is unsatisfactory. The Government's agreement merely to keep the situation under review maintains the uncertainties and is not conducive to facilitating investments which might be necessary to optimise recovery of North Sea Oil. We therefore recommend that the Government endeavor to devise a fiscal scheme for facilitating incremental investments which are profitable on a pre-tax basis but unprofitable after tax".

The Select Committee captured the essence of the problem - the present fiscal climate is not conducive to facilitating incremental investments.

II.3 Recommendation

The discussions described above took place when oil prices were $30/bbl. Shortly thereafter they collapsed and are now around $18/bbl. We believe that this should remove any remaining doubt about the necessity for immediate action on incremental investment, and should have greatly reduced Government's previous concerns regarding the cost-effectiveness of a remedial measure.

Our first recommendation, which is not strictly a fiscal one, is that the geological criteria for granting separate ring fence status to incremental reserves not exploited by the original development should be applied as flexibly as possible. For example, the Department of Energy should be prepared to take into account the existence of a sealing fault or a different pressure regime and should be prepared to acknowledge the separateness of deeper or shallower reservoirs.

Secondly, in the light of recent oil price developments UKOOA believes its original proposal regarding an incremental investment allowance should be enacted without further qualification. Namely:

A PRT Incremental Investment Allowance (IIA), of either:-

i) 25% immediately or, equivalently
ii) 50% spread over 10 years

Either approach (or some intermediate configuration) would achieve the objective of restoring fiscal neutrality with broadly equivalent before- and after-tax returns for marginal projects. The larger allowance, spread over time, may be more attractive to Government in that the direct cost would more closely track additional revenues, reducing the likelihood of any short term cost to Government.

The definition of qualifying expenditure would be all expenditure qualifying for uplift incurred after expiry of safeguard (subject to a satisfactory outcome of current Inland Revenue review of expenditure within safeguard).

II.4 Justification

Real oil prices are lower than at any time since 1973. Industry therefore has a case for some reversal of the increases in taxation which occurred in the higher oil price era. An IIA represents a timely and efficient means of effecting a minor part of that reduction.

At any oil price it can be demonstrated that there will be a range of incremental projects which are attractive before tax but not after. At a $30/bbl projects with unit costs (inclusive of return) between $20-30/bbl were in the critical range. At the current $18/bbl price the range becomes $12-18/bbl. The development of oil prices over the past 24 months increases the urgency for action. (See Appendix 1 for details).

Whenever the average company share of net income is as low as 15%, there is a natural reluctance to take on the 100% management of significant physical and manpower resources in order to earn such a meagre share of the financial resources.

Prior submissions to Government contained a number of examples of significant potential incremental development opportunities which were at the conceptual stage. Crystallizing such opportunities into commercial projects requires much effort by operators. There is a long lead time for the planning studies necessary to develop technical solutions appropriate to the current oil price outlook. Such efforts require an investment climate that is conducive to ultimate implementation of successful endeavours.

There is a limited 'window of opportunity' for many incremental investments, as the optimum timing of the investment is dictated by reservoir management considerations. The 1981-83 new field development hiatus induced by the fiscal regime may have only deferred the recovery of reserves. This cannot be assumed to be the case for additional development activity at producing fields. The fields of concern are reaching the mature phase, being some 50-70% depleted. Creating an environment conducive to additional development therefore requires immediate action.

11.5. Costs & Benefits to Government

Members submissions to UKOOA indicate planned future expenditures of £200-300 million p.a. in currently PRT paying fields post safeguard. UKOOA would anticipate these expenditures to be broadly consistent with the 'low estimate' submitted to NEDO. Whilst commitment of much of this expenditure will be dependent on the economics at the time, UKOOA's data implies a maximum "dead weight cost" to Government of only £20-30 million p.a. The benefit to Government derives from the stimulus such a measure would give to additional development opportunities which are currently at no more than the conceptual stage.

An expenditure related allowance as proposed by UKOOA is well targeted in that lower unit cost projects receive proportionately less relief. Prior UKOOA representations have demonstrated how an IIA typically reduces Government take on the incremental investment by 15%. Thus a broad balance in Government revenues would be achieved if only one additional project were triggered by IIA for every five projects which would have proceeded anyway.

III. ROYALTY

III.1. The Problem

Royalty is one of the special Government levies that places an increasing burden on the industry as profitability is being eroded. It is not a profit-based levy, and therefore could accelerate field abandonment and inhibit incremental investments in existing fields. Its impact is mainly felt by the least profitable fields which don't pay PRT. It has many of the same drawbacks as APRT and SPD, which have now been abolished.

III.2. Background

In the 1983 Royalty Relief Act, royalty was abolished for new UKCS fields outside the Southern Basin. Following the oil price collapse in 1986 UKOOA made representations to Government for the reduction or abolition of royalty on existing fields as one of a number of measures which could revive confidence in the UK upstream oil industry and maintain activity.

The May 1987 report of the Energy Committee of the House of Commons on "The Effect of Oil & Gas Prices on Activity in the North Sea" recognised that royalty is not profit-based and could accelerate field abandonment. It recognised problems of profitability with incremental investments in existing fields. However the Committee stopped short of recommending royalty abolition, and instead proposed that the Government publish guidelines, "preferably in the form of a formula", indicating the conditions under which royalty refunds would be given to prevent premature abandonment of fields (using the Secretary of State for Energy's powers under Section 41 (3) of the Petroleum and Submarine Pipelines Act 1975).

III.3. Recommendation

Royalty abolition would remove distortions and provide additional cashflow for further investment in UKCS activity. However, UKOOA recognises that royalty abolition would be expensive to Government, particularly in the first year of abolition. Therefore, UKOOA recommends the introduction of a production tranche which is exempt from royalty (similar to the oil allowance for PRT) for each field. A royalty exempt production tranche of 20,000 barrels per day per field would reduce the impact on Government revenues compared to total royalty abolition by two thirds in the initial two years.

III.4. Justification

Royalty reduction is better targeted than cash flow relief delivered through changes to the rate of PRT because the burden of royalty is heaviest on those fields which pay no PRT. For profitable fields most of the concession is recaptured through increased PRT and CT.

The Treasury argued in its submission to the Energy Committee that royalty is worked out on a largely profits-related basis. However, most drilling costs have no allowance whatsoever for royalty relief, and the majority of other platform costs are only 60%-70% allowable. Appendix 2(a) illustrates how royalty will represent a rising percentage of the cashflow before Government take of royalty-paying oilfields over the ensuing years, rising from a current level of around 12-13% to around 15-20% by 1995. This is a consequence of the allowances for major capital expenditure being exhausted and of lower production yielding a reduced margin over operating costs. For fields in 5th round or later licenses, which will include an increasing number of gas fields, royalty is levied on the landed value with no allowances for costs.

Royalty on existing fields inhibits incremental investment and hence tends to diminish oil recovery and field life. Whereas royalty is levied immediately on incremental revenues generated, relief from royalty is allowed on capital expenditure only over an 8 year depreciation period, and generally only around 60% of expenditure incurred will qualify for relief. In the case of recompletions, there is no royalty relief on expenditure. Reduction of the royalty burden would reduce the gap between rates of return on incremental projects pre and post Government take and is potentially important in later field life.

Royalty also tends to reduce the economic life of a field. As production falls towards the end of field life royalty becomes a higher and higher percentage of net revenue. Appendix 2(b) illustrates this. Royalty can increase to over half the total net revenue in the last year before abandonment. The impact of royalty on the timing of abandonment depends on operational decisions in the years preceding abandonment. Examples of such decisions include abandonment of individual wells, curtailment of well workover activity and reduction of processing capacity. These investments (or their absence) will determine the quantity of oil recovered in the last few years of field life and the ultimate timing of field abandonment.

III.5. Costs and Benefits to Government

a) Impact on Government cashflow

A 20,000 barrel per day royalty free production allowance per field is "well targeted" insofar as the benefits are proportionally greater for the less profitable fields which pay no PRT. For PRT-paying fields most of the benefit to companies from reduction of royalty is recaptured through a higher PRT take. The concession could eliminate royalty payments immediately on about a third of existing oil and gas fields, leaving the most productive fields still liable to royalty.

Over the period 1989-2025, UKOOA estimated Government take from existing royalty paying oil and gas fields is some £32 billion. The proposed royalty concession could reduce Government revenues by an average of 3-4% over this period. (Details and assumptions can be provided).

b) Benefits derived from a relaxation of the Royalty burden

It is clear that the potential benefits are very significant:-

i) The cash flow improvement would help to restore confidence and provide funds for investment in new fields.

ii) The economics of incremental investments would be improved leading to increased recovery and field life extension. The proposed concession would result in immediate royalty abolition for about a third of existing fields. About a dozen more would have royalty abolished at least 4 years prior to their field abandonment.

iii) There is potential to reduce the heavy administrative burden on industry & Government.

These effects would generate activity, improve the balance of payments and increase the PRT/CT take, thus offsetting the initial cost of a reduction in royalty take.

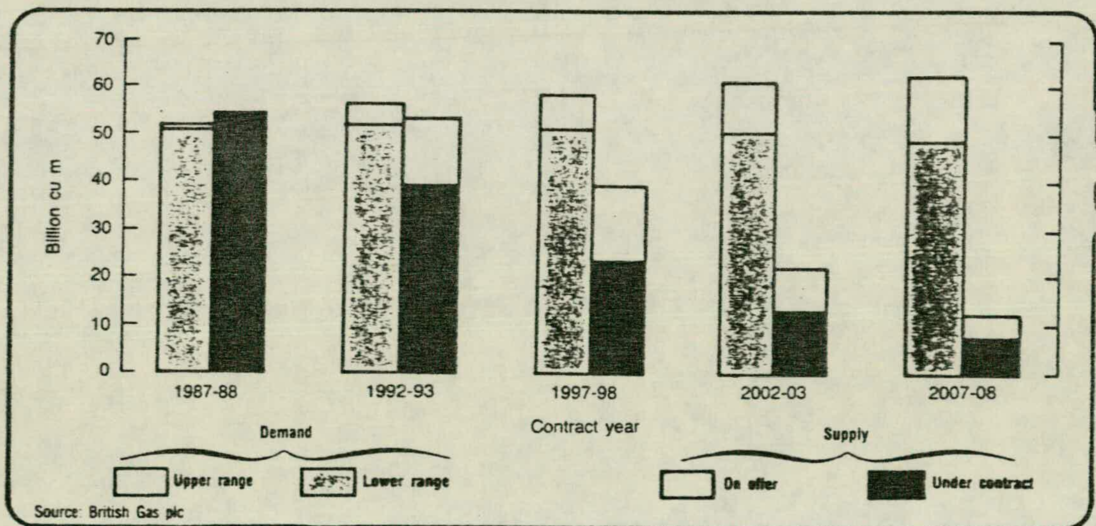
IV. SOUTHERN BASIN INCENTIVES

IV.1. The Problem

New fields in the Southern Basin were specifically excluded from the 1983 fiscal incentives which have so successfully stimulated development activity in the UK North Sea. This distinction between Southern Basin and other UKCS fiscal terms will result in the long run in fewer resources being allocated to gas exploration and development than is economically justified in the national interest.

Several years down the road, a large gas supply shortfall is anticipated by British Gas. This gap can and should be filled by UK producers at competitive prices. This outcome will be inhibited if a significant proportion of future gas discoveries are attractive pre-tax but unattractive post-tax. The time to remedy this is now, so that today's exploration and appraisal activity will adequately provide for tomorrow's needs.

The outlook for U.K. gas supply/demand



IV.2. Background

The reason given by the Government in 1983 for the discrimination against the Southern Basin, was that the costs of production were lower than elsewhere. HM Treasury and the Inland Revenue in their memorandum to the Select Committee on Energy (Third Report 1986-87) also noted that there had as yet been no fall-off in Southern Basin activity.

The current high level of activity in the Southern Basin represents a continuing response to the improved prices offered by British Gas for contracts signed in the mid-1980's. These prices became necessary in order to restart Southern Basin exploration after the long hiatus in the 1970's. Gas prices have now fallen but not in the same proportion as oil prices.

All of the present level of exploration activity, and more, will be needed if British Gas' projected supply gap in the 1990's is to be filled mainly by UKCS gas. Yet the level of current exploration activity for Southern Basin is vulnerable if prices offered by British Gas were to fall below the current expectation, combined with the increased costs associated with the smaller and more complex fields of the future. Following the fall in oil prices, the current expectation of gas prices is substantially below that of 1985.

IV.3. Recommendation

Our recommendation is that Southern Basin fiscal terms for new fields be brought into line with those which prevail elsewhere by the removal of royalty and a doubling of the PRT volume allowance for new fields. The most important element of the differential is the treatment of royalty. It is also the most targeted, as the most profitable fields would pay more PRT and CT and get less benefit from the abolition of royalty. The reduction of royalty, as suggested elsewhere in this paper, would therefore have the additional benefit of mitigating the Southern Basin problem.

IV.4. Justification

Unit costs of Southern Basin discoveries are not necessarily lower than elsewhere. Several UKOOA members currently involved in the development of 4tcf of UKCS gas in both the Central and Southern areas say that the unit costs of their Southern Basin project are 50% higher than the unit cost of their Central North Sea gas condensate development. This is particularly significant because the Southern Basin project is of very significant size. Other members point to the high unit costs associated with the increasingly common 30-50 bcf fields found in the Southern area. And even if unit costs were, on average lower than elsewhere in the North Sea, what matters is the post-tax economic viability of current and future discoveries in the area.

UKOOA's 1984 technical study, "Potential Oil and Gas Production from the UK Offshore to the Year 2000" used drilling results to date and Bayesian mathematical techniques to forecast the likely future exploration results from the mature areas of the UK North Sea. The following tabulation shows the expectations result of a 15 well per year drilling program over ten years in the Southern Basin.

FUTURE SOUTHERN BASIN GAS FIELDS

Size Range BCF	% Fields in Range	% Future Reserves
0 - 49	36.6	2.6
50 - 174	28.5	9.5
175 - 399	16.3	14.5
400 - 774	9.5	17.5
775 - 1249	4.1	13.6
1250 +	5.0	42.3
	100.0	100.0

It is striking that 80% of expected Southern Basin discoveries are expected to be below the 400 bcf level. About a quarter of the expected technically recoverable reserves also fall into this category and something like one half are expected to be in accumulations smaller than 750 bcf.

The problems of small field sizes and increasingly complex reservoirs in the Southern Basin have been addressed above. On the other hand, more new gas fields are able to take advantage of existing transportation infrastructure. There is therefore no hard-and-fast reserves cutoff below which a Southern Basin field is expected to be uneconomic. However, work done by individual UKOOA members points to some kind of threshold at around 400-500 bcf. Accumulations smaller than this are likely to be uneconomic unless all conditions are favourable.

How much of this can be attributed to tax? Recent work done by Alex Kemp and Graham Kellas on a study soon to be published on the economics of new gas fields includes a variety of field types in the 250-750 bcf range. This study suggests that the gap between pre- and post-tax real rates of return for Southern Basin fields ranges from a minimum of 6% to a maximum over 20%. While most of the fields studied look economic before tax, many are questionably economic post-tax.

Finally, the UK tax regime should not encourage gas imports. Although Norwegian gas has to bear a heavy tax burden, the post-tax unit cost could well be lower than in the UK because of larger field sizes. The UK Government's objective should be to see that all UK gas that is potentially competitive before tax is available to meet UK market demand.

IV.5. Costs and benefits to the Government.

It is generally acknowledged that the 1983 reduction in the fiscal take outside the Southern Basin resulted in a greatly increased activity level and a consequent net benefit to Government. We believe, that a similar phenomenon could be anticipated in the Southern Basin.

It might be suggested that in view of the current gas surplus, a stimulation of activity is undesirable in the UKCS. This appears to us to be short-sighted, in view of the growing supply gap faced by British Gas. However, even if such a stimulus were to generate an "excessive" pace of activity, depressing future price levels and disappointing producers, it must be the case that this would still serve the UK national interest. Therefore we suggest that the case for some sort of fiscal incentive in the Southern Basin is a strong one.

FISCAL IMPACT ON INCREMENTAL DEVELOPMENTS

Current Tax Treatment

CATEGORY	ROYALTY		CORPORATION TAX	REAL PV OF TAX	
	Allowable	Treatment		10%	15%
CAPITAL (P&M)	70%	Capital	25% WDA	75.7	74.0
DRILLING	0	-	30% tangible	80.0	79.4
OPERATING COSTS	60%	Expense	Expense	82.6	82.2
REVENUE	100%	Revenue	Revenue	84.8	84.5

The 'real PV of tax' incorporates timing delays for Royalty & CT relief and assumes 5% inflation. PRT @ 75% is assumed in all cases.

Unit Cost Before Tax

On a before tax basis the real unit cost represents that constant real crude price for the project to breakeven

$$\text{Unit Cost (Breakeven Price)} = \frac{\text{Total Real Costs}}{\text{Production}}$$

Where both costs and production are discounted at a specified discount rate, the 'discounted unit cost' represents the breakeven constant real crude price which will generate the specified real return on a before tax basis.

Unit Cost After Tax

The above concept can be extended to an after tax basis by considering the after tax cost/value of expenditure and revenue (production) in the above formula. Thus at a 15% real discount rate :

$$\text{Unit Cost A.T.} = \frac{\text{Capex } (1-0.74) + \text{Drilling } (1-0.79) + \text{Expense } (1-0.82)}{\text{prodn. } (1-0.85)}$$

$$\frac{\text{Unit Cost A.T.}}{\text{Unit Cost B.T}} = \frac{C^* 0.26 + D^* 0.21 + E^* 0.18}{0.15}$$

where C,D & E are the proportional NPV's of Capex (P&M), Drilling and Operating Expense in a specific project. The table below considers three different types of project assuming a unit cost after tax of 18 $/B (i.e. current crude price).

	Typical Project	Capex Intensive Project	Drilling Intensive Project
Capital (C)	0.5	0.7	0.2
Drilling (D)	0.3	0.15	0.5
Expense (E)	0.2	0.15	0.3
Ratio after:before tax unit cost	1.43	1.54	1.34
Breakeven unit cost before tax if oil price = 18 $/Bbl	12.6 $/B	11.7 $/B	13.7 $/B

Thus at any oil price there is a band of projects which have an acceptable return before tax but not after tax. At an 18 $/B oil price, projects with a unit cost before tax between approx 12 $/B and 18 $/B will fall into this category.

Appendix 2

RELATIONSHIP OF ROYALTY TO NET REVENUE

a) Overall Position (Royalty as % of Oil Fields' Cashflow before Government Take)

	£11.5/barrel %
Average 1979 - 87	12.9
88	12.5
89	11.4
90	12.1
91	12.8
92	13.9
93	16.7
94	28.5
95	17.9

b) Approaching Abandonment (Fields in Royalty Rate Band)

Rate	Years to Abandonment					
	6	5	4	3	2	1
0% to <10%	3	4	3	2	1	0
10% to <20%	16	16	16	13	7	5
20% to <30%	2	-	-	6	-	-
30% to <40%	2	1	2	1	14	5
40% to <50%	-	2	1	-	1	6
50% to <60%	-	-	1	1	-	4
60% to <70%	-	-	-	-	-	3
	23	23	23	23	23	23
Fields abandoned before 1.1.89	2	2	2	2	2	2
Fields in Study	25	25	25	25	25	25

The Scotch Whisky Association

Limited Liability Registered in Scotland No. 35148

TEL: 031-229 4383 TELEX: 727626

20 ATHOLL CRESCENT · EDINBURGH EH3 8HF
REGISTERED OFFICE

FROM
THE DIRECTOR GENERAL

HFOB/KPT/RCE

4th November 1987

CH/EXCHEQUER
REC. 5 NOV 1987
ACTION Mr Michie
COPIES TO CST FST PMG
Sir Peter Middleton
Sir T. Burns Mr Cassell
Mr R.I.G. Allen Mr Scholar Miss Sinclair
Mr Cropper Mr Tyrie Mr Call
PS/C&E PS/IR

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1P 3AG

Dear Chancellor,

We are most grateful to you for affording us the opportunity again this year to meet you and your principal colleagues to discuss the various tax issues of continuing concern to the Scotch Whisky Industry (your secretary's letter of 5th August refers).

In that regard, I enclose three copies of a report prepared in conjunction with our Economic Consultants, Pieda.

The issues which we would like to raise are exactly the same as previously although you will, no doubt, be aware that we shall be raising them this year against a background of further market deterioration. Perhaps I should add that it is our understanding that the main facts of the situation are agreed between ourselves and your officials but we should be happy to enter into appropriate discussions with them prior to the meeting if you should feel there is any particular aspect which requires further clarification.

The members of our delegation will be the same as last year; namely, in addition to myself:

Mr J A R Macphail	Chairman of the Association
Mr D A Connell	Vice Chairman of the Association
Mr I C Straker	Chairman of the Public Affairs Committee
Professor D I MacKay	Chairman of Pieda and Economic Consultant to the Association.

4th November 1987

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer

We shall much look forward to seeing you at 4.00 pm on 9th December in the Treasury.

With kind regards meantime,

Yours sincerely

Bill Bewsher

H F O Bewsher

Enclosures

4/12 ~~5/12~~
BIF meeting
This needs to go to Sir T Burns + RIG Allen
They sd be invited to the meeting

The Scotch Whisky Association

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Sir T. Burns Mr Cassell
Mr R.I.G. Allen Mr Scholar Miss Sinclair
Mr Cropper Mr Tyrie Mr Call
PS/C&E PS/IR

5/11 ✓

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1P 3AG

Dear Chancellor,

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With kind regards meantime,

Yours sincerely

Bill Bewsher

H F O Bewsher

Enclosures

BRINDEX

The Association of British Independent Oil Exploration Companies

Please reply to:

G.J. Hearne Esq., Chairman,
c/o Enterprise Oil plc,
5 Strand,
LONDON WC2N 5HU

Tel. No. 01 930 1212

5th November 1987

The Rt. Hon. Peter Lilley, M.P.,
Economic Secretary to the Treasury,
Treasury Chambers,
Parliament Street,
LONDON
SW1P 3AG

ECONOMIC SECRETARY
REC'D
ACTION Mr Johns - IR
COPIES TO PS/Chancellor
PS/FST
Mr Williams
Ms Leahy
Mrs Hubbard - IR
Miss Hill - IR
PS/IR

Dear Peter,

For the sake of good order, I am enclosing a copy of the letter I have today sent to the Chancellor, setting out Brindex's representations on the measures that our members would like the Treasury to consider in next year's Finance Bill. We are wholly at your disposal if any clarification is needed.

Yours sincerely,

Graham

Graham Hearne

Enc.

BRINDEX

The Association of British Independent Oil Exploration Companies

Please reply to:

G.J. Hearne Esq., Chairman,
c/o Enterprise Oil plc,
5 Strand,
LONDON WC2N 5HU

Tel.No. 01 930 1212

4th November 1987

The Rt. Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
Treasury Chambers,
Parliament Street,
LONDON SW1P 3AG

Dear Chancellor,

OIL TAXATION

I am writing on behalf of the Brindex Members to bring to your attention certain changes in the oil taxation provisions which we hope you will consider favourably for inclusion in next years Finance Bill.

The two aspects of particular concern to the Brindex Members - namely the capital gains tax treatment of exploration farm-outs and the restoration of PRT Relief for onshore drilling - are addressed in more detail below. The other issues which are more technical in nature are covered in the attached Appendix. We would, however, welcome the opportunity to discuss the issues raised with your officials at an appropriate time.

On the question of the capital gains tax treatment of exploration farm-outs, you will be aware that discussions have been taking place between Brindex, UKOOA and UKOITC and the Economic Secretary and the Inland Revenue and these discussions are continuing. I would, however, like to take this opportunity to press the case for exempting such transactions from the scope of capital gains tax.

The case rests essentially on the premise that the process of farm-in and farm-out is a natural, and we believe, efficient method of increasing exploration activity in the United Kingdom and that such activity is to be encouraged as the means of making new discoveries and bringing on-stream new taxable developments. Brindex believes that the Revenue's proposal would, if implemented, be an undesirable and unnecessary impediment to increased exploration activity. Furthermore we would be

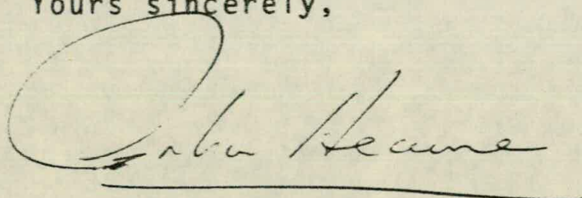
surprised if the benefits to the Exchequer outweighed the substantial burden both to the Revenue and the companies inherent in the process which will be needed to tax them. We have, therefore, proposed that farm-outs at the exploration phase where no cash profit is realised should be exempt from the charge to capital gains tax. We do, of course, recognise that there are definitional difficulties but we believe these can be overcome and that the discussions now in progress will provide a solution.

As regards exploration and appraisal relief for expenditure onshore in the United Kingdom, as you will be aware Brindex has consistently urged the reinstatement of this relief since it was withdrawn in 1985. The exploration, appraisal and development of onshore oil and gas fields is a natural field of activity for UK independent companies. It is an area in which they can develop their expertise and operating capability and generally maintain the momentum and continuity of their exploration programmes even during periods of oil price instability. British independents are relatively more heavily represented as operators and licence holders onshore than they are offshore. The fact that onshore exploration is now more expensive, after tax, than offshore activity seems inequitable and is certainly prejudicial to the interests of the Brindex Members. We believe that in the long run it will impede the progress of UK onshore exploration and development. We therefore urge you to consider the reinstatement of the relief in the 1987 Finance Bill.

Finally, we have been apprised of the submissions being made to you on the taxation front by UKOOA and would like to record our support for the measures they propose with particular reference to the extension to the southern basin of the regime currently applicable in the north.

I am copying this letter to Peter Morrison, Minister of State at the Department of Energy and also to the Economic Secretary.

Yours sincerely,



GRAHAM HEARNE

Attach.

APPENDIX

Tariff Receipts Allowance Dilution

The current tax system has an anomalous effect on the economics of tariffing gas as well as liquids through one principal field. This anomaly can markedly influence the commercial negotiation of tariffing arrangements resulting in a severe disadvantage to operators in some systems, excessive tariff rates being required for some fields and bringing about a real disincentive to production of gas.

The Problem in Detail

Section 9(9) OTA 1983 states that "Oil" for the purpose of Tariff Receipts Allowance (TRA) includes gas: 1,100 cubic metres of gas at 15 degrees centigrade and 1 atmosphere shall be counted as equivalent to 1 metric tonne of oil. A metric tonne of gas computed in this way attracts a much lower sales price than a metric tonne of oil, and consequently supports a lower rate of tariff perhaps by a factor of up to three. The TRA formula at Schedule 3(2) OTA 1983 effectively exempts the receipts on 250,000 metric tons of "Average" oil per chargeable period. If the tariff relates only to liquids the value of this allowance can be computed and a commercial proposition advanced accordingly. If there is a proposal also to transmit gas from the user field, the tariff receipts from an "Average tonne" of hydrocarbon reduces deflating the TRA accordingly. An illustrative computation is attached. The post tax economics of transporting the oil itself are impaired and the gas tariff rate must reflect this impairment. The high gas tariff rates required to correct this effect are naturally unattractive to a potential user, as is accepting the loss on gas tariffing to the transporter if the stand alone gas tariff rate is maintained to attract the oil transportation contract. This effect makes it difficult to offer a competitive tariff for transporting both phases of hydrocarbon from a field even when the pre tax position is the best of the available options. In post tax terms it may be cheaper for a user to lay a significant stretch of pipeline to another field so as to benefit from the effect of non dilution on the oil tariff rate or, if no such option is available, not "save" gas. This is clearly a case where the tax system is distorting commercial reality and the problem is easily solved.

Solution

The fundamental problem of the different values of the two fluids has already been recognised and addressed in relation to oil allowance. In that case an election to compute the allowance on the basis of liquids only is available (Section 8(4) OTA 1975). A similar elective system could be easily introduced to Schedule 3 OTA 1983 to rectify this real and commercially damaging anomaly.

TARIFF RECEIPTS ALLOWANCE DILUTION

Illustrative Computation

Tariff Parameters

Production per period	- Oil 300,000 metric tonnes Gas 30,000 metric tonnes
Tariff Rate	- Oil £11.25 mt Gas £3.90 mt

Tariff Receipts Allowance - Oil only -	250,000 x 11.25 =	£2,812,500
Oil and Gas -	227,000 x 11.25 =	2,553,750
	23,000 x 3.90 =	89,700
		£2,643,450

DEDICATED MOBILE ASSETS

In the 1986 representation we referred to an anomaly concerning the PRT charge on disposal receipts in relation to smaller oilfields which would not otherwise have been subject to PRT.

The tax problem arises mainly in conjunction with dedicated mobile assets such as floating production vessels. Typically oilfields developed using a floating facility as opposed to a fixed platform will be the smaller accumulations with shorter field lives. These smaller oil accumulations are unlikely to attract much, if anything, in the way of PRT liability as production will frequently be exempted by oil allowance. However, the whole of any asset disposal proceeds will be brought into PRT.

The result is that a small oilfield development, the profit on which can normally be expected to be taxed at an averane of around 35% (CT rate only) can bring about a charge of up to 83.75% on the residual value of assets used in producing that profit. This is clearly an anomalous result which militates against economics of smaller oilfield developments.

An approach to this problem was suggested in detail in the 1986 representation. Essentially, the proposal was that on the occasion of disposal of a long term asset, or use for other than a UK oilfield, the taxpayer should be allowed to calculate the amount by which allowable expenditure on the asset concerned has been displaced and replaced by oil allowance. The amount of the reduction in allowable expenditure could then be offset against disposal proceeds from that same asset.

NOMINATIONS

Our members are becoming increasingly concerned about both the administrative cost and the potential for penalties involved in the nomination scheme. These seem particularly inappropriate burdens given that the scheme was as we understand it aimed at preventing retrospective picking and choosing of tax reference prices and the ability to fall back to market values if higher returns can be achieved using non arms length routes. If these are the aims then we would expect that it would be to the advantage of both the Inland Revenue and Industry to take out of the administrative burden as many companies as possible and target the scheme only at companies whose affairs are such as to give rise to the transactions of concern to the Inland Revenue.

To this end we therefore think an exemption from the scheme should be made for participators who can sign a declaration that neither they nor any company associated with them sold or purchased any oil other than their own equity production in arms length transactions. We see this as having to apply on a six monthly basis and that it could implemented either by regulations or an amendment to S.61(e).

LOSS AFTER PAYBACK - UPLIFT

Also in our 1986 representations we referred to the problem that can be created when a field goes into loss for PRT purposes after having paid back. S113 FA 1981 gives some protection but it is limited in extent. We feel these restrictions could be lifted and uplift allowed whenever a field goes into an overall cummulative loss post payback. Such uplift would only be due on otherwise qualifying expenditure and only until such time as payback is once more reached.

Such occasions are in fact only likely to occur where incremental investments are made to produce additional oil from a field. It seems to us only reasonable that such investments should attract uplift.

RELIEF FOR UKCS EXPLORATION EXPENDITURE

PRT is becoming increasingly complex and unwieldy as expenditure, the same in nature, but spent in different areas or at different times obtains different reliefs. We suggest that a relatively low cost change which would simplify the system would be to give PRT relief for all unrelieved pre 15 March 1983 UKCS exploration expenditures. This of course only puts it in the position that post March 1983 expenditure has in any case.

By the time this change could be implemented none of these expenditures will be less than 5 years old and some considerably more. Therefore, if the areas concerned are not currently being developed they are clearly not immediately viable commercial prospects. The current abortive rules are unsatisfactory and cause difficulties out of scale with the amounts concerned. Typically this happens where oil has

been found albeit in such small quantities or of a type or in a structure that presents such technological difficulties that they are not likely to be developed for very many years, if ever. Monitoring and discussing such items is time consuming and we consider it would be sensible to remove this arbitrary distinction between reliefs given for exploration expenditures incurred pre or post 15 March 1983, which are all by now equally worthy of receiving relief.

By giving this relief a further anomaly in the system will be removed. A person may dispose of their total interest in a licence for no consideration because it is felt that there is no likelihood of commercial quantities of oil being found in that area. However, PRT abortive relief cannot necessarily be obtained at that time for any pre 15 March 1983 exploration expenditures incurred on these transferred areas transferred. As no benefit to the participator concerned will ever be obtained from any field that might be developed in that area, the costs are definitely abortive in financial terms to that transferee. Under the present regime it is the view of the Inland Revenue that expenditure can only be claimed as abortive under Section 5, OTA 1975 once the search for oil in that area has been given up by all participators. We feel that when a participator gives up his share in a licence for no consideration abortive relief should be available to that participant and if the first change above cannot be made then in equity at least this last change should be so made.

3769/018

FROM: P D P BARNES
DATE: 9 November 1987

MISS HILL - IR

cc PS/Chancellor
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Williams

Mr Johns - IR
Mrs Hubbard - IR
Mr Kuczys - IR

LETTER FROM BRINDEX

The Economic Secretary would be grateful for briefing on the letter from BRINDEX to the Chancellor of 4 November. He wonders whether it would be politic to meet them as well as UKOOA.

PB

P D P BARNES
Private Secretary

pmp

Telephone 01-636 [illegible]3/4

URGENT REPLY NEEDED.

HM TREASURY – MCU
RECD. 11 NOV 1987
ACTION

BEDFORD OFFICE
29A MONTAGUE STREET
LONDON WC1B 5BL

1905B/JMS/MH 10 November 1987

Dear Mr. Lamont,

Enclosed with this letter is the submission to the Chancellor of the Exchequer from the Landowners Group in respect of the 1988 Budget.

We believe that the first Budget of the third term in office of this Government provides the best possible opportunity for a radical reform, particularly of capital taxation. We would very much like to have the opportunity to discuss the contents of our submission with you.

We understand how busy you will be at this time of year and I will telephone your Diary Secretary a day or two after dispatching this letter to make an appointment. We would of course be delighted if you could spare time to lunch with us and perhaps you could let your Secretary know of any dates on which this would be possible.

Yours sincerely,

Michael Sword

J M SWORD

URGENT

The Rt Hon Norman Lamont MP
Financial Secretary
H M Treasury
Treasury Chambers
Parliament Street
London SW1

FINANCIAL SECRETARY
REC. 12 NOV 1987
ACTION Mr. Thomson IR.
COPIES TO PPS, CST
Mr. Scholar.

LANDOWNERS GROUP (LOG)

REPRESENTATIONS TO THE CHANCELLOR OF THE EXCHEQUER
THROUGH THE FINANCIAL SECRETARY

SUMMARY

1. Large Landed Estates are still seriously at risk from Inheritance Tax and Capital Gains Tax (on long-term gains) - even with the benefits of special reliefs for business, agricultural and heritage assets.

2. Cuts in the rates will not reduce yields in the same proportions. Capital assets currently immobilised by high rates will be disposed of and reinvested in assets yielding higher income.

3. LOG recommends that capital taxes should be reduced to levels at which they can be paid without serious damage to the capital assets on which they are assessed.

4. Inheritance Tax: the top rate on death should be reduced to 30 per cent with corresponding reductions in lower rates and for lifetime transfers, and with retention of existing reliefs.

5. Inheritance Tax: the tax penalty for reserving a benefit out of a lifetime gift should apply only to the value of the benefit reserved, not to the whole of the property donated.

6. Capital Gains Tax: the rate should be reduced to 25 per cent, indexation abolished and there should be tapering relief after the third, fourth, fifth and sixth years of ownership, with no charge in respect of assets held for more than 7 years.

7. Additional Rate Tax: should be abolished, or at worst should be reduced to 15 per cent; and should not be applied to the income of Maintenance Funds.

LANDOWNERS' GROUP (LOG)

REPRESENTATIONS TO THE CHANCELLOR OF THE EXCHEQUER - THROUGH THE FINANCIAL SECRETARY

in relation to

THE 1988 BUDGET

GENERAL

As always, particularly since the introduction of Capital Transfer Tax in 1975, the principal concern of LOG is with capital taxation. This does not mean that we are not concerned with taxes on income and expenditure. We have very much welcomed the reductions in the rates, especially the top rates, of Income Tax, all the efforts that have been made to reduce the demands of the public sector on the available wealth of the country and, in large measure, the shift from tax on income and capital and towards tax on expenditure. We have appreciated the various reliefs, including some reduction in rates for payers of Capital Transfer Tax (now Inheritance Tax) and especially the abolition of Development Land Tax.

The introduction with Inheritance Tax of the opportunity to make Potentially Exempt Transfers and the opportunity to make such transfers involving interest in possession trusts, are welcome, although we have some particular representations to make.

Despite these substantial improvements in the tax system, we do still think that the reform of capital taxes forecast on pages 30 and 31 of "The Right Approach to the Economy" (1977) has not yet been completely fulfilled. The "process of savaging large estates" still goes on and there are substantial holdings of wealth, particularly in urban estates, which have benefitted only marginally from capital tax legislation enacted since 1979.

We have submitted several papers designed to show that substantial cuts in the rates of Inheritance Tax would not cut the yield, at any rate, proportionately. Attached is a shortened and amended version of the latest of these, which was submitted two years ago. Because of the reported increase in yields from Income Tax and Corporation Tax, the rates of which have been reduced, we hope that Treasury Ministers are now convinced of this for taxes on income. Reductions especially in the higher rates appear to have increased the yield and also to have left more spending power in the hands of tax payers, thus increasing the yield from VAT and Excise Duty.

It is against this background that we make our strong plea for major alleviation of capital taxes with the principal object of making it possible for them to be paid without serious damage to the private sector capital assets on which they are assessed.

INHERITANCE TAX

Our principal recommendation is for halving the top rates, both for lifetime transfers and transfers on death. We are concerned but of course to a lesser degree about what graduations there should be between the nil-rate band and the halved top rate and we put forward the following proposal:

Inheritance Tax Rates

Present			Proposed		
Chargeable Transfer £'000	Rate on death	Rate for lifetime transfers	Chargeable Transfer £'000	Rate on death	Rate for lifetime transfers
0-90	NIL	NIL	0-250	NIL	NIL
90-140	30%	15%	250-500	10%	5%
140-220	40%	20%	500-1000	20%	10%
220-330	50%	25%	1000 +	30%	15%
330 +	60%	30%			

We appreciate that such an enlargement of the Nil rate band would have an effect on yield, but it seems sensible in view of the steady escalation in the value of houses and the wider distribution, as well as the increase in value of private wealth. Indeed one of our principal arguments for a major reduction in the burden of Inheritance Tax is that to tax private estates heavily runs counter to the policy of privatisation.

To quote directly from "The Right Approach to the Economy" - "The justification for capital taxes is not to be found in their yield, which is relatively tiny proportion of total tax receipts and involves high collection costs and substantial economic distortion" and again "We would like to see the habit of personal capital accumulation, making vast numbers of people owners as well as earners, much more deeply ingrained in our society."

We see no reason why all the special reliefs which have been introduced for business, agricultural and heritage property should not continue within this much lighter tax regime since they recognise the importance of the production of wealth and the special burdens of maintaining agricultural and heritage property. Indeed, we would support the argument for similar relief for all "listed buildings".

Gifts with Reservations

The name of Capital Transfer Tax was changed to Inheritance Tax in the 1986 Finance Act, with the unfortunate result that the concepts underlying Capital Transfer Tax and some of those applying to Estate Duty are now interwoven. The basic character of the Tax has not changed. The application of the Estate Duty interpretation regarding benefits reserved out of gifts is one unfortunate result. This was removed by the Capital Transfer Tax legislation provided of course possession and enjoyment of the property had been assumed by the donee from the date of the gift. Any beneficial interest reserved by the donor was treated as a settlement by the donee in favour of the donor and the value of that interest at the termination of the settlement on the death of the donor, fell to be valued as part of the donor's estate. The effectiveness of the remainder of the original gift was not impaired. The difficulty of complying with certainty with the present rules and the risk of disaster on failure to do so are an onerous burden on donors. It is recommended that the law should be restored to the position as it was under the CTT regime, but retaining the 7 year period for cumulations and potentially exempt transfers.

CAPITAL GAINS TAX

Our first choice would be for tapering relief over 7 years with abatement of the rates of tax after the third year of ownership on the same basis as that now provided for lifetime transfers potentially exempt from Inheritance Tax. That is:

Years between disposal and acquisition	Percentage of full charge at 30%
0-3	100%
3-4	80%
4-5	60%
5-6	40%
6-7	20%
7 or more	no charge

In view of the complications involved in indexation - for both tax collector and taxpayer - we recommend that it should be abolished and the rate of tax reduced to 25 per cent.

We are well aware that the adoption of our proposal would have a considerable effect on yield, but we can see no justification on grounds of economics or equity between taxpayers for retaining an unindexed tax on inflationary gains in the value of assets between 1965 and 1982.

If these recommendations are not acceptable we would prefer to fall back on amending the base valuation date from 1965 to 1982, retaining indexation after 1982; noting that for indexation purposes a valuation in 1982 of assets acquired before that date is required in any case.

c

ADDITIONAL RATE TAX

As this tax is in the outcome only paid on income accumulated in trusts and as such accumulated income is a form of saving for the future which is often profitably invested in the meantime, we would recommend the abolition of ART.

If abolition is not acceptable we recommend that at the most it should be levied at the rate of 15 per cent, not as at present at the difference between 45 per cent and the Basic Rate. Moreover we suggest that the only income that should need to be returned for the assessment of this tax should be that retained by trustees and not distributed to beneficiaries.

We recommend that the income of Maintenance Funds - which cannot be applied otherwise than to the maintenance (and in some respects the improvement) of the designated property - should be taxed at the basic rate only, and only to the extent that it is not applied directly to the maintenance of the designated property.

10.11.87

DRAWING THE TEETH OF INHERITANCE TAX

How lower rates of tax can benefit the Exchequer

Reforms in taxation since 1981 have been welcomed by the owners of agricultural and forestry land and other productive assets, but the top rates of Inheritance Tax (IHT) are still much too high. The Treasury as well as the taxpayer would benefit from their reduction. The top rate of IHT on death should be halved to 30% with appropriate reductions to the lower rates, bringing the UK more into line with other EEC countries for rates of tax on transfers to direct lineal descendants. This paper summarises, under six headings, the effects of such a cut in IHT.

The yield from IHT

A rate of tax above the point of maximum revenue yield is counter-productive because it harms the revenue as well as the taxpayer. The appendix argues, on fiscally conservative assumptions (that is, on assumptions biased towards the conventional principle of Treasury budgetary arithmetic that taxpayer behaviour does not change when rates of income tax and capital taxes change) that the maximum revenue for the Exchequer is produced by a combination of taxes on income and capital aggregating to not more than 58% of the income from the asset concerned. Any increase in the tax rate over 58% will mean a reduction in tax revenue; a reduction in the tax rate below 58% brings no immediate decrease in tax revenue.

In this discussion, IHT is considered only as a tax on long-term saving; that is why IHT is treated as being equivalent to an additional income tax on the yield from long-term saving. IHT is the most important single tax for owners of businesses, unquoted companies and property, including private houses, all of whom are long-term savers. Their essential problem is to fund the income equivalent of capital taxes out of generally low-yielding assets. An increase in asset values due to a reduction in the current rate of return at a constant level of income makes the long-term owner/taxpayer poorer not richer, because his capital tax liabilities increase while everything else remains unchanged; and there is no relief through indexation for rises in the values of assets subject to IHT above the £330, 000 threshold for the top rate of 60%. When inflation forces prices up, investment income lags behind, but taxable asset values may rise faster. Savers and investors lose from each element in this process.

If the sum of taxes on income and the income equivalent of taxes on capital is more than the income itself, saving is subject to fiscal prohibition. Retrospective taxation, to which saving may be subject, makes matters even worse.

At present IHT is partly retrospective. It relies on the taxpayer working and saving for reasons other than to increase money income. It falls partly on a taxpayer's inability to plan precisely for what happens after his death, the date of which is unpredictable, and so it exploits family misfortune. It produces conflict between a property owner's wish to pass on his assets at a low or zero rate of tax during his lifetime and the tax penalty of failure to do so as a result of premature death. None of this provides a sound basis for taxation.

The Potentially Exempt Transfer (PET) introduced in the 1986 Finance Act, although welcome as far as it goes, is not a very satisfactory way of passing on assets because of the cost, the risk of death within seven years and, in the case of estates in property, the difficulties and risks attached to reservation of benefits.

Total revenue from taxes on saving

When a property owner dies, the prospective burden of IHT is 60% on the top tranche of an estate worth more than £330,000. If the estate is held over successive generations its asset value is of little practical consequence for purposes other than capital taxation; it is better characterised as simply the source of a flow of income.

If IHT were the only tax on saving and it was levied at this rate on an estate every 25 years, then — ignoring inflation — an income yield of about $3^2/_3$% free of income tax would be needed to save up for it. This yield is about one and a half times the historical "real" rate of pre-tax return on saving.

The 60% rate of IHT cuts this income by 60%, and the remaining 40% is cut 60% by the present top rate of income tax; income tax thus takes 24% and the taxpayer is left with 16%. This amounts to a tax of 84% to which must be added at least 1% to cover Capital Gains Tax and Stamp Duty, and a further 1% to cover the incidence on saving of taxes on spending — both probably substantial underestimates: the final tax bill is a minimum of 86% and the flow of income is reduced by at least that percentage. The income yield available is thus reduced to ½% on the original value of the estate.

The appendix shows that, if fiscal discouragement is measured in the form of an arithmetical progression, a cut in the rate of tax from 86% to 57-58% would increase tax revenue by 72%. However, a rate of 57% is below the present maximum income tax rate of 60%, so that the tax on saving cannot be reduced to the maximum yield level unless income tax is cut in addition to the abolition of IHT.

Tax revenue in aggregate

A reduction in tax on saving towards the maximum revenue rate would increase aggregate tax revenue. Such a reduction may also increase economic activity by reducing the fiscal discouragement to working. Hong Kong provides an example of the creation of wealth out of minimal natural resources as a result of minimising the impact of Government on

the economy, through taxation and otherwise.

Taxes on saving are more likely to cause a loss of revenue:— if the marginal rates of tax on saving are high; if the tax take is high; if the element of the tax take representing the taxes on saving is high; and if there are possibilities of avoidance, for example, through successful PETs and emigration. The Inland Revenue do not attempt to quantify these influences on the cost of tax cuts, although they acknowledge their existence. In practice, second-round effects of cuts are generally favourable to the Revenue and often outweigh the unfavourable first-round effects; there is now good evidence of this both from Britain and from the United States.

Employment and government expenditure

Reduction in IHT would be in line with the present Government's privatisation policy. This transfers assets from the public sector into private hands, which is the opposite process to the taxation of private capital. The tax itself makes the investment of those subject to it expensive and their spending cheap; it thus massively distorts the private investment pattern. It also tends to concentrate trading and portfolio assets in the hands of quoted companies and financial institutions. This process also intensifies short-term behaviour in contrast to the longer-term, more stable objectives of private companies and landed estates, especially as concerns employment. The fall in the stock market in October 1987 illustrates the unwisdom of a tax system that discriminates against personal holding of assets and favours holding by impersonal institutions.

The British economy cannot reach its full potential if the accumulation and retention of capital in personal hands are subject to crippling fiscal penalties from which competing forms of capital ownership, mainly through institutions of various kinds, are exempt.

IHT has had an adverse effect on employment in at least four ways. First, IHT and its predecessors have suppressed large numbers of personally owned firms. It is an illusion to suppose that they can be replaced by fiscally favoured competitors without substantial loss to the economy. Second, this happens year by year: where one form of business organisation suffers a fiscal penalty and a competing form does not, the economy as a whole will lose each year. Third, statistics show (and it is now widely accepted) that new employment is to be expected from small and privately-owned firms, including the self-employed, rather than from large qutoed companies, many of which are engaged in correcting years of overmanning. Fourth, IHT attacks the expansion of private firms because the schedule of rates is graduated as well as high. A cut in IHT would increase employment or reduce unemployment. The Exchequer would thus gain further through increased collection of income tax and a corresponding reduction in expenditure on unemployment relief.

Public sector borrowing requirement

Capital is not a source of tax revenue independent of the income it generates. An increase in the PSBR resulting from a reduction in IHT does not raise interest rates, whereas increases in PSBR for other reasons do. A reduction in IHT increases the supply of investment funds, and interest rates are affected little or not at all.

These facts are obscured by the budgetary arithmetic of recent years, which has neglected the distinction between current and capital items. Emphasis on 'full-year' rather than 'first-year' costs of capital tax reduction is

also misleading. By the time the yield from capital tax accrues, there will have been at least one other Budget in a new and different situation.

Social, political and economic effects

IHT at present rates weakens the market economy and damages its performance. It does little or nothing to redistribute wealth, and it can be avoided by emigration, spending or successful exempt transfers. It is a tax on commitment, vocation, and stewardship, all of which benefit the community through the provision of services at less than market value. It thus encourages excessive materialism. IHT therefore has undesirable social consequences, as well as being bad for the Exchequer.

CONCLUSION

If only to conserve the tax base — 'the goose that lays the golden eggs' — and thus the revenue yield, IHT should be cut — at least by half.

Appendix

Table 1 on the next page is constructed on the following principle. Maximum turnover (or unitary price elasticity) is at a tax rate of zero. Fiscal prohibition is at a tax rate of 100 per cent. Fiscal discouragement (or the reduction of turnover) is distributed in the form of the arithmetical progression 1, 2, 3, 4 ..... 97, 98, 99, 100 as the rate of tax rises from zero to 100 per cent. These three assumptions are sufficient to determine the rate of tax that yields most revenue to the Exchequer. This rate is between 57 and 58 per cent; in other words, if the rate is 58 per cent or more, tax revenue is reduced by an increase in the rate and increased by a reduction.

There is only one pattern of arithmetical progression that starts at zero and cumulates to the whole of the original turnover over the range from maximum turnover to fiscal prohibition. Geometrical progressions and other more complex algebraic series lack this determinacy: some would give a higher figure than 57/58 per cent for the maximum-revenue tax rate and others a lower figure. On grounds of simplicity, determinacy and centrality (in the sense of policy neutrality or objectivity), the arithmetical progression used in Table 1 seems preferable to alternatives.

The assumption that fiscal prohibition is at 100 per cent and not some lower rate of tax increases the resulting figure of the maximum-revenue tax rate. Our argument is therefore understated through being based on this assumption. What is perhaps likelier, is that nearly all the yield has been destroyed when the tax rate has reached a much lower figure such as 80 or 90 per cent, even if not all of it is destroyed until the rate reaches 100 per cent. Allowance for this consideration could reduce the maximum-revenue rate of tax substantially below the 57/58 per cent given above.

If the rate of tax is 60 per cent and the maximum-revenue rate of tax is 57/8 per cent, the revenue gains both marginally and in total through a reduction in the rate from 60 per cent to 57/8 per cent; it loses marginally but still gains in total if the reduction in the rate from 60 per cent is carried through from 57/8 per cent until a lower figure of (say) 55 per cent is reached at which the losses of the revenue over the tranche 57/8 - 55 per cent equal the gains of the revenue over the tranche 60 - 57/8 per cent; below the figure of 55 per cent the revenue loses in total as well as marginally.

TABLE 1

Maximum tax yield (unitary price elasticity at a tax rate of zero)

(1)	(2)	(3)	(4)	(5)	(6)
.10	1.1111	4995	4495.6	499.4	
.20	1.2500	4840	3872.0	968.0	
.30	1.4286	4585	3209.4	1375.6	
.40	1.6667	4230	2538.0	1692.0	
.50	2.0000	3775	1887.5	1887.5	
.55	2.2222	3510	1579.5	1930.5	
.56	2.2727	3454	1519.8	1934.2	+ .19
.57	2.3256	3397	1460.7	1936.3	+ .11
.58	2.3810	3339	1402.4	1936.6	+ .02
.59	2.4390	3280	1344.8	1935.2	- .07
.60	2.5000	3220	1288.0	1932.0	- .17
.70	3.3333	2565	769.5	1795.5	
.80	5.0000	1810	362.0	1448.0	
.81	5.2632	1729	328.5	1400.5	- 3.28
.82	5.5556	1647	296.5	1350.5	- 3.57
.83	5.8824	1564	265.9	1298.1	- 3.88
.84	6.2500	1480	236.8	1243.2	- 4.23
.85	6.6667	1395	209.2	1185.8	- 4.62
.86	7.1429	1309	183.3	1125.7	- 5.07
.87	7.6923	1222	158.9	1063.1	- 5.56
.88	8.3333	1134	136.1	997.9	- 6.13
.89	9.0909	1045	115.0	930.0	- 6.80
.90	10.0000	955	95.5	859.5	- 7.58
1.00	∞	0	0	0	0

(1) Gross rate of tax

(2) Price = 1 + net rate of tax

= the percentage increase in (2)

= the reciprocal of the tax-exclusive element of the price

(3) Turnover, which is assumed to decline in an arithmetical progression from unitary price elasticity to fiscal annihilation

(4) Quantity or volume = (3) ÷ (2)

(5) Tax revenue or yield of tax = (3) - (4) = (4) x ((2) -1)

(6) Percentage change in (5), comparable with (2), which is the percentage change in itself.

Inland Revenue

Policy Division
Somerset House

FROM: A W KUCZYS

DATE: 11 NOVEMBER 1987

1. Miss Hill Brindex approached us yesterday about setting up a meeting with officials (para 3 of this note) This meeting has now been fixed for 19 November

2. PS/ECONOMIC SECRETARY

OIL TAXATION: BRINDEX REPRESENTATIONS

Mr Graham Hearne wrote to the Chancellor on 4 November with Brindex's 1988 Budget Representations. He also wrote to the Economic Secretary on 5 November, enclosing a copy of the letter to the Chancellor.

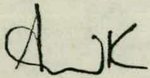
In your minute of 9 November, you ask whether it would be politic for the Economic Secretary to meet Brindex as well as UKOOA. In their covering letter Brindex repeat a number of representations on well-trodden ground - exploration farmouts, onshore exploration and the Southern Basin. The rest of their representations are largely technical in nature. We do not, therefore, think it is necessary - or particularly appropriate - for the Economic Secretary to see them. Nor do we consider there would be any awkwardness in the Economic Secretary meeting UKOOA but not Brindex: this has certainly happened before and in part simply reflects the rather different nature of the representations made by these two bodies.

---

cc. PS/Chancellor
PS/Financial Secretary
Mr Cassell
Mr Scholar
Miss Sinclair
Mr M L Williams
Ms Leahy
Mr Johns
Mr Elliss
Miss Hill
Mrs Hubbard
Mr Kuczys
PS/IR

Instead, we would propose to have a meeting, at official level, with Brindex to discuss their representations. This is what has happened in previous years, and is what Mr Hearne asks for in paragraph 2 of his letter to the Chancellor. We would then report back to the Economic Secretary on the outcome of the meeting.

Meanwhile, an acknowledgement is required to Brindex's letters, and I attach a draft for the Economic Secretary's signature.



A W KUCZYS

Graham Hearne Esq
Chairman
The Association of British Independent
 Oil Exploration Companies
c/o Enterprise Oil PLC
5 Strand
LONDON
WC2N 5HU

The Chancellor has asked me to thank you for your letter of 4 November; thank you also for your letter to me of 5 November.

It is helpful to have Brindex's representations, which will of course be considered carefully. You say that you would welcome an opportunity to discuss the issues with officials, and I agree that that would be a good idea. I understand that you have already approached the Inland Revenue, and a meeting has been fixed for 19 November.

PETER LILLEY

pwp

PS/Chancellor 2
PS/FST
Mr Cassell
Mr Scholar
Miss Sinclair
Mr M Williams
Ms Leahy
Mr Johns - IR
Mrs Hubbard - IR
Miss Hill - IR
Mr Kuczys - IR
PS/IR.

Treasury Chambers. Parliament Street. SWIP 3AG

Graham Hearne Esq
Chairman
The Association of British Independent
Oil Exploration Companies
c/o Enterprise Oil PLC
5 Strand
LONDON
WC2N 5HU

12 November 1987

Dear Graham

The Chancellor has asked me to thank you for your letter of 4 November. Thank you also for your letter to me of 5 November.

It is helpful to have Brindex's representations, which will of course be considered carefully. You say that you would welcome an opportunity to discuss the issues with officials, and I agree that that would be a good idea. I understand that you have already approached the Inland Revenue, and a meeting has been fixed for 19 November.

Yours sincerely

Peter

PETER LILLEY

4426/97/AC

FROM: MISS S WALLIS

DATE: 16 November 1987

1. MRS BURNHAMS
2. MISS SINCLAIR
3. MCU
4. FINANCIAL SECRETARY

cc PS/Chancellor
PS/CST
PS/EST
PS/Paymaster General
Mr Wilson
PS/IR
Mr D Shaw (IR)

BUDGET DEPUTATION : LANDOWNER'S GROUP

Mr Sword's letter of 10 November enclosed a submission to the Chancellor of the Exchequer seeking an opportunity to discuss with Ministers the Group's proposals for the 1988 Budget.

2. The Landowner's Group are not on the "core list" of organisations that Ministers meet as a matter of course. Although they were met by Ministers last year, we, and the Revenue, feel that their proposals offer nothing new.

3. Unless you have a particular reason for wishing to meet a delegation from the group, we suggest you turn down their request.

4. I attach a draft reply.

S Wallis

MISS S WALLIS

4426/098/AC

Treasury Chambers, Parliament Street, SW1P 3AG

J M Sword Esq
Landowner's Group
Bedford Office
29A Montague Street
LONDON WC1B 5BL

November 1987

Thank you for your letter of 10 November, which set out your representations for the 1988 Budget.

As you can imagine, Treasury Ministers receive numerous requests for meetings from representative bodies before each Budget. Ministers try and see as many organisations as possible, but, as I am sure you will appreciate, they cannot see every organisation which requests a meeting. I am afraid, therefore, that it will not be possible for Treasury Ministers to see you in the run-up to the 1988 Budget.

I can assure you, however, that your representations will be carefully considered.

NORMAN LAMONT

1

Telephone 01-636 [illegible]3/4

BEDFORD OFFICE
29A MONTAGUE STREET
LONDON WC1B 5BL

HM TREASURY – MCU
RECD 11 NOV 1987
ACTION

URGENT REPLY NEEDED.

1905B/JMS/MH 10 November 1987

Dear Mr. Lamont,

Enclosed with this letter is the submission to the Chancellor of the Exchequer from the Landowners Group in respect of the 1988 Budget.

We believe that the first Budget of the third term in office of this Government provides the best possible opportunity for a radical reform, particularly of capital taxation. We would very much like to have the opportunity to discuss the contents of our submission with you.

We understand how busy you will be at this time of year and I will telephone your Diary Secretary a day or two after dispatching this letter to make an appointment. We would of course be delighted if you could spare time to lunch with us and perhaps you could let your Secretary know of any dates on which this would be possible.

Yours sincerely,

Michael Sword

J M SWORD

URGENT

The Rt Hon Norman Lamont MP
Financial Secretary
H M Treasury
Treasury Chambers
Parliament Street
London SW1

12 NOV 1987

Mr Thomson IR.
PPS, CST
Mr Scholar.

9/158/11

LANDOWNERS GROUP (LOG)

REPRESENTATIONS TO THE CHANCELLOR OF THE EXCHEQUER
THROUGH THE FINANCIAL SECRETARY

SUMMARY

1. Large Landed Estates are still seriously at risk from Inheritance Tax and Capital Gains Tax (on long-term gains) - even with the benefits of special reliefs for business, agricultural and heritage assets.

2. Cuts in the rates will not reduce yields in the same proportions. Capital assets currently immobilised by high rates will be disposed of and reinvested in assets yielding higher income.

3. LOG recommends that capital taxes should be reduced to levels at which they can be paid without serious damage to the capital assets on which they are assessed.

4. Inheritance Tax: the top rate on death should be reduced to 30 per cent with corresponding reductions in lower rates and for lifetime transfers, and with retention of existing reliefs.

5. Inheritance Tax: the tax penalty for reserving a benefit out of a lifetime gift should apply only to the value of the benefit reserved, not to the whole of the property donated.

6. Capital Gains Tax: the rate should be reduced to 25 per cent, indexation abolished and there should be tapering relief after the third, fourth, fifth and sixth years of ownership, with no charge in respect of assets held for more than 7 years.

7. Additional Rate Tax: should be abolished, or at worst should be reduced to 15 per cent; and should not be applied to the income of Maintenance Funds.

LANDOWNERS' GROUP (LOG)

REPRESENTATIONS TO THE CHANCELLOR OF THE EXCHEQUER
THROUGH THE FINANCIAL SECRETARY

in relation to

THE 1988 BUDGET

GENERAL

As always, particularly since the introduction of Capital Transfer Tax in 1975, the principal concern of LOG is with capital taxation. This does not mean that we are not concerned with taxes on income and expenditure. We have very much welcomed the reductions in the rates, especially the top rates, of Income Tax, all the efforts that have been made to reduce the demands of the public sector on the available wealth of the country and, in large measure, the shift from tax on income and capital and towards tax on expenditure. We have appreciated the various reliefs, including some reduction in rates for payers of Capital Transfer Tax (now Inheritance Tax) and especially the abolition of Development Land Tax.

The introduction with Inheritance Tax of the opportunity to make Potentially Exempt Transfers and the opportunity to make such transfers involving interest in possession trusts, are welcome, although we have some particular representations to make.

Despite these substantial improvements in the tax system, we do still think that the reform of capital taxes forecast on pages 30 and 31 of "The Right Approach to the Economy" (1977) has not yet been completely fulfilled. The "process of savaging large estates" still goes on and there are substantial holdings of wealth, particularly in urban estates, which have benefitted only marginally from capital tax legislation enacted since 1979.

We have submitted several papers designed to show that substantial cuts in the rates of Inheritance Tax would not cut the yield, at any rate, proportionately. Attached is a shortened and amended version of the latest of these, which was submitted two years ago. Because of the reported increase in yields from Income Tax and Corporation Tax, the rates of which have been reduced, we hope that Treasury Ministers are now convinced of this for taxes on income. Reductions especially in the higher rates appear to have increased the yield and also to have left more spending power in the hands of tax payers, thus increasing the yield from VAT and Excise Duty.

It is against this background that we make our strong plea for major alleviation of capital taxes with the principal object of making it possible for them to be paid without serious damage to the private sector capital assets on which they are assessed.

INHERITANCE TAX

Our principal recommendation is for halving the top rates, both for lifetime transfers and transfers on death. We are concerned but of course to a lesser degree about what graduations there should be between the nil-rate band and the halved top rate and we put forward the following proposal:

Inheritance Tax Rates

Present			Proposed		
Chargeable Transfer £'000	Rate on death	Rate for lifetime transfers	Chargeable Transfer £'000	Rate on death	Rate for lifetime transfers
0-90	NIL	NIL	0-250	NIL	NIL
90-140	30%	15%	250-500	10%	5%
140-220	40%	20%	500-1000	20%	10%
220-330	50%	25%	1000 +	30%	15%
330 +	60%	30%			

We appreciate that such an enlargement of the Nil rate band would have an effect on yield, but it seems sensible in view of the steady escalation in the value of houses and the wider distribution, as well as the increase in value of private wealth. Indeed one of our principal arguments for a major reduction in the burden of Inheritance Tax is that to tax private estates heavily runs counter to the policy of privatisation.

To quote directly from "The Right Approach to the Economy" - "The justification for capital taxes is not to be found in their yield, which is relatively tiny proportion of total tax receipts and involves high collection costs and substantial economic distortion" and again "We would like to see the habit of personal capital accumulation, making vast numbers of people owners as well as earners, much more deeply ingrained in our society."

We see no reason why all the special reliefs which have been introduced for business, agricultural and heritage property should not continue within this much lighter tax regime since they recognise the importance of the production of wealth and the special burdens of maintaining agricultural and heritage property. Indeed, we would support the argument for similar relief for all "listed buildings".

Gifts with Reservations

The name of Capital Transfer Tax was changed to Inheritance Tax in the 1986 Finance Act, with the unfortunate result that the concepts underlying Capital Transfer Tax and some of those applying to Estate Duty are now interwoven. The basic character of the Tax has not changed. The application of the Estate Duty interpretation regarding benefits reserved out of gifts is one unfortunate result. This was removed by the Capital Transfer Tax legislation provided of course possession and enjoyment of the property had been assumed by the donee from the date of the gift. Any beneficial interest reserved by the donor was treated as a settlement by the donee in favour of the donor and the value of that interest at the termination of the settlement on the death of the donor, fell to be valued as part of the donor's estate. The effectiveness of the remainder of the original gift was not impaired. The difficulty of complying with certainty with the present rules and the risk of disaster on failure to do so are an onerous burden on donors. It is recommended that the law should be restored to the position as it was under the CTT regime, but retaining the 7 year period for cumulations and potentially exempt transfers.

CAPITAL GAINS TAX

Our first choice would be for tapering relief over 7 years with abatement of the rates of tax after the third year of ownership on the same basis as that now provided for lifetime transfers potentially exempt from Inheritance Tax. That is:

Years between disposal and acquisition	Percentage of full charge at 30%
0-3	100%
3-4	80%
4-5	60%
5-6	40%
6-7	20%
7 or more	no charge

In view of the complications involved in indexation - for both tax collector and taxpayer - we recommend that it should be abolished and the rate of tax reduced to 25 per cent.

We are well aware that the adoption of our proposal would have a considerable effect on yield, but we can see no justification on grounds of economics or equity between taxpayers for retaining an unindexed tax on inflationary gains in the value of assets between 1965 and 1982.

If these recommendations are not acceptable we would prefer to fall back on amending the base valuation date from 1965 to 1982, retaining indexation after 1982; noting that for indexation purposes a valuation in 1982 of assets acquired before that date is required in any case.

ADDITIONAL RATE TAX

As this tax is in the outcome only paid on income accumulated in trusts and as such accumulated income is a form of saving for the future which is often profitably invested in the meantime, we would recommend the abolition of ART.

If abolition is not acceptable we recommend that at the most it should be levied at the rate of 15 per cent, not as at present at the difference between 45 per cent and the Basic Rate. Moreover we suggest that the only income that should need to be returned for the assessment of this tax should be that retained by trustees and not distributed to beneficiaries.

We recommend that the income of Maintenance Funds - which cannot be applied otherwise than to the maintenance (and in some respects the improvement) of the designated property - should be taxed at the basic rate only, and only to the extent that it is not applied directly to the maintenance of the designated property.

10.11.87

DRAWING THE TEETH OF INHERITANCE TAX

How lower rates of tax can benefit the Exchequer

Reforms in taxation since 1981 have been welcomed by the owners of agricultural and forestry land and other productive assets, but the top rates of Inheritance Tax (IHT) are still much too high. The Treasury as well as the taxpayer would benefit from their reduction. The top rate of IHT on death should be halved to 30% with appropriate reductions to the lower rates, bringing the UK more into line with other EEC countries for rates of tax on transfers to direct lineal descendants. This paper summarises, under six headings, the effects of such a cut in IHT.

The yield from IHT

A rate of tax above the point of maximum revenue yield is counter-productive because it harms the revenue as well as the taxpayer. The appendix argues, on fiscally conservative assumptions (that is, on assumptions biased towards the conventional principle of Treasury budgetary arithmetic that taxpayer behaviour does not change when rates of income tax and capital taxes change) that the maximum revenue for the Exchequer is produced by a combination of taxes on income and capital aggregating to not more than 58% of the income from the asset concerned. Any increase in the tax rate over 58% will mean a reduction in tax revenue; a reduction in the tax rate below 58% brings no immediate decrease in tax revenue.

In this discussion, IHT is considered only as a tax on long-term saving; that is why IHT is treated as being equivalent to an additional income tax on the yield from long-term saving. IHT is the most important single tax for owners of businesses, unquoted companies and property, including private houses, all of whom are long-term savers. Their essential problem is to fund the income equivalent of capital taxes out of generally low-yielding assets. An increase in asset values due to a reduction in the current rate of return at a constant level of income makes the long-term owner/taxpayer poorer not richer, because his capital tax liabilities increase while everything else remains unchanged; and there is no relief through indexation for rises in the values of assets subject to IHT above the £330, 000 threshold for the top rate of 60%. When inflation forces prices up, investment income lags behind, but taxable asset values may rise faster. Savers and investors lose from each element in this process.

If the sum of taxes on income and the income equivalent of taxes on capital is more than the income itself, saving is subject to fiscal prohibition. Retrospective taxation, to which saving may be subject, makes matters even worse.

At present IHT is partly retrospective. It relies on the taxpayer working and saving for reasons other than to increase money income. It falls partly on a taxpayer's inability to plan precisely for what happens after his death, the date of which is unpredictable, and so it exploits family misfortune. It produces conflict between a property owner's wish to pass on his assets at a low or zero rate of tax during his life-time and the tax penalty of failure to do so as a result of premature death. None of this provides a sound basis for taxation.

The Potentially Exempt Transfer (PET) introduced in the 1986 Finance Act, although welcome as far as it goes, is not a very satisfactory way of passing on assets because of the cost, the risk of death within seven years and, in the case of estates in property, the difficulties and risks attached to reservation of benefits.

Total revenue from taxes on saving

When a property owner dies, the prospective burden of IHT is 60% on the top tranche of an estate worth more than £330,000. If the estate is held over successive generations its asset value is of little practical consequence for purposes other than capital taxation; it is better characterised as simply the source of a flow of income.

If IHT were the only tax on saving and it was levied at this rate on an estate every 25 years, then — ignoring inflation — an income yield of about $3^2/_3$% free of income tax would be needed to save up for it. This yield is about one and a half times the historical "real" rate of pre-tax return on saving.

The 60% rate of IHT cuts this income by 60%, and the remaining 40% is cut 60% by the present top rate of income tax; income tax thus takes 24% and the taxpayer is left with 16%. This amounts to a tax of 84% to which must be added at least 1% to cover Capital Gains Tax and Stamp Duty, and a further 1% to cover the incidence on saving of taxes on spending — both probably substantial underestimates: the final tax bill is a minimum of 86% and the flow of income is reduced by at least that percentage. The income yield available is thus reduced to ½% on the original value of the estate.

The appendix shows that, if fiscal discouragement is measured in the form of an arithmetical progression, a cut in the rate of tax from 86% to 57-58% would increase tax revenue by 72%. However, a rate of 57% is below the present maximum income tax rate of 60%, so that the tax on saving cannot be reduced to the maximum yield level unless income tax is cut in addition to the abolition of IHT.

Tax revenue in aggregate

A reduction in tax on saving towards the maximum revenue rate would increase aggregate tax revenue. Such a reduction may also increase economic activity by reducing the fiscal discouragement to working. Hong Kong provides an example of the creation of wealth out of minimal natural resources as a result of minimising the impact of Government on

the economy, through taxation and otherwise.

Taxes on saving are more likely to cause a loss of revenue:- if the marginal rates of tax on saving are high; if the tax take is high; if the element of the tax take representing the taxes on saving is high; and if there are possibilities of avoidance, for example, through successful PETs and emigration. The Inland Revenue do not attempt to quantify these influences on the cost of tax cuts, although they acknowledge their existence. In practice, second-round effects of cuts are generally favourable to the Revenue and often outweigh the unfavourable first-round effects; there is now good evidence of this both from Britain and from the United States.

Employment and government expenditure

Reduction in IHT would be in line with the present Government's privatisation policy. This transfers assets from the public sector into private hands, which is the opposite process to the taxation of private capital. The tax itself makes the investment of those subject to it expensive and their spending cheap; it thus massively distorts the private investment pattern. It also tends to concentrate trading and portfolio assets in the hands of quoted companies and financial institutions. This process also intensifies short-term behaviour in contrast to the longer-term, more stable objectives of private companies and landed estates, especially as concerns employment. The fall in the stock market in October 1987 illustrates the unwisdom of a tax system that discriminates against personal holding of assets and favours holding by impersonal institutions.

The British economy cannot reach its full potential if the accumulation and retention of capital in personal hands are subject to crippling fiscal penalties from which competing forms of capital ownership, mainly through institutions of various kinds, are exempt.

IHT has had an adverse effect on employment in at least four ways. First, IHT and its predecessors have suppressed large numbers of personally owned firms. It is an illusion to suppose that they can be replaced by fiscally favoured competitors without substantial loss to the economy. Second, this happens year by year: where one form of business organisation suffers a fiscal penalty and a competing form does not, the economy as a whole will lose each year. Third, statistics show (and it is now widely accepted) that new employment is to be expected from small and privately-owned firms, including the self-employed, rather than from large quoted companies, many of which are engaged in correcting years of overmanning. Fourth, IHT attacks the expansion of private firms because the schedule of rates is graduated as well as high. A cut in IHT would increase employment or reduce unemployment. The Exchequer would thus gain further through increased collection of income tax and a corresponding reduction in expenditure on unemployment relief.

Public sector borrowing requirement

Capital is not a source of tax revenue independent of the income it generates. An increase in the PSBR resulting from a reduction in IHT does not raise interest rates, whereas increases in PSBR for other reasons do. A reduction in IHT increases the supply of investment funds, and interest rates are affected little or not at all.

These facts are obscured by the budgetary arithmetic of recent years, which has neglected the distinction between current and capital items. Emphasis on 'full-year' rather than 'first-year' costs of capital tax reduction is

also misleading. By the time the yield from capital tax accrues, there will have been at least one other Budget in a new and different situation.

Social, political and economic effects

IHT at present rates weakens the market economy and damages its performance. It does little or nothing to redistribute wealth, and it can be avoided by emigration, spending or successful exempt transfers. It is a tax on commitment, vocation, and stewardship, all of which benefit the community through the provision of services at less than market value. It thus encourages excessive materialism. IHT therefore has undesirable social consequences, as well as being bad for the Exchequer.

CONCLUSION

If only to conserve the tax base — 'the goose that lays the golden eggs' — and thus the revenue yield, IHT should be cut — at least by half.

Appendix

Table 1 on the next page is constructed on the following principle. Maximum turnover (or unitary price elasticity) is at a tax rate of zero. Fiscal prohibition is at a tax rate of 100 per cent. Fiscal discouragement (or the reduction of turnover) is distributed in the form of the arithmetical progression 1, 2, 3, 4 ..... 97, 98, 99, 100 as the rate of tax rises from zero to 100 per cent. These three assumptions are sufficient to determine the rate of tax that yields most revenue to the Exchequer. This rate is between 57 and 58 per cent; in other words, if the rate is 58 per cent or more, tax revenue is reduced by an increase in the rate and increased by a reduction.

There is only one pattern of arithmetical progression that starts at zero and cumulates to the whole of the original turnover over the range from maximum turnover to fiscal prohibition. Geometrical progressions and other more complex algebraic series lack this determinacy: some would give a higher figure than 57/58 per cent for the maximum-revenue tax rate and others a lower figure. On grounds of simplicity, determinacy and centrality (in the sense of policy neutrality or objectivity), the arithmetical progression used in Table 1 seems preferable to alternatives.

The assumption that fiscal prohibition is at 100 per cent and not some lower rate of tax increases the resulting figure of the maximum-revenue tax rate. Our argument is therefore understated through being based on this assumption. What is perhaps likelier, is that nearly all the yield has been destroyed when the tax rate has reached a much lower figure such as 80 or 90 per cent, even if not all of it is destroyed until the rate reaches 100 per cent. Allowance for this consideration could reduce the maximum-revenue rate of tax substantially below the 57/58 per cent given above.

If the rate of tax is 60 per cent and the maximum-revenue rate of tax is 57/8 per cent, the revenue <u>gains</u> both marginally and in total through a reduction in the rate from 60 per cent to 57/8 per cent; it <u>loses</u> marginally but still <u>gains</u> in total if the reduction in the rate from 60 per cent is carried through from 57/8 per cent until a lower figure of (say) 55 per cent is reached at which the losses of the revenue over the tranche 57/8 - 55 per cent equal the gains of the revenue over the tranche 60 - 57/8 per cent; below the figure of 55 per cent the revenue <u>loses</u> in total as well as marginally.

TABLE 1

Maximum tax yield (unitary price elasticity at a tax rate of zero)

(1)	(2)	(3)	(4)	(5)	(6)
.10	1.1111	4995	4495.6	499.4	
.20	1.2500	4840	3872.0	968.0	
.30	1.4286	4585	3209.4	1375.6	
.40	1.6667	4230	2538.0	1692.0	
.50	2.0000	3775	1887.5	1887.5	
.55	2.2222	3510	1579.5	1930.5	
.56	2.2727	3454	1519.8	1934.2	+ .19
.57	2.3256	3397	1460.7	1936.3	+ .11
.58	2.3810	3339	1402.4	1936.6	+ .02
.59	2.4390	3280	1344.8	1935.2	− .07
.60	2.5000	3220	1288.0	1932.0	− .17
.70	3.3333	2565	769.5	1795.5	
.80	5.0000	1810	362.0	1448.0	
.81	5.2632	1729	328.5	1400.5	− 3.28
.82	5.5556	1647	296.5	1350.5	− 3.57
.83	5.8824	1564	265.9	1298.1	− 3.88
.84	6.2500	1480	236.8	1243.2	− 4.23
.85	6.6667	1395	209.2	1185.8	− 4.62
.86	7.1429	1309	183.3	1125.7	− 5.07
.87	7.6923	1222	158.9	1063.1	− 5.56
.88	8.3333	1134	136.1	997.9	− 6.13
.89	9.0909	1045	115.0	930.0	− 6.80
.90	10.0000	955	95.5	859.5	− 7.58
1.00	∞	0	0	0	0

(1) Gross rate of tax

(2) Price = 1 + net rate of tax
= the percentage increase in (2)
= the reciprocal of the tax-exclusive element of the price

(3) Turnover, which is assumed to decline in an arithmetical progression from unitary price elasticity to fiscal annihilation

(4) Quantity or volume = (3) ÷ (2)

(5) Tax revenue or yield of tax = (3) − (4) = (4) x ((2) − 1)

(6) Percentage change in (5), comparable with (2), which is the percentage change in itself.

4426/058/AC

S163.

27071/87

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

W C Owen Esq
Chief Executive
Tobacco Advisory Council
Glen House
Stag Place
LONDON SW1E 5AG

18 November 1987

CJ This is now fixed for 20 Jan at 3.00pm. This years' team consisted of PMG, & Mr Cropper – Mr Jefferson-Smith & Mr Boardman from C+E. Do you want a similar team for this meeting? Julie 8/12.

Yes, tho EST not PMG.

Dear Mr Owen

Thank you for your letter of 2 November, which enclosed your representations for the Budget

I would be delighted to meet a deputation from the Tobacco Advisory Council again this year. I have asked my office to be in touch with the details.

Yours sincerely
Nigel Lawson

NIGEL LAWSON

4426/111/AC

pmp

FROM: MISS S WALLIS

DATE: 20 November 1987

1. MRS BURNHAMS ✓ TB 23/11
2. MISS SINCLAIR AJ 23/11
3 MCU
4. FINANCIAL SECRETARY

cc PS/Chancellor 12/2
PS/CST
PS/Paymaster General
PS/EST
Mr Wilson
PS/IR
A Walker (IR)
PS/C & E
J Fisher (C & E)

BUDGET DEPUTATION: MANAGERIAL, PROFESSIONAL AND STAFF LIAISON GROUP (MPG)

The Managerial, Professional and Staff Liaison Group (MPG) have sent in their representations for the Budget, and are asking for an opportunity to discuss them with Ministers.

2. The MPG are not on the "core list" of organisations that Ministers should see as a matter of course; however, they were met last year to provide an alternative trade union view to the TUC.

3. We and the Revenue Departments see no advantage in you agreeing to a meeting this time round, particularly as the Chancellor will be attending the January NEDC and a separate meeting may not, therefore, take place with the TUC. We, therefore, recommend that you turn down their request.

4. I attach a draft reply.

SWallis

MISS S WALLIS

4426/110/AC

Treasury Chambers, Parliament Street, SW1P 3AG

W Aspinall Esq
Executive Director
Managerial Professional and Staff
Liaison Group
Tavistock House, Tavistock Square
LONDON WC1H 9JP

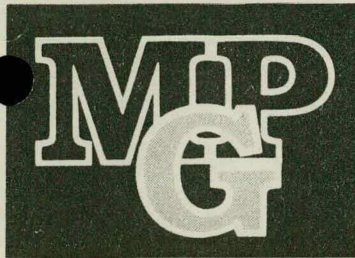
November 1987

Thank you for your letter of 5 November to the Chancellor of the Exchequer setting out your representations for the Budget and asking for an opportunity to discuss them with Ministers.

As you can imagine, Treasury Ministers receive numerous requests for meetings from representative bodies before each Budget. Ministers try and see as many organisations as possible, but as I am sure you will appreciate, they cannot see every organisation which requests a meeting. I am afraid, therefore, that it will not be possible for Treasury Ministers to see you in the run-up to the 1988 Budget.

I can assure you, however, that your representations will be carefully considered.

NORMAN LAMONT



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TELEPHONE
01 387 4499
01 380 0472 (Direct line)

Executive Director: Wilfred Aspinall
Secretary: Dr. J D J Havard MA MD LLB

MANAGERIAL, PROFESSIONAL AND STAFF LIAISON GROUP

WA/NF

BR

HM TREASURY – MCU
RECD. – 9 NOV 1987
ACTION Mrs Brenhams PP
cc IR, CE
FST
27568/87

5 November 1987

Rt Hon Nigel Lawson
Chancellor of the Exchequer
Treasury
Parliament Street
London
SW1P 3AG

Dear Mr. Lawson

I attach a copy of our Submission which has been prepared following extensive discussion within our Organisation.

You will see that we continue to support the general objectives of the Government however, we do consider that not enough is being done to resolve the anomalies in the tax structure with regard to the "married couple".

In line with our previous policy, we seek a shift from direct to indirect taxation.

You will recall that in 1986 we had the opportunity of meeting the Financial Secretary, the Rt Hon Norman Lamont MP, and although I realise that Ministers' diaries are very full, I do hope that we will be given the chance to have a similar meeting this year.

I look forward to hearing from you.

Yours sincerely

Wilfred Aspinall
Executive Director

Member EC Economic and
Social Consultative Assembly

1988 BUDGET SUBMISSION

London
Managerial, Professional & Staff Liaison Group
November 1987

BUDGET 1988 - SUBMISSION TO THE CHANCELLOR OF THE EXCHEQUER

1. SUMMARY

1.1 The Managerial, Professional and Staff Liaison Group (MPG) is a federation of trade unions representing management, professional and staff employees in industry, commerce, health services, education and local authorities. Each year we place a submission before the Treasury in order that the views of this important section of the working population which we represent can be taken into account by the Chancellor of the Exchequer when formulating his policy.

1.2 In order that we can express an opinion on behalf of our members, MPG has sent out a questionnaire to a representative cross section of our members within the individual organisations. This submission has been prepared on the basis of the majority opinions expressed in the replies. The conclusions have been debated extensively by all participating organisations and the final decision made by our Executive Committee.

1.3 MPG sees three priorities for this and future budgets:

* Introduction of a married persons allowance.
* A shift from direct to indirect taxation.
* Maintenance and improvement of public and social services.

1.4 Our main proposals are that the Chancellor should, in his 1988 budget,

* Introduce a married persons income tax allowance to replace the present married man's allowance and wife's earned income allowance.

* Reduce the standard rate of income tax and higher rates proportionately.

* Raise the income threshold at which income tax becomes payable.

* Introduce a higher rate of VAT on certain specified luxury goods.

* Introduce a lower rate of VAT on certain items.

* Increase substantially the excise duty levied on tobacco products.

* Increase substantially the excise duty levied on alcoholic drinks.

* Increase off-course betting duty and gaming machine duty.

2. THE PROPOSALS IN DETAIL

* INTRODUCING A MARRIED PERSONS ALLOWANCE

2.1 A major conclusion from our questionnaire analysis is that our members would favour proposals similar to those in the Green Paper "Reform of Personal Taxation". A substantial majority thought that achievement of equal taxation for one-earner and two-earner families with the same total income is a greater priority than reduction of the basic rate of income tax. They encouraged us to put proposals to this end into our submission to you with regard to the 1987 budget, and to urge you to take action in that Budget and not to wait for implementation of the Green Paper in toto. This view has once again been expressed in our 1987/88 questionnaire.

2.2 Our proposal is quite simple and does not involve transferability of allowances nor does it need to await computerisation of the Inland Revenue. It is that both the married man's allowance and the married woman's earned income allowance shall be abolished and replaced by a married persons' allowance equal to 2.5 times the present single persons allowance.

2.3 The allowance would belong to husband and wife jointly and would apply to their total joint income unless they elect, as they are entitled to do, to be taxed separately. It would apply to both earned and investment income, whereas the present married woman's allowance applies only to earned income. It would rectify the injustice whereby if a married man is the single earner, only 1.5 times the single allowance is available whereas if both partners, or the wife only, are earning then 2.5 times the single allowance is available.

2.4 We believe that social justice and sex equality demand that the amount of tax paid by a married couple should be determined only by their total income irrespective of who earns it.

* REDUCING INCOME TAX RATES

2.5 In considering the subject of the basic income tax we do of course support the Chancellor's objective of reducing the basic rate of income tax to 25%, or even less.

2.6 However as mentioned above, our members feel the greatest urgency should be given to reforming the taxation of married couples. We feel that the Government should not become fixated with achieving the figure of 25% at the cost of retaining the anomolies which exist at present.

2.7 Additionally, MPG urges that any reduction in income tax rates should be across the board and not limited to particular bands, and we suggest that each of the existing income tax rates be reduced by 2p in the pound.

* RAISING INCOME TAX THRESHOLDS

2.8 MPG has commented before on the disincentives that the lower paid worker faces, with the imposition of income tax at 27% on each pound earned as soon as income tax becomes payable. Coupled with the way National Insurance Contributions are levied, we feel that this is a disincentive to earn more and encourages the black economy. Increasing the threshold at which income tax becomes payable would be an incentive to lower paid workers. Lower paid workers would be prepared to take a lower income if their income tax and NIC rates did not penalise that prospect. We suggest that main personal allowances be increased by at least ten per cent.

* INTRODUCING DIFFERING RATES OF VAT

2.9 MPG continues to favour a shift from direct to indirect taxation because we believe that employees should be free to spend as high a percentage of their income as possible in whatever way they wish. We believe that this will assist the competitiveness of British industry because increased consumer spending generates demand for manufactured goods and improves employment prospects.

2.10 The continued growth in the economy is to be supported at all levels of our society and therefore our proposals are geared towards that development. We believe that an increase in VAT if levied equally on all goods irrespective of their origin will also assist in the development of this growth.

2.11 We believe the Government should be mindful of the advantages that would accrue if the Single European Act were fully implemented, and that approximation of indirect taxation is an essential part of this programme.

2.12 Our members do not wish to see the abolition of the zero rate on food and children's clothing, but they do see the possibility of a reduced VAT rate applying to certain commodities and for a higher rate on certain luxury goods. MPG would therefore not be against varying levels or bands of VAT being introduced, although we recognise that this may be at some administrative cost.

* INCREASING EXCISE DUTIES ON TOBACCO PRODUCTS

2.13 MPG was very disappointed at the failure of the Government to increase excise duties on tobacco and alcohol in the 1987 Budget and urges strongly that these be substantially increased in this Budget. We do not wish to stop people indulging in smoking, drinking or gambling by <u>law</u> (although we would try to do so by education) but we believe that they should pay comparatively dearly for their indulgence. We realise that there is a difficulty that smoking and drinking are taken into account in the cost of living index and that any substantial increase in their cost would increase that index and trigger off pay and pension increases which are index-linked, but we do not regard this as an insuperable objection.

Furthermore, if the increased prices reduce consumption of alcohol and tobacco, this will of course reduce the importance of these items in the calculation of the retail price index.

2.14 The Government will be aware of the call by the British Medical Association for a 30 pence rise in the price of a packet of twenty cigarettes and MPG fully supports this proposal. The adverse health effects of smoking are fully documented and the cost to the economy caused by this ill health is astronomical. A recent study in the United States for example estimated the cost there to be 54 billion dollars a year and there is no reason to believe that a pro rata figure does not apply here.

2.15 It should also be noted that the use of tobacco, cigars, cigarettes and pipes is potentially harmful not just to the smoker but to all those who are exposed to the fumes.

2.16 We note also, that excise duties on tobacco products other than cigarettes, yield about 10% of the total of these duties but that rates on these have not been altered for some years. We urge therefore that very considerable increases in duty be imposed on these products.

* INCREASING EXCISE DUTY ON ALCOHOLIC DRINKS

2.17 Regarding alcohol, MPG recognises that this is perhaps not a problem when taken in moderation but that the adverse effects of excess consumption are horrific in both social and economic terms. We welcome the setting up by the Government of the Ministerial group to study alcohol abuse and hope that this will lead to a coherent policy. Abuse of alcohol is a massive drug problem in this country. MPG believes that there should therefore be a strong disincentive for people to drink excessively, especially as the Government appears to wish to relax licensing laws and thereby increase the availability of alcohol. Our suggestions are therefore for an increase in the price of a bottle of spirits of £2.50, for 5 pence on a pint of beer and, for 25 pence on a bottle of wine, and for similar increases in duties on other alcoholic drinks.

* INCREASING OFF-COURSE BETTING DUTY AND GAMING MACHINE DUTY

2.18 MPG was disappointed last year at the Government's decision to abolish on-course betting duty. Gambling is a non-productive activity which can lead to diversion of productive resources. It seems right that it should make a substantial contribution to taxation. We propose that the general betting duty should be raised to 15%. We welcome the increases last year in gaming machine licence duty but feel that there is no justification for there to be a lower rate on machines in public houses, arcades etc. and we suggest that the rate on these be brought up to the same level as for jackpot machines.

3. BACKGROUND TO THE SUBMISSION

3.1 We are disturbed that there has been a general increase in the level of taxation plus national insurance contributions as a percentage of gross income. The commitment of the Conservative Government to reduce taxation has some contradictions. We accept that direct taxation at the standard rate has been reduced but we have seen national insurance contributions increase (see Table A1 and Figure 1 in the appendix).

3.2 MPG accepts that real incomes have increased during the period from 1979 to date but nevertheless, we do believe that some attempt should be made to reduce the overall tax liability of the individual taking into account taxation and NIC.

3.3 MPG remains implacably opposed to any proposal that the upper earnings limit for employee national insurance contributions be abolished altogether, and was pleased to see that the limit has been retained in the Chancellor's recent Autumn Statement. We have always maintained that national insurance contributions are a direct tax and such a suggestion would run counter to the Government's professed desire to lower direct taxes and also to the principles underlying social security benefits.

3.4 MPG members, in common with the public as a whole, hold a wide variety of views on the subject of the privatisation of public corporations and nationalised industries. There is however a concensus on how the sums realised by the programme should be used. In our discussions with the Financial Secretary to the Treasury, Mr Lamont argued that Government revenue was not earmarked and it would be impractical to identify any sums raised in a particular form as appropriate for a particular kind of expenditure. We do not accept this view since certain sums are at present hypothecated e.g. the NHS component of national insurance contributions and indeed the contributions themselves. Our members believe that the proceeds from the sales of public assets should not be viewed in the same terms as other forms of current expenditure but should be used for longer term purposes which will yield returns, be they social or financial, long into the future. Such a pattern of expenditure would reflect the existing nature of the resources being privatised.

3.5 MPG recognises that the search for efficiency and unit cost reductions should be no less rigorous in the public than in the private sector. Such savings as can be realised in this fashion are an appropriate addition to resources provided by central Government. These savings should not be viewed as an excuse to provide a lower level of funding than is appropriate and the savings which accrue should be shared by the other two parties involved as well as the employer : namely the consumer in the form of a better service and the employee in the form of real improvements in his or her terms and conditions of service.

4. FURTHER POINTS FOR DISCUSSION

HOUSING

4.1 The purchase of a house is for most people the most important purchase that they make during their lives. We believe therefore that there should be special encouragement for this purchase. Firstly, we are in favour of an increase in the limit of mortgage interest relief. We also believe that the present anomoly which allows two single people to have a mortgage on a single property and to claim relief to be iniquitious and that only one mortgage should be allowable on any one property.

4.2 Secondly, we believe that the limit that stamp duty becomes payable should be increased and that it should be a graduated tax payable only on the excess above the limit. This need have no revenue effects as a higher rate could apply at higher levels which would affect only a very small number of house buyers.

CAPITAL GAINS

4.3 We noted with interest the innovation in last years Budget concerning the treatment of capital gains of companies, whereby they are now to be taxed (after indexation allowances and exemptions) along with other profits. We would suggest a similar system could apply to capital gains made by individuals, so that any profits above the exempt limits would be added to the individual's taxable income and taxed at their highest applicable rate. We would suggest that this would be more equitable than the present flat rate.

PENSIONS

4.4 MPG would wish to enter into discussion about the prospects of tax relief on pensions and in particular the proposals set out in the 1987 Finance Act relating to Additional Voluntary Contributions. We remain adamantly opposed to any suggestion that lump sum payments to employees on retirement or pension fund income should be subject to taxation.

5. COST OF PROPOSALS

5.1 Our estimates of the revenue effects of our proposals are shown in the table below. We have made our proposals on the assumption that the strength of tax revenues in this year will create for the Government a "windfall" gain of about £5 billion. MPG feels that this would present an ideal opportunity for the Government to introduce the changes we have proposed. Should the amount of the "windfall" be less than we have estimated then, as pointed out in our submission, our members place the greatest priority on the introduction of the married persons allowance.

5.2 MPG supports the principle of indexation of allowances and thresholds for income tax, and of revalorization of duties. Our proposals in this submission are additional to such indexation and revalorisation. We consider that any taxation system should take account of general changes in the value of money separately from structural changes.

ESTIMATED REVENUE EFFECTS OF PROPOSALS

		Cost/Revenue Gain (£ Billion)
Personal taxation allowance for married couples = 2.5 times single allowance		-2,750
Reduce rates of income tax by 2 pence		-2,300
Increase main personal allowances by 10%		-1,700
Introduce differential VAT rates on specified luxury goods and certain zero rated items		+1,000
Tobacco	- increase excise duties by approximately 28%	+750
Alcohol	- Increase excise duties on spirits by £2.50 bottle	+375
	- Increase excise duties on beer by 5 pence pint	+375
	- Increase excise duties on wine 25 pence bottle	+175
	- Increase excise duties on other drinks	+25
Gambling	- Increase off-course betting duty to 15%	+300
	- harmonize gaming machine duty	+85
TOTAL NET COST		-3,665

- APPENDIX -

TABLE A1

CURRENT ACCOUNT OF CENTRAL GOVERNMENT

RECEIPTS (%)	1980	1981	1982	1983	1984	1985	1986
Taxes on Income	38.8	39.3	39.7	39.3	39.4	39.6	38.7
Taxes on Expenditure	35.4	35.0	34.0	33.6	33.5	33.0	34.7
National Insurance etc	17.4	17.3	17.7	18.9	18.8	18.5	19.0
Misc Income	8.5	8.4	8.6	8.2	8.3	9.0	7.6
	100.0	100.0	100.0	100.0	100.0	100.0	100.0
		-- £ BILLION --					
Total Receipts	79.6	91.7	102.2	109.8	118.7	131.3	135.9
Total Expenditure	82.4	96.1	106.1	114.8	124.8	134.6	140.4
Deficit	2.7	4.3	3.9	5.1	6.1	3.3	4.5

SOURCE: CSO National Accounts.

COMMENT: The structure of central Government recipts has shown very little change throughout the 1980s, although there has been an increase in the share from national insurance contributions. Expenditure taxes have not increased their share of total receipts.

TABLE A2

INDIRECT TAXES AS A PERCENTAGE OF DISPOSABLE INCOME FOR EACH QUINTILE GROUP OF NON-RETIRED HOUSEHOLDS RANKED BY ORIGINAL INCOME, 1985

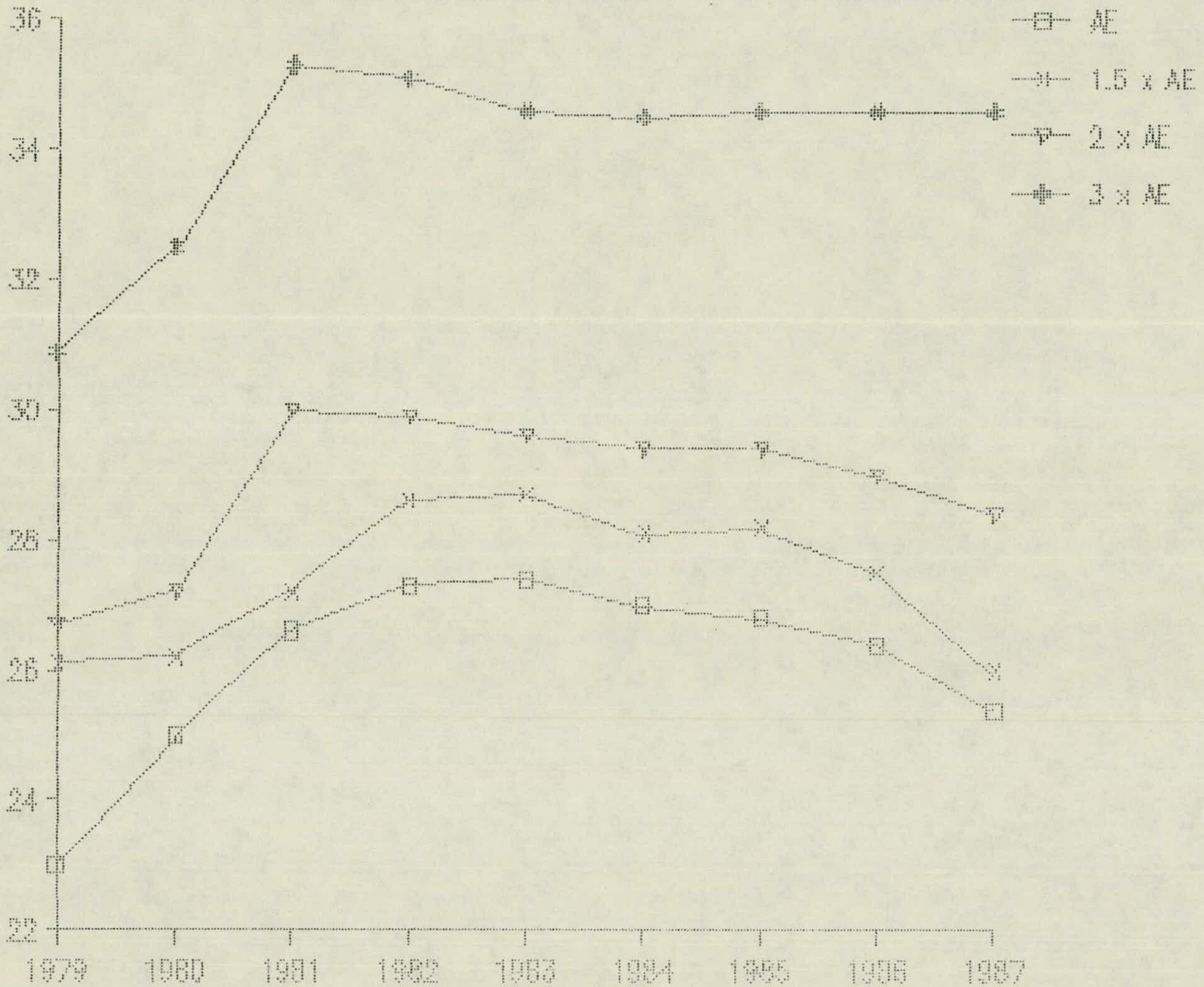
	QUINTILE GROUP BOTTOM	2ND	3RD	4TH	TOP	TOTAL
Domestic Rates (a)	3.9	4.8	4.1	3.7	2.8	3.6
VAT	7.7	8.0	7.8	7.7	7.3	7.6
Duty on Beer	1.2	1.3	1.1	1.1	0.9	1.1
Duty on Wines and Spirits	0.8	0.9	0.9	1.0	1.1	1.0
Duty on Tobacco	5.3	3.3	2.5	1.8	1.2	2.2
Duty on Hydrocarbon Oils	1.2	1.6	1.7	1.7	1.5	1.6
Car Tax and Vehicle Excise Duty	0.8	1.1	1.1	1.1	1.0	1.0
Other Taxes on Final Goods and Services	2.1	1.9	1.6	1.4	1.1	1.5
Intermediate Taxes	5.7	5.5	5.1	4.9	4.5	4.9
	---	---	---	---	---	---
Total	28.6	28.3	25.9	24.4	21.4	24.5

(a) Net of rate rebates and the rates element of housing benefit supplement, but including water etc. charges.

SOURCE: Economic Trends, July 1987, p.105.

COMMENT: The argument that indirect taxes are regressive and so less equitable than proportional income taxes is not a strong one. The redistributive effect of benefits and other transfer payments mitigate this effect. Although households in the lower quintiles pay a slightly greater proportion in indirect taxes, a large part of this is accounted for by tobacco duties.

FIGURE 1



AE = Average Earnings. Figures assume a married man contracted out of the state scheme. Average earnings in 1987 are estimated to increase by 8%.

COMMENT: Despite declining in the past few years, the combined tax and national insurance burden for most earners is still higher than in 1979, due mainly to increase in national insurance contributions. Only in the case of an earner on one and half times average earnings has the figure fallen back to just below its 1979 level.

Board Room
H M Customs and Excise
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FROM: P JEFFERSON SMITH

DATE: 24 November 1987

ECONOMIC SECRETARY

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

BUDGET REPRESENTATIONS: THE NATIONAL ASSOCIATION OF CIDER MAKERS (NACM) AND THE NATIONAL ASSOCIATION OF PERRY MAKERS (NAPM)

1. The NACM have sent us their representations for the 1988 Budget (copy attached). Subsequently we met their representatives along with those of the NAPM. I undertook to report their views to Treasury Ministers. The Associations will not be seeking a meeting with a Minister.

2. The Associations' main points were similar to those made in previous years. They stressed the need for market stability and that there should be no alteration in the current beer:cider duty relativity detrimental to cider. They made a strong plea that if there were to be a closing of the gap between the beer and cider duties, such a change should be introduced gradually.

3. They said that:

(i) After a period of expansion, the cider market has been in the doldrums since the middle of 1984 after the large duty increase in the Budget. The main factor in the market growth up to 1984

Internal distribution: CPS
Mr Knox
Mr Whitmore
Mr Allen
Mr Tullberg
Mr Baust
Ms Noonan

319/11/87

was an increase in the distribution of draught cider in the on-trade where it competes with beer. The potential for further growth by that route seemed limited. Despite the launching of two new draught ciders and an increase in advertising support, the trade did not see any prospect of a resumption of the rapid growth in the cider market prior to 1984; they expected 1987 to show a slight decline on 1986.

(ii) Companies had already reduced their labour force (by almost 30% since 1984) and made other economies, but there was a limit to what can be achieved by such rationalisation. A further downturn in the cider market would soon have a serious effect on employment and supply industries, in particular apple growers.

(iii) If a new duty structure were introduced for low-strength wine and mixed-drinks the Associations would prefer cider-based products to be excluded. They were concerned that the existing favourable duty treatment of cider and perry might be high-lighted and they brought into question.

4. **Alcohol misuse.** The industry are aware of the pressure that is building up for an increase in the duty on cider, which currently pays only about half the duty on typical strength beer, a difference of about 10p per pint with associated VAT. The Associations make the point that the consumer looks at the price of the product not the duty, and they claim that in pubs cider costs on average about 10p per pint more than bitter and about 2p per pint more than lager. The NACM contend that the extra costs of making and distributing cider counter-balance the duty advantage and wholesalers and retailers generally apply higher margins to cider than beer.

5. The Associations also argue against tackling the problem of alcohol misuse by means of substantial increases in duty because this would affect consumption by all groups, penalising moderate drinkers of all ages and particularly those with lower incomes.

They do not believe it would materially affect those with an excessive drinking problem. The industry itself is considering initiatives. They intend to run an educational campaign, they are looking at the possibility of introducing a "low alcohol" cider category (an existing industry code of practice has a minimum strength of 3% for cider); and subsequently they expect to move on to examine the potential for manufacturing "non-alcoholic" cider.

6. Cider may be more expensive to manufacture than beer, and the point about the customer looking at the price he pays not the amount of duty is valid. However, although cider may cost more than beer in a pub, it can also be very much stronger. Because cider duty is charged at the same rate irrespective of strength, up to a maximum of 8.5% alcohol, strong cider is substantially under-taxed by reference to its alcoholic strength.

7. The Inter-Departmental Working Group considered the desirability of reducing the differential between cider and beer taxation, and also of relating the duty to alcoholic strength. There is no technical obstacle to changing the ratio between the beer and cider duties but a sliding scale according to alcoholic strength would create significant difficulties. A duty based on alcoholic strength would increase trade and official costs, and would be likely to encounter sustained opposition. One problem would undoubtedly be the high cost of equipment for accurately measuring the alcoholic strength of cider and particular objections could be expected from small-scale producers. Nearly 90% of cider production is by the five biggest companies, but there are 90 other producers, mostly in the West Country. We believe that these smaller cider makers produce stronger than average cider and the double burden of an increase in administrative burden and higher duty would be bound to provoke a strong political reaction.

8. The Working Group's conclusion reached in respect of cider is at paragraph 34 of the report which reads as follows:

"Although the relatively low level of cider consumption means that duty changes would have at best only a marginal effect on overall alcohol consumption, the Group noted the concern that cider is a particularly popular drink amongst under-age drinkers. Moreover, there appears to be widespread ignorance about its strength. Cider is typically stronger than beer, but parents are known to give it to children as a "safe" drink, and because it is taxed at a flat rate strong cider is a relatively cheap source of alcohol. Cider is undertaxed compared with beer and this is undesirable on health and crime grounds. The Group **concluded** that there should be a positive policy of moving the cider duty towards parity with the beer duty. However, the fragile nature of the cider market suggests that this should be a gradual process so as not to cause undue adverse effects on the industry."

9. We will take into account the cider makers views and those of the Inter-Departmental Working Group when advising Ministers in the context of the drinks duties and the excise package as a whole.

P JEFFERSON SMITH

The National Association of Cider Makers

Secretary:
A. T. BRAIN, F.C.A.

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THE CIDER MARKET - AN INDUSTRY VIEW

1. CIDER MARKET PERFORMANCE

In 1984, cider excise duty was increased by 47%, at the same time as beer duty rose by 11% and wine duty was reduced by 20%. Three years later the cider market is struggling to regain its volume and to restore its margins to earlier levels. There are certainly no indications of a return to growth at present.

A year of stagnation in 1984, and a year of decline in 1985, were followed in 1986 with a return to marginal recovery with the market up 2.1% to 65m gallons. As Appendix 1 shows, that growth has not continued into 1987. The first three quarters of 1987 have all posted falls against 1986. The 3rd quarter has shown a 4.3% decline, bringing the M.A.T. down to 64.1m gallons, a fall of -1.2%.

The prime reason for this lack of growth would appear to remain the long term impact from the 1984 duty increase, which has had the effect of increasing cider prices beyond those of beer/lager in both the On and Off Trade sectors and of limiting the marketing funds available to promote growth.

In Appendix 2, it can be seen that, after the introduction of duty on cider in 1976, it took 5 years for the market to recover. A similar time-scale would now appear likely before the peak of 1983 can be bettered, providing no further penalty is placed on the industry.

2. CIDER INDUSTRY RESPONSE

The decline experienced in cider volumes has hit particularly hard, because it occurred at a time when manufacturers were expecting and planning for further growth. All cider companies have had, as a result, to go through a painful process of taking cost out of the business to improve productivity both to restore margins and to find the funds to invest in the development needed to bring a return to growth:-

a) **Greater efficiency:** to compensate for the higher duty costs and reduced volumes, the cider industry throughout 1984-7 has sought substantial productivity improvements in their business. Partly this has been achieved by investment in new plant and technology, but there has also had to occur a radical reduction in total workforce. In the three major cider companies, 1984-7 saw a fall in employees of almost 800 people or 28% of the workforce. Almost certainly further job losses have occurred in supply industries.

b) **Price increases:** the price sensitivity of cider to lager and beer has forced price increases to be kept to below the level of inflation, despite the need to fund increased levels of marketing support behind cider brands. The Table below demonstrates that over the last 4 years, the real net revenue ("Yield") increase per gallon obtained by the industry was 12% as against an R.P.I. increase of 20.7%. The figures are based on averages across the 3 major draught brands.

Table 1 - Yield, R.P.I. and Duty Movements

	1983	1984	1985	1986	Forecast 1987
Volume Index	100	100	96	99	96
Yield per gallon (indexed)	100	105	106	106	112
Movement: Y.O.Y.	-	+5%	+1.1%	-0.2%	+6.4%
R.P.I. (indexed)	100	105	112	116	121
Movement: Y.O.Y.	-	+5.2%	+6.9%	+3.0%	+4.2%
Excise Duty Returns (indexed)	100	147	155	160	155
Movement: Y.O.Y.	-	+47.5%	+5.7%	+2.5%	-3.0%

Source: NACM Estimates

What this table also indicates is the movement in duty payment on cider volumes over the same period of time. They have increased at a much higher rate over the term, but have now slowed and gone into decline in line with cider volumes.

The higher tax cost together with the caution taken with price increases, have reinforced the pressure on the industry to reduce costs.

c) **Increased marketing activity:** The Table below demonstrates the immediate reduction in numbers of people consuming cider following the 1984 duty increase, in terms both of absolute numbers an the proportion consuming the heaviest quantities (i.e. at least 1 pint per week).

Table 2 - Cider Penetration

	1984	1985	1986	1987
All cider drinkers (m)	17.9	16.6	17.6	17.9
% total population	40.9	37.6	40.3	40.5
Heavy users (m) (1 + pint a week)	3.0	2.8	2.7	2.5
% total cider drinkers	17%	17%	15%	14%

Source: T.G.I.

The number of people "ever drinking" cider is low compared to those drinking beer or lager and the quantities of cider they consume are much less than those of beer and lager. This demonstrates the opportunities that still remain for expanding the cider market, if attractive and acceptably priced ciders are presented to consumers in a compelling way.

All the major cider manufacturers have been working to exploit this opportunity by funding an increase in advertising levels through productivity gain and by more new product introduction:

i. There has been a return to substantially increased levels of support on both existing and new brands over the last 2 years, after the reductions seen in 1984/5.

Table 3 - Total T.V. and Press Spend

£m	1983	1984	1985	1986	1987 (9 months)
Bulmers	4.0	3.1	1.2	2.9	2.0
Taunton	2.8	2.7	3.5	2.5	3.4
Showerings	2.8	1.9	1.4	2.0	1.9
Merrydown	-	-	-	0.1	0.2
Symonds	-	-	0.2	0.4	-
Total	9.6	7.7	6.3	7.9	7.6

Source: M.E.A.L.

ii. An impressive number of new lines have also been introduced: Diamond White and Cool from Taunton: Copperhead, Addlestones and Festival Vat from Showerings: Crispin and Strongbow 1080 from Bulmers - to provide the consumer with a more interesting choice of cider tastes and presentations.

3. CIDER'S PROSPECTS FOR THE FUTURE

The cutbacks of the last 3 years have gone as far as possible, in a relatively small-scale industry, in improving productivity. It would be difficult to source further profit and volume growth from additional cost saving exercises. Such improvements must now come from increasing the scale of the industry - from growth.

Any further disproportionate penalty placed on the cider industry would encourage stagnation if not decline and would severely endanger the ability of the industry to fund a recovery. Employment levels (down 28% in the last 4 years) would fall further. The reduced demand for cider would have a knock on effect on the supply industries, particularly cider apple growers, as the demand (and price paid) for apples and other materials falls. There would also be less commitment to the planting of new apple trees and the acreage devoted to the cider apples would decline further.

without such penalties, the opportunity for a return to growth could still exist. The low levels of cider awareness and consumption can be increased by maintaining the higher level of advertising support now being committed to, and by continuing to invest in new product development.

4. CIDER INDUSTRY NEEDS

The industry needs a positive environment that would allow manufacturers to continue to invest with confidence in the future. Specifically it needs:

i. Stable duty relativity: the relative level of duty attached to cider as against beers should remain unchanged. A previous submission to H.M. Customs & Excise in November, 1984 (Precis Appendix 4 attached) showed that the cost penalties attached to cider production, distribution, marketing and retailing, were effectively balanced by the lower excise duty payable. This relationship has not materially changed.

The duty "advantage" therefore enables cider to do no more than maintain a competitive position in the market place. Any further increase of cider duty closer to that of beer would force the price premium that cider already has over beers to widen even further. Stats MR have consistently shown an average price premium charged by retailers for cider over beer of 10p per pint, since the 1984 Duty changes. To absorb any such increase into cost would now be impossible, following the cost cutbacks already ~~experienced~~, and would result in severely reduced margins and a drastic further effect on jobs and capital investment.

ii. No substantial increase in duty: The NACM would argue against any move to attack the problem of alcohol abuse through the mechanism of a substantial increase in duty levels on lower alcohol strength drinks. Such a move would affect consumption by all groups, penalising moderate drinkers of all ages, particularly those with lower incomes. It would not materially affect those with an excessive drinking problem. The industry is considering other initiatives to combat the problem, highlighted below.

iii. Exclusion from a "cooler" duty band: The NACM continues to be very concerned about the possible impact of a new lower duty band to accommodate alcohol/fruit juice mixes. We would still prefer to see cider/perry based products excluded from any such bands, both to preserve the quality perception of cider and to minimise the risk of prejudicing, now or in the future, the relative rates of duty of the two categories.

5. CIDER INDUSTRY ACTION ON ALCOHOL ABUSE

The cider industry is particularly sensitive to public pressure to encourage moderate drinking. This pressure has sometimes been unduly focussed on cider, despite its comparatively very low levels of consumption particularly compared to beer/lager. The following table demonstrates the relative proportions of beer/lager and cider volumes consumed by beer/cider drinkers over a 7 day period.

Table 4 - Relative % Volume of Beer and Cider consumed in last 7 days

	All Adult	18-24 Year Olds
Any Cider	3	7
Beer and Cider	1	1
Draught/Keg Bitter	34	24
Draught Lager	29	42
Other Draught Beer	8	4
Beer Mixes (incl. Shandy)	8	6
Packaged Beer	17	16

In addition, though cider is undoubtedly popular amongst young people, it remains true that the majority is consumed by those over 25, as this table demonstrates.

Table 5 - % Total Cider Volume consumed by Age, Sex, Profile

		% Cider consumption	% GB Population
Sex -	Male	66	48
	Female	34	52
Age -	18-24	43	15
	25-34	25	18
	35-49	22	25
	50+	10	42
Socio Economic Group	AB	15	18
	C1	24	23
	C2	31	28
	DE	30	32

Source: P.A.S. 1986/7

The industry is looking hard at the possibility of introducing a "low alcohol" cider category within existing definitions of cider, providing that the considerable difficulties in ensuring cider product qualities at these low alcohol levels are overcome.

Measures to educate cider consumers as to the dangers of alcohol abuse are also being considered.

6. CONCLUSIONS:

The cider industry remains a sick man needing support. After a marginal return to growth in 1986, in 1987 it looks set to fall again despite a considerable increase in brand investment by all major manufacturers and an increase in innovative brand presentations.

A return to profitable growth in the cider industry can no longer come either from cost cutting exercises or further drives for distribution. Growth must now come from increasing penetration and frequency of purchase through the introduction of more interesting products. For this to happen, a supportive duty environment is required, and no further disproportionate duty increase should be put against the cider product category.

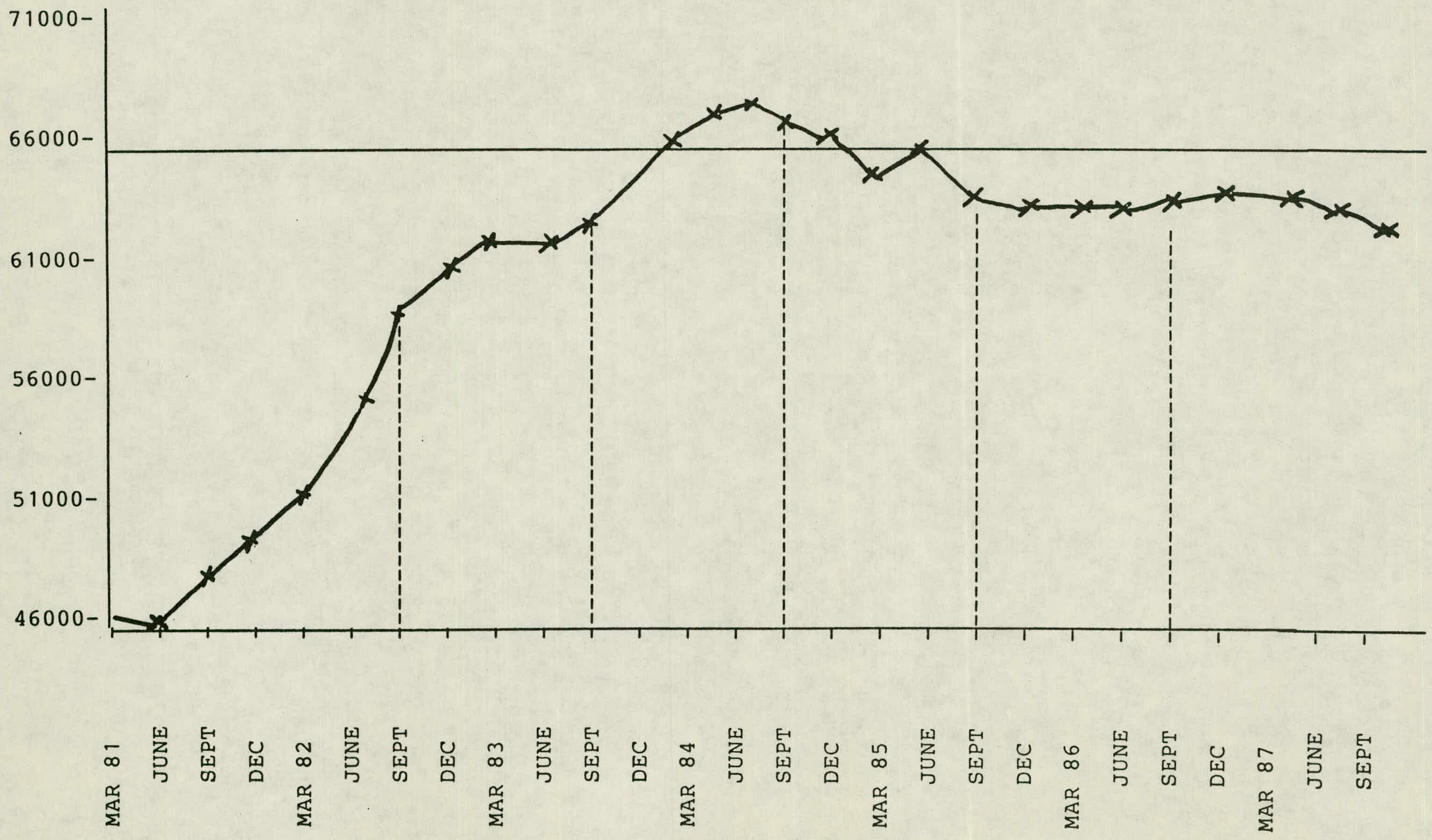
National Association of Cider Makers

November, 1987

APPENDIX 1

TOTAL CIDER MARKET

Source: NACM



APPENDIX 2 - Comparison of Movements in Cider Volumes, Duty rates and Duty yield

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Rate: £ per hectolitre	4.84	5.32	5.32	5.32	6.05	7.20	8.16	9.69	14.28	15.80	15.80	15.80
% Change: Y.O.Y.	-	+9.9	0	0	+13.7	+19.0	+13.3	+18.8	+47.4	+10.6	0	0
Volume: m gall	48	45	46	47	47	50	60	67	67	64	66	64
% Change: Y.O.Y.	-	-6.3	+2.2	+2.2	0	+6.4	+20.0	+11.7	0	-4.5	+2.5	-3.0%
Yield £m	2.64	10.9	11.1	11.4	13.0	16.3	22.2	29.6	43.5	46.0	47.2	45.8
% Change: Y.O.Y.	-	-	+1.8	+2.7	+14.0	+25.4	+36.2	+33.3	+47.0	+5.7	+2.5	-3.0%

APPENDIX 3

Year	All Cider m. gals	All Cider £m RSV	All alcoholic drinks (inc. imports) £m RSV	Cider as of A.A.D
1976	48	65	5,714	1.1
1977	45	90	6,545	1.4
1978	46	110	7,281	1.5
1979	47	150	8,664	1.7
1980	47	190	9,954	1.9
1981	50	230	11,153	2.1
1982	60	300	12,004	2.5
1983	67	345	13,372	2.6
1984	67	360	14,416	2.5
1985	64	370	15,765	2.3
1986	66	394	15,783	2.4
1987	64*	393*		

* Forecast

APPENDIX 4

Precis of NACM submission to H.M. Customs & Excise in November, 1984, headed Lager and Cider Cost Comparison.

1. Introduction

Cider represents less than 5% of beer volumes.

2. Materials

Cider costs are £11 a barrel compared to £6 for beer - our raw material is agriculturally produced and seasonal, with few economies of scale and much risk attached. It also requires substantial stockholding of juice.

3. Production

Cider costs are £23 per barrel as against £16 for beer - primarily because of different scale economies, longer fermentation periods and inability to run a continuous process.

4. Distribution

Cider costs are £13 per barrel against £10 for beer. Higher beer volumes allow fewer loads, fewer drops and larger drop sizes per trip. Cider makers also have longer distribution distances to cover prior to radial distribution.

5. Other support costs

Additional cider costs are £14 per barrel, whilst for beer is £11. These costs relate both to promotional activity and to the supply and servicing of keg dispense units. Lower volumes and levels of throughput cause the difference.

6. Retailer margins

Because of the lower throughputs achieved for draught cider as against beer, higher margins are charged to cider by the retailers.

7. Higher VAT calculation for cider

Because of its lower manufacturers' price, but higher retail price.

8. Summary

The differentials summarised below are broadly offset by the lower duty payable on cider.

	Cost Penalty
Materials	+£ 5 per barrel
Production	+£ 7
Distribution	+£ 3
Other support costs	+£ 3
	+£18 per barrel

(Duty per barrel on Beer: £47.63 v £25.86 on cider)

42/2 4368/14vj

pmp

FROM: MISS S J FEEST
DATE: 24 NOVEMBER 1987

1. MRS BURNHAMS

2. MISS S WALLIS

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Paymaster General
Miss Sinclair
Mr Wilson
PS/IR
Mr D Shaw (IR)

BUDGET DEPUTATION: LANDOWNER'S GROUP

The Financial Secretary has seen your minute of 16 November 1987. However, he would like to meet this delegation. (He pointed out that Mr Sword is a member of the TCC.)

2. I would therefore be grateful if you could arrange briefing for the meeting.

3. I will let you know the date as soon as possible.

Susan Feest

SUSAN FEEST
ASSISTANT PRIVATE SECRETARY

mjd 5/43J

UNCLASSIFIED

BF 7/12

FROM: MRS JULIE THORPE

DATE: 27 November 1987

MR G McKENZIE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr R I G Allen
Ms Sinclair
PS/C&E
PS/IR

BUDGET REPRESENTATIONS: THE SCOTCH WHISKY ASSOCIATION

Following my minute to you of 30 September, the Chancellor's meeting with a delegation from the Scotch Whisky Association has now been moved from Wednesday 9 December at 4.00pm to Monday 14 December at 4.00pm here in the Treasury.

2. The Financial Secretary and Economic Secretary will also attend the meeting and the Chancellor has asked if Sir T Burns and Richard Allen could come along as well.

3. I would be grateful if you could coordinate briefing to arrive in this office by close of play on Thursday 10 December.

Julie Thorpe

MRS JULIE THORPE
Diary Secretary

Inland Revenue

Policy Division
Somerset House

FROM: MRS C B HUBBARD
DATE: 27 NOVEMBER 1987

ECONOMIC SECRETARY

OIL TAXATION: BRINDEX REPRESENTATIONS

1. Graham Hearne wrote to the Chancellor on 4 November and to you on 5 November setting out BRINDEX's 1988 Budget Representations. You replied agreeing that a meeting with Inland Revenue officials would be a good idea, and we saw them on 19 November. This note gives some of the background to their more technical representations and summarises our discussion with them.

2. The covering letter repeated a number of representations on well-trodden ground - exploration farmouts, onshore exploration, and the Southern Basin. On the basis that it had been covered at your meeting the previous day with UKOOA, there was little substantive discussion of the Southern Basin issue. But BRINDEX clearly continue to feel strongly about exploration farmouts and onshore exploration relief - both of which are arguably more important for the smaller independent companies in BRINDEX than for the typical UKOOA member.

---

cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Mr Scholar
Mr Culpin
Mr Williams
Miss Sinclair
Ms Leahy
Mr Wilson
Mr C J Riley
Mr Painter
Mr Pollard
Mr Beighton
Mr Johns
Mr Elliss - OTO
Mr Cleave
Mr Beauchamp - OTO
Mrs Hubbard
Miss Hill
Mr J Evans
Dr Parker
PS/IR

3. On the more technical representations, which were set out in the Appendix to Mr Hearne's letter, a fuller account is given below.

Tariff Receipts Allowance Dilution

4. BRINDEX argue that where both oil and gas are to be tariffed through one principal field, the fact that both the oil and the gas tariffs are taken into account in the calculation of the cash equivalent of the Tariff Receipts Allowance (TRA) dilutes its value to such an extent that it might distort economic decisions, eg on whether to save the gas or flare it (on the assumption that Department of Energy would permit flaring), or whether to build a separate pipeline for it to another field. They point out that for the calculation of the cash equivalent of the oil allowance each participator has the option of electing to have it calculated by reference to the oil alone, ignoring the gas. This is advantageous where the oil price is higher than the gas equivalent. They argue that the same option should be available for TRA, because the lower tariffs for gas are depressing the cash equivalent of TRA.

5. The reasons for the difference in treatment are, however, twofold. At the time the legislation was introduced in 1983, it appears that the tariffs then being charged for gas throughput were the same or higher than oil. Therefore an option to elect to have the TRA calculated by reference to oil alone did not seem necessary. Also, and more importantly in our view, where an election is made in the oil allowance case, the respective oil and gas profit figures will relate either to arm's length sales or to non-arm's length sales or appropriations to which the market value rules apply. In relation to tariffs there is no PRT concept of an arm's length rate, and no machinery to police respective attributions to gas and oil within an overall tariff charge. If we allowed participators to choose to have TRA calculated only by reference to the oil tariff, loading the oil tariff at the expense of the gas tariff is a very real possibility.

6. We pointed this out to BRINDEX, who had not considered it in that light. They agreed to consider further whether they could propose any way in which an option could be policed, other than giving the Revenue powers to challenge "unreasonable" tariffs, which we said would be too contentious. They also undertook to let us have examples, if there are any, of where the present "dilution" of TRA has actually had the effect of encouraging companies not to save the gas or to construct new facilities rather than tariff existing ones.

7. More generally, the current TRA scheme requires a single calculation for all the tariffs received by a particular chargeable yield from a particular user field. If the calculation were to be split between separate oil and gas tariff rates we would undoubtedly face representations to deal separately with oil and gas throughput figures. We have resisted the suggestion that the current legislation permits this (see my note of 21 October 1987 concerning the method of computing TRA where different assets are tariffed separately). As pointed out in my 21 October note, disaggregated TRA calculations dealing separately with oil and gas throughput would in certain situations produce significant tax costs.

Dedicated Mobile Assets

8. BRINDEX regard as anomalous the present situation which allows a field which, because of oil allowance, might not have paid any PRT on its oil production, to be charged to PRT on disposal receipts from qualifying assets (eg a floating production system) at the end of its life. (There can be no oil allowance when there is no oil won and saved from the field in the period in question.) BRINDEX believe that companies ought in that situation to be given a deduction against the disposal receipts chargeable to PRT for expenditure on the assets in question which has not effectively been allowed for PRT because it has been replaced by oil allowance in earlier periods.

9. In fact it is not the expenditure which has been replaced by oil allowance, but the other way round. 100% relief is given for expenditure on a long-term asset which may reduce oil allowance used in earlier years and the field may not be able to utilise its full oil allowance quota later on. What BRINDEX are after is to make the two reliefs complimentary so that oil allowance displaced by expenditure relief is not lost. But this would be contrary to the nature and purpose of oil allowance which is only given after all other reliefs (except safeguard) have been allowed.

10. It could be argued nevertheless that there should be an allowance, comparable to TRA on tariff receipts, for disposals to maintain tax neutrality between commercial alternatives. Industry asked for this in 1983. This is a difficult point. In 1983 we were not convinced that any comparable and reliable alternative allowance could be found but in any case concluded that there was some advantage in not adding a further incentive into the tax system to encourage a marginal user to acquire an interest in assets, which he may not be able readily to afford, rather than to enter into a tariff arrangement. We considered the overall tax treatment, PRT and CT, better for a disposal even without an allowance than for tariff income with an allowance.

11. We told BRINDEX that we could not accept their analysis. In particular we did not accept that relief for expenditure was being denied. BRINDEX pointed out that the charge on the disposal receipts could in certain circumstances be avoided eg if the asset was disposed of more than two years after it had ceased to be used in connection with any field or if the asset was leased from a company which was not itself a field participator. They argued that floating production facilities would increasingly be used in the development of small fields, and the present rules distorted economic decisions. They undertook to provide us with more information on future developments which could be affected.

Comment

12. It would seem to us that this is another point which could be examined in the context of our review of the provisions of Oil Taxation Act 1983, which you authorised (Mr Barnes' minute of 26 October) in response to Budget Starter 352. It will probably also emerge in any discussion of abandonment costs when we see UKOOA's detailed representations.

Nominations

13. BRINDEX urges that provision be made to enable certain companies to "opt out" of the nomination scheme. This option would be available to any company that is prepared to sign a declaration that neither that company itself, nor any any company associated with it, had sold or bought any oil other than its own equity production. (At the meeting BRINDEX, recognising that what mattered for the purpose of the nomination scheme was future transactions, refined their proposal to make the declaration prospective.)

14. BRINDEX mentioned two reasons for putting forward this proposal. The first is the sheer administrative burden of complying with the nomination scheme. Clearly there is some administrative cost here, but in response to representations such as these, a facility for making composite nominations has been provided (Regulation 4). This means that the typical BRINDEX member selling his equity under a term contract will not be required to make a separate nomination for each delivery under that contract: instead he can make one composite nomination covering all deliveries in either a 6 or 12 month period.

15. Second there is BRINDEX's desire to avoid any possibility of being affected by the anti-abuse provision. In particular they urge the need to prevent cases of innocent error being caught by the penalty under the anti-abuse provision. We recognise that cases of innocent error would indeed need protection, were the anti abuse provision to be triggered: this

may be something which can be done administratively - or at least without the need for primary legislation.

16. It became clear from discussion that BRINDEX had not really thought through the consequences of their proposed declaration. As we see it, it would have a number of drawbacks. First companies would need to be able to demonstrate, after the event, that their declaration had not been breached: this itself would impose some administrative burden. And if it had been breached, it is not clear from their written proposal what should happen then. At the meeting BRINDEX suggested that in that event all relevant transactions should be subject to tax at market value. If a company had been engaging in abusive transactions this would be a considerably smaller "penalty" than the enhanced market value to which those in the scheme would be subjected, and in some circumstances might be no penalty at all.

17. More generally adopting the BRINDEX proposal would mean making a distinction, if not between Brent producers and others, at least between those companies whose sole market activity was to dispose of their equity production and all other companies. Our own November 1986 proposals were of course universally condemned by the industry on the grounds they were "discriminatory". So it must be doubtful whether a rule which would enable certain companies to opt out of the nomination scheme would be acceptable to the industry as a whole. Moreover, as the proposed declaration was extremely limited, available only to a company which had done nothing but sell its own equity oil at arm's length, it would seem to be of potential benefit to so few companies, that the facility to "opt out" would be of very little value. BRINDEX was asked to research the potential coverage.

18. At the meeting we told BRINDEX that we were sympathetic to the concerns which led to the formulation of their proposal. But we hoped that the facility for composite nominations had eased any administrative burden. As regards the anti-abuse provision, we had already recognised that cases of innocent error would need

protection. But we were not convinced that their proposal would be right way to achieve this. Our discussions with UKOITC on the anti-abuse provision generally are continuing, and we undertook to keep BRINDEX in touch with any developments.

Loss After Payback - Uplift

19. BRINDEX urge that the rules on the cut-off of uplift at payback be relaxed to meet the situation where a field goes back into overall cumulative deficit more than three years after reaching payback. Similar representations have been made by the Dorset Group of companies who have a 50% interest in Wytch Farm. The point is covered in a further note being sent separately.

Relief for UKCS Exploration Expenditure

20. BRINDEX first raised this subject as a representation for the 1987 Budget, when they wrote to the Chancellor on 3 December 1986. Their main request is that PRT relief for unrelieved exploration expenditure incurred before 16 March 1983 be now made available. As a separate more limited measure they asked for immediate PRT relief for unrelieved pre 16 March 1983 exploration expenditure incurred by a company before withdrawal from a licence group where other companies retained their licence interest.

21. Prior to the 1983 Finance Act, the cost of exploring for oil could be claimed against PRT for any field if it was accepted as abortive (Section 5 OTA 1975). If a field was discovered and developed, relief for the exploration expenditure would be given in that field. Section 5A, introduced by FA 1983, introduced immediate cross field relief for all exploration and appraisal expenditure incurred after 15 March 1983, provided it does not relate to a PRT field for which development consent has already been given. All expenditure incurred before 16 March 1983 falls to be treated under the old rules, ie it must either await the

development of the field discovered (if any), or fulfil the test in Section 5 to be declared abortive, that is, it must be shown that it is not, and is unlikely to become, allowable for any field.

22. Although in the majority of cases where S5 relief has been claimed the exploration was readily shown to be abortive there may in marginal cases be a difficulty in showing that the expenditure is not likely to become allowable for a field. In certain cases, accumulations of oil were discovered which were not considered at the time to be viable developments, but may at some future date be reappraised and developed. Moreover, the test has to be resolved for all participators at the same time: withdrawal from a licence group by one member of the group does not affect the facts of whether a field development is likely to take place in the licensed area. If, at some later date, the abortive test is fulfilled for all members of the licence group, Section 5 relief will also be available to the company which relinquished its licence interest earlier.

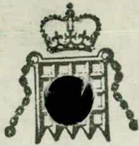
23. We told BRINDEX that we accepted that there could be some difficulty for companies to know when a claim to Section 5 relief might be allowable, if they had long since left licence groups. This was one of the many facets of the field basis of PRT and the difficulty was to find a solution which did not give rise to other problems.

Comment

24. BRINDEX describe the cost of implementing their proposal as relatively low. In 1983, however, the total of unrelieved exploration expenditure was estimated to be about £1200 million. This overhang will have declined gradually, either as fields are developed or claims to Section 5 relief have been agreed, but we think that there could still be a very substantial cost in accepting BRINDEX's proposal.

CHubbard

MRS C B HUBBARD



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

PMP

PS/EST

FROM: P R H ALLEN
DATE: 30 NOVEMBER 1987

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Culpin
Miss Sinclair
Mr Michie
Mr Cropper

BUDGET DEPUTATION : MEETING WITH THE AUTOMOBILE ASSOCIATION ON 3 DECEMBER

The Economic Secretary is due to meet Sir Ralph Carr-Ellison, Chairman of the AA and Mr Simon Dyer, the AA's Director General on Thursday 3 December at 4.45pm in the Treasury to discuss motoring taxation and expenditure. A brief based on material from the Department of Transport, Treasury and Customs is attached, and official support will be provided by Mr Michie of Fiscal Policy Division, and Mr Boardman and Ms Noonan of Customs.

RA.

P R H ALLEN

Internal Circulation:
CPS MR KNOX MR JEFFERSON SMITH MR BREUER MR McGUIGAN
MR BOARDMAN MS NOONAN MR BERRY

MEETING WITH THE AA : 3 DECEMBER 1987

1. The Automobile Association

The Automobile Association has over 6 million members. It is the major representative organisation of road and vehicle users, particularly the individual motoring tax-payer.

2. Object of meeting

The Association is not on the "core list" of bodies for Budget deputations. However, as the major representative body for motorists, it is usual for a meeting to be granted. The AA saw the Chancellor and the Minister of State before last year's Budget, and the Paymaster General originally agreed to this year's meeting.

3. Written representations

The AA's written representations for this year's meeting are set out in Sir Ralph Carr-Ellison's letter of 20 November to the EST. The main topics are:

a) road investment,

b) road maintenance,

c) petrol prices, and

d) vehicle excise duty.

Supplementary topics listed "if time permits" are

e) unleaded petrol and clean cars (proposal to give car tax relief for vehicles which can accept unleaded petrol),

f) EC harmonisation of VAT rates and excise duties,

g) expenditure on police resources/law enforcement, and

h) resources for road safety research and publicity.

4. Points likely to be raised

a) Road investment

AA view

The Association views current levels of investment on roads as inadequate, and is pressing for fresh construction to meet the needs of a greater traffic volume forecast for the end of the century.

ROADS EXPENDITURE POLICY - 1987

Background

1 The Conservative Manifesto stated:

"The Conservative Government is proud of a record that has:

modernised the transport system by investing over £10 billion in the nation's motorways, roads, airports, seaports and railways;

since 1979 completed over 680 miles of motorway and trunk roads and 67 bypasses;

secured greater efficiency by privatising British Airways, the National Freight Corporation, Sealink and Associated British Ports;

increased competition by deregulating long-distance coach services and abolishing local bus licensing.

These measures have laid the foundations of an efficient and more flexible transport system. We will develop it further along these lines...

We are committed to a major capital investment programme through:

new investment to build an extra 450 miles of motorway and trunk roads in 1989/90: ...

private sector financing, construction and operation of the Dartford Bridge and the Channel Tunnel."

2 White Paper "Policy on Roads in England 1987" said: continue to develop trunk road and motorway network, so that it can cope with projected growth in traffic, to make it safer for users and to improve the environment of towns and villages by taking traffic from unsuitable roads.

Line to take

We intend to maintain the momentum of the roads programme through increased provision for and expenditure on construction and repairs.

a) Road investment (continued)

ROADS INVESTMENT SINCE 1979

Background

Tables show investment in trunk roads and motorways in England since 1979. This shows an increase in real terms (provision for 1987/88 onwards) using 85/86 prices. Includes new construction, improvement, maintenance.

NATIONAL ROADS ENGLAND: VOTE EXPENDITURE

£m (real terms 85/86 prices)

	78/9	79/80	80/1	81/2	82/3	83/4	84/5	85/6	86/7
CAPITAL	618	649	644	691	778	711	763	734	744
CURRENT	74	71	68	86	69	70	83	77	90
TOTAL	692	720	712	777	847	781	846	811	834

NATIONAL ROADS ENGLAND : PLANNED EXPENDITURE

£m (real terms 85/86 prices)

	87/8	88/9	89/90	90/1
CAPITAL	830	815	808	812
CURRENT	77	80	80	79
TOTAL	907	895	888	891

Line to take

Roads must compete with other priorities for scarce resources. Expenditure now 30% higher in real terms than it was in 1978/79 (end of previous administration). Investment now at appropriate level to maintain momentum of programme as outlined in White Paper. In Autumn Statement it was announced that over £3 billion was to be invested in trunk programme for the UK over the three years from 1988/89 with £2 billion of that being for new construction.

a) **Road investment (continued)**

ROADS EXPENDITURE AND TRAFFIC FORECASTS

Background

The Government is determined to continue to develop the trunk road and motorway network so that it can cope with growth in traffic. The programme, as authorised in the White Paper "Policy for Roads in England 1987", gives more emphasis to schemes intended to meet future needs in a timely fashion than to tackling problems which have already arisen and are obvious to everyone.

Expenditure requirements are kept under review in the light of forecasts of traffic growth and adjusted as necessary. The forward programme contains some 350 schemes at present, worth over £5 billion.

Line to take

Objective is to develop trunk road and motorway network, in light of forecast growth in traffic.

Programme gives more emphasis to schemes intended to meet forecast needs than to tackling existing problems.

Reviewed every two years. Last in April 1987. Additions to programme brought total to 350 schemes worth over £5 billion. Results fully reported in White Paper 'Policy for Roads in England: 1987".

b) Road Maintenance

AA view

The AA welcomes Government's intention to eliminate the maintenance backlog on national roads by 1992 and suggests that money allocated to Local Authorities (LA's) for maintenance of local roads should be safeguarded for that purpose, and not included in block grants.

Line to take

Specific grants distort local accountability and encourage rising LA spending. They are generally only of use where the interests of central and local government differ; road maintenance does not fall into this category.

c) Petrol Prices

AA view

The Association considers Britain's motorists to be amongst "the most heavily taxed" compared with other countries, and sees petrol prices as the most sensitive area of motoring taxation. The AA welcomed the freeze on petrol duty in the 1987 Budget, and is pressing for a continued freeze in 1988.

Line to take

The Government is not anti-motorist. Taking both VED and petrol duty together, the increase in motoring taxes in the 1986 Budget was equal to the rate of inflation, and in 1987 motorists enjoyed a total freeze in petrol and derv duties. Comparisons with motoring taxation in other countries are complex and of debatable relevance; but it is worth noting that UK petrol duty would have to be raised by 23 per cent to reach "average" EC levels under the EC harmonisation proposals. The Government does not consider that the UK motorists currently faces an unacceptable burden.

d) Vehicle Excise Duty

AA view

The Association welcomes the freeze on car VED in the 1987 Budget, and hopes it will be repeated for 1988.

Background

1. VED is administered by the Department of Transport, but decisions on the duty rates are the responsibility of the Chancellor of the Exchequer.

2. Average annual VED receipts amount to about £2,570 million.

3. Duty is payable according to type and use of vehicle. Private cars and light vans are liable to duty at a flat rate; motor cycles according to engine capacity; heavier goods vehicles by gross weight; heavy lorries by gross weight and axle configuration; taxis and buses by seating capacity, and haulage vehicles by unladen weight. Some heavy goods vehicle's (HGV's) drawing trailers pay a trailer supplement.

Line to take

Vehicle excise duty rate for cars has remained unchanged for the last three years at £100. Customary not to comment on possibility of duty changes in the next Budget.

e) Unleaded Petrol and Clean Cars

AA view

The AA are suggesting that the Chancellor considers exempting new vehicles which use unleaded petrol from the payment of car tax.

Background

As regards **revenue considerations,** car tax in the main is charged only on new small passenger carrying vehicles. Therefore any car tax incentive would clearly not apply to all users of unleaded petrol. If adopted, the AA's proposal would give rise to significant revenue losses as the number of vehicles capable of using unleaded petrol increases.

Control problems would arise in administering a tax which distinguished at the manufacturing stage between otherwise very similar vehicles. Moreover, vehicles are now being produced which are capable of running on both leaded and unleaded petrol. Abuse would therefore be encouraged by making it worthwhile to convert exempted vehicles to use leaded petrol once they had passed the tax point. This is especially so where conversion to and from use of unleaded petrol is a relatively cheap and easy procedure.

The proposal provides no incentive at all for motorists to convert the considerable number of **existing vehicles** already purchased and in use.

Line to take

The Government is mindful of the advantages to public health and to the environment which follow from a switch from leaded to unleaded petrol, but many factors have to be taken into consideration in deciding how best to encourage the take-up of unleaded fuel. A duty differential of 5p a gallon in favour of unleaded petrol itself was introduced this year and Ministers undertook to review the position for the 1988 Budget. The AA representation will be carefully considered, but it would not be appropriate to comment further at this stage.

f) EC Harmonisation of VAT Rates and Excise Duties

AA view

The Association's concerns are that recent EC tax approximation and harmonisation proposals may increase UK petrol prices "by some 15 per cent", and cause abolition of VAT zero-rating of books, especially motoring publications.

Line to take

1. **UK stance on removal of fiscal barriers.** UK committed to completion of internal market; but in line with conclusions of Milan and Brussels European Councils (June 1985 and June 1987) we do not regard fiscal harmonisation as priority area.

Have only recently received full approximation proposals from Commission. Detail still being studied, but already clear that have fundamental difficulties with Commission's approach. Apart from question of future of VAT zero rating, also have misgivings about implications of excise duty proposals (petrol duty up by 23 per cent, derv duty down by 24 per cent, cigarette duty down by 10 per cent; alcohol duty down by between 40 per cent and 85 per cent.)

UK ready to enter into discussions about role of appropriate tax measures in completion of internal market. We shall not be alone in seeing difficulties in proposals.

2. **Government's future intentions for VAT.** Government have made position perfectly clear. In exceptional circumstances of election campaign, Prime Minister gave undertakings about several specific zero rates (ie food, gas, electricity and young children's clothing). Declined to go beyond these commitments (eg to books) because unwilling unnecessarily to constrain Chancellor's freedom to take decisions on tax in light of circumstances of future Budgets.

f) EC Harmonisation (continued)

3. **European Commission's tax proposals and zero rating.** Again position quite clear. Adoption of package will require unanimity and the Chancellor made it clear to the Council of Finance Ministers on 16 November that the UK will not permit to come into force any proposals which will in any way conflict with pledges Government has given on UK's zero rate of VAT.

4. **What happens next?** Procedural discussions took place at ECOFIN on 16 November. Ministers requested further expert study of proposals before reaching conclusions. Judging from past experience, progress will be very slow.

g) Expenditure on Police Resources/Law Enforcement

AA view

The Association holds the firm view that an increased police presence on the roads - and especially on motorways - would have a beneficial effect on road user behaviour and on road safety.

Line to take

Human error main factor in 70 per cent and contributory in 95% of accidents. Increasing awareness of effects of drinking and driving.

Department of Transport recently sought views of AA on results of major review of road safety. Review recognised role of police in contributing to casualty reduction and recommended Home Office conduct study in one or more force areas of effects on accident levels and driver behaviour of different levels of policing.

Deployment of police resources a matter for Chief Police Officers.

Department of Transport allocated additional £600,000pa to Transport and Road Research Laboratory for research into fundamental factors in accident causation.

Point to put to AA

Interested to know what positive help AA will be offering in response to consultation exercise which invited views on priorities and proposals for support or action to reduce casualties. AA has superb communication links with majority of motoring public - how propose to utilise them and what other steps proposed?

h) Resources for Road Safety Research/Publicity

AA View

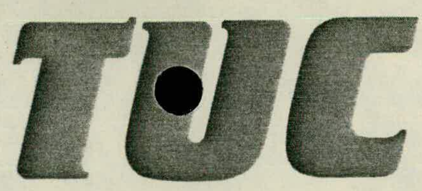
The Association hopes that the Treasury will look sympathetically at requests from the Department of Transport (DTp) for real increases to its budget for road safety research and publicity.

Line to take

It is a matter for the Secretary of State to reconcile his expenditure priorities with the competing demands on his budget.

The Department of Transport has stepped up its continuing publicity aimed at reducing drinking and driving with a harder hitting £2.5m TV campaign this year. It was shown in the summer and autumn and the next round will begin on 8 December.

personal folder.



Trades Union Congress

Congress House
Great Russell Street
London WC1B 3LS

01-636 4030

Your reference:

Our reference: E/SF/EK

Date: November 30 1987

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London
SW1

Dear Mr Lawson

1988 Budget Technical Representations

I am enclosing the General Council's technical representations for the 1988 budget. These representations comprise measures which could bring an immediate improvement to the fairness and efficiency of taxation. I hope that you will give them consideration in preparing your Budget statement and the 1988 Finance Bill.

I shall be sending you later the TUC's major proposals for the Budget and I look forward to discussing these with you at the January meeting of the National Economic Development Council.

Yours sincerely

Norman Willis

General Secretary,

Encs

HM TREASURY – MCC
RECD. - 4 DEC 1987
ACTION Mrs Brownhams
cc CHX, CST, EST, PMG, EST, Sir P Middleton, Sir T Burns, Mr Cassell, Mr Monck, Mr G Allen, Mr Culpin, Miss Sinclair.
SIGNATURE CHX.

TUC TECHNICAL REPRESENTATIONS FOR THE 1988 BUDGET

Introduction

1 The TUC's technical representations for the 1988 budget focus on three issues of wide concern to affiliated unions and the taxpaying public: tax compliance, the application of VAT, and tax reliefs relating to employment Technical representations on these issues, although consistent with the TUC's policy proposals to be presented at the next meeting of the National Economic Development Council, stand seperately from them. They are a pragmatic response to identified problems and concerns. There is no reason to delay the implementation of measures that could bring an immediate improvement to the fairness and efficiency of taxation, and the TUC hopes that the technical representations set out below will be given early consideration for inclusion in the 1988 Finance Bill.

Tax Compliance

2 Although the Inland Revenue works hard to achieve satisfactory rates of tax compliance, there remain serious grounds for concern about revenues lost through tax evasion and avoidance. Related to this, the TUC has recently been reminded of tax practitioners' concern that equity in tax administration is being reduced. The proposals for legislation in the consultative document "The Inland Revenue and the Taxpayer" should make an important contribution both to streamlining tax administration and improving enforcement, and the TUC welcomes the measures already introduced in the 1987 Finance Act. For the corporate sector however, the TUC would urge two amendments to enhance the effectiveness of the new Pay and File system. First, to ensure compatibility with other aspects of business practice, it would be sensible to bring the time limit for submission of accounts into line with the Companies Act. Second, unincorporated traders should be brought within the scope of the Pay and File system. The Comptroller and Auditor General has expressed particular concern about tax evasion and fraud by small companies. It is therefore neither financially sensible nor equitable to exclude from Pay and File requirements a sector from which as many as nine out of ten tax returns have been found to be inaccurate.

VAT

3 In October, the TUC sought a commitment that proposals from the European Commission to harmonise VAT rates across the European Community would be vetoed by the Government. Since entry to the EEC, the UK has with the Commission's acceptance provided for essential items such as food, fuel and public transport to be excluded from VAT in order to assist consumers on low incomes. An extension of VAT to industries such as printing would increase prices, depress demand and lead to a loss of jobs and international competitiveness. From the consumers' perspective, it would restrict leisure and educational opportunities. Charging VAT on items such as children's footwear would damage health by encouraging substitution to ill-fitting and poorer quality shoes. Although no reply to these points has yet been received, the TUC is encouraged by the fact that Ministers, including the Prime Minister, have defended the social case for applying VAT exemptions or zero rates to essential goods and services, such as children's clothing and footwear.

4 Similarly, there is no justification for charging VAT on sanitary protection. Adding 15 per cent to the cost of essential sanitary protection is both discriminatory and anomalous. The principle of granting exclusions from VAT on social grounds is longstanding in the British tax system. As

mentioned, other basic requirements such as food and fuel, are already excluded and there are precedents for exemption for reasons of health. Safety helmets and boots, for example, are zero-rated and equal consideration for sanitary protection is long overdue. It would be a simple matter to incorporate in the 1988 Fiannce Bill a clause abolishing VAT on sanitary protection.

Tax Reliefs

Personal Taxation

5 The TUC pressed, in its 1987 representations, for the tax threshold for benefits in kind to be indexed in line with inflation. The £8500 earnings limit above which benefits in kind are currently taxable has, despite the general practice of uprating reliefs, remained unchanged since 1976. The TUC has previously registered concerns that, in consequence, an increasing number of lower paid workers across a range of industries are being drawn into this tax net. The failure to revalue this tax threshold is arbitrary and unfair in comparison to the lucrative tax perks enjoyed by people on top incomes. The TUC accordingly remains of the view that there should be an immediate increase in the tax threshold for benefits in kind to £10,000 and subsequent regular upratings in line with the RPI.

6 The TUC has also pressed for the reinstatement of tax exemption on employer contributions to childcare facilities. The Government's decision to ignore the views presented by a range of organisations on this matter has created severe difficulties for many women workers. The 1987 TUC Women's Conference expressed continuing concern that taxing child care facilities acts as a disincentive for women to take up paid employment or to continue in employment once they have children. Government Ministers have repeatedly expressed the view that families should not be dependent on state benefits. Yet during a period over which the numbers of people in poverty has risen sharply, to around 11.7 million in 1985, women have been deterred by Government policy from making a financial contribution to their own families. The recent decision to freeze child benefit will undoubtedly make this situation worse and the TUC considers that the opportunity should be taken in the 1988 budget to restore full tax relief for employer contributions to childcare facilities.

7 The TUC asked in 1986 for Clause 30 of the 1984 Finance Act, withdrawing tax relief on overseas personal earnings, to be reversed. The TUC has kept under review the effects of this measure, and is informed by affiliated, unions directly concerned that individual seafarers and aircrew continue to suffer hardship. From a wider perspective, the Government has made no response to reports from the European Commission and House of Lords Select Committee on the European Communities that "a favourable direct tax regime for Community seafarers is a reasonable way of helping to maintain the employment of EEC nationals on Community ships." It is difficult, in the light of recent experience, to understand the Government's intransigence on this issue. Clause 30 of the 1984 Finance Act should, at minimum, be modified. It will be recalled that, in the course of consideration by the House of Commons Finance Committee, an extension of the qualifying period for tax relief was proposed. The TUC's view is that this could help to mitigate the most damaging consequences for seafarers and aircrew while still meeting concerns about the abuse of overseas tax relief by business executives.

Company Taxation

8 The TUC's attention has recently been drawn to inadequacies in the tax provisions for secondment to community organisations. It was recognised in the 1983 Finance Act that secondees, who might otherwise be forced to take

early retirement, are able to contribute valuable skills and experience to charitable work in run-down communities. It is therefore unfortunate, especially in the light of the Government's own interest in inner cities, that assistance to companies offering secondment has been allowed to erode with changes to the corporate tax regime.

9 The TUC is well aware that the 35 per cent tax relief against profits currently available is pegged to the rate of corporation tax. Nonetheless, the view of voluntary organisations directly involved is that a larger incentive is needed to encourage more companies to help through secondment. The TUC has consistently supported the principle of financial aid for socially desirable criteria and considers that it would be reasonable to provide a higher subsidy to participating employers. This could be done by changing the basis of support from tax relief on company profits to direct reimbursement of costs incurred. In the TUC's view it would be reasonable for the Government to undertake to meet half the total cost of seconded staff. The advantages of providing for employers to reclaim 50 per cent of employment related expenditure are twofold. First, the average financial incentive would be increased and second, by seperating administration from the general process of company accounting, greater visibility would be given to the benefits of secondment.

10 Also in the corporate sphere, in October the TUC submitted to the National Economic Development Council a Memorandum on 'Industry Policy Issues'. The TUC Memorandum empahsised the key position held by manufacturing industry in the national economy as well as its wider contribution to the balance of payments. However, it noted persistent problems of inadequate investment in new capacity and low commitment to research and development, both of which will impinge on future growth prospects. Although the TUC has emphasised the need for a coherent industrial policy to support long term investment in key areas of manufacturing, there is in addition scope for immediate action to meet specific requirements. In the motor industry for example, the TUC accepts the view of the Society of Motor Manufacturers and Traders that there should be relief on the duty payable under the Hydrocarbon Duties Act on fuels used for research and testing. This would bring the UK into line with other European countries and thus remove the incentive to transfer research and test facilities overseas.

SF/EK
November 3 1987

LPD/3742/055

FROM: P D P BARNES
DATE: 1 December 1987

MRS HUBBARD - IR

cc PS/Chancellor
Mr Scholar
Mr Culpin
Mr Williams
Miss Sinclair

Mr Painter - IR
Mr Johns - IR
Miss Hill - IR
PS/IR

PMP

OIL TAXATION : BRINDEX REPRESENTATIONS

The Economic Secretary was grateful for your submission of 27 November.

2. The Economic Secretary would be grateful for a simple explanation of pipeline/shared asset taxation.

PB

P D P BARNES
Private Secretary

1240/25

FROM: MARK CALL
DATE: 1 DECEMBER 1987

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Cropper
Mr Tyrie

BACKBENCH FINANCE COMMITTEE: 1 DECEMBER

Messrs Taylor and Lansley of the Association of British Chambers of Commerce reported on their members view of the economic situation, and outlined their early thoughts on the Budget. Attendance: 8.

2. The latest ABCC quarterly survey of 3,000 firms indicated that home orders were up, while exports showed a slight decline. Sixty per cent of firms said that interest rates were their main concern, with 25% putting exchange rates at the top of their worry list. The survey indicated that businesses in London and the South East were markedly less optimistic than those in the rest of the UK. The survey indicated widespread support for the unified business rate. Another strong message from the survey was that businesses were experiencing severe shortages of skilled labour. This problem was particularly acute in the South East, with 75% of respondents in the Thames Valley reporting shortages, compared to around 40% of firms in the North. In Mr Taylor's view fiscal incentives were needed to address this. Mr Taylor added as an afterthought that the survey was taken in September, prior to the stock market fall.

3. Mr Lansley said that the ABCC was still in the process of consulting its members on its Budget submission, but said the following would probably be included:

- a £1 bn PSBR would be deflationary, and £2-2½ bn would be better.

- There should be 3 rates of personal tax: 25%, 30%, and 40%.
- The UEL should be abolished, and the LEL threshold phased out.
- Company taxes should be "reduced".
- CGT should be abolished, at least for long term gains (more than 2 years).
- To help small firms the limit on P11Ds should be raised, and Industrial Building Allowances reintroduced.

pp MARK CALL

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The Scotch Whisky Association

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REGISTERED OFFICE

HFOB/KPT/RCE

3rd December 1987

Miss J Thorpe
Diary Secretary
The Chancellor of the Exchequer's Office
HM Treasury
Parliament Street
London
SW1P 3AG

Dear Miss Thorpe

4.15pm.

I write simply to confirm our recent telephone conversation in which it was agreed that this Association's delegation would now meet with the Chancellor of the Exchequer at 4.00 pm on Monday 14th December and not on Wednesday 9th December as originally planned. We are very grateful to you for the trouble you took to arrange this alternative date. I understand when you spoke to my secretary, you asked that we confirm the names of our delegation. These remain as previously advised in our letter to the Chancellor of 4th November 1987.

Yours sincerely

H F O Bewsher

H F O Bewsher

Inland Revenue

Policy Division
Somerset House

FROM: MRS C B HUBBARD

DATE: 3 DECEMBER 1987

ECONOMIC SECRETARY

OIL TAXATION: BRINDEX REPRESENTATIONS: SHARED ASSET TAXATION

1. You asked (Mr Barnes' minute of 1 December) for a simple explanation of pipeline/shared asset taxation.

2. With my submission of 21 October on various Oil Taxation 1983 issues (BS 352), I sent a background note on the aims of the legislation (copy attached). This set out the history of the legislation. I have tried below to provide a brief description of how the legislation works in practice.

3. The general idea is that full and immediate PRT relief is now available against income from the field in respect of expenditure incurred on a long term asset irrespective of the fact that the asset may not be expected to be used in the field for the whole of its useful life. But the corollary is that licensees are now chargeable to PRT not only on profits from the sale or appropriation of oil won from the field but, since July 1982, also in respect of any tariff payments to them from licensees of other fields using those field assets. Receipts from the disposal of the assets are also liable to PRT. A special allowance (TRA) is given to reduce (and, in some cases, eliminate) the PRT liability of the participators in receipt of tariffs for the use of these assets, but no such special allowance is given against disposal receipts.

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cc		
cc	Chancellor	Mr Painter
	Mr Scholar	Mr Johns
	Mr Culpin	Mr Elliss - OTO
	Mr Williams	Mr Beauchamp - OTO
	Miss Sinclair	Mrs Hubbard
		Mr J Evans
	Mr C J Riley	Dr Parker
		PS/IR

4. The PRT charge on tariffs is mainly concerned with qualifying tariff receipts, which are defined as tariffs received from a participator in a user field in connection with the use of an asset or the provision of services for extracting, transporting, initially treating or initially storing oil won other than from the principal field. The typical example will be a pipeline system for which the user field pays a tariff to the principal field for transporting the user field's oil to the terminal. The contract may also cover initial storage and initial treatment by the principal field on behalf of the user field. But it is probably simpler to consider an example of a transportation tariffing contract with one fixed tariff per tonne of throughput.

Example

Field A - the principal field - owns a pipeline which isused by Field B - the user field. The participators in Field A get full front-end relief for the cost of the pipeline. The tariffs are chargeable to PRT in Field A, and the participators in Field B get a deduction against their PRT (if any) for the tariffs paid. The participators in Field A receive a Tariff Receipts Allowance (TRA) of 250,000 tonnes for each chargeable period for each user field.

The tariffing agreement provides for a tariff of £10 per tonne, and the throughput in the chargeable period is 750,000 tonnes.

The cash equivalent of the TRA for the participators in Field A for each user field is calculated as:

$$£A \times \frac{B}{C}$$

Where A is the qualifying tariff receipts (750,000 x £10)

B is the tariff receipts allowance (250,000 tonnes)

C is the metric tonnes of oil to which A relates (750,000)

Thus the TRA is £7.5m x $\frac{250,000}{750,000}$ = £2.5

The participators in Field A are therefore chargeable to PRT on the qualifying tariffs £7.5m less the cash equivalent of TRA £2.5m, ie on £5m. The participators in Field B are allowed a deduction from their chargeable profits of the full amount of tariffs paid, namely £7.5m.

If the throughput in a chargeable period is less than 250,000 tonnes, the TRA extinguishes all PRT liability on the tariff income.

5. If there was more than one user field, the participators in Field A would receive a TRA for each user field. This follows from the reasons for having an allowance, namely to make it possible for owners to charge lower tariffs than they would otherwise feel constrained to do, and also to recognise that there is an element of risk in sharing facilities.

6. For corporation tax purposes there is greater symmetry between user and principal field. The user field gets a revenue deduction for tariffs paid to the principal field, and the principal field is liable on the tariff income, without any abatement. For CT purposes the pipeline owner gets relief for the full amount of the expenditure incurred both for the purposes of his own production and for tariffing.

CHubbard

MRS C B HUBBARD

ANNEX A

OIL TAXATION ACT 1983 - BACKGROUND NOTE

1. OTA 1983 fulfilled a commitment in the 1982 Budget to legislate to deal with certain special problems affecting PRT expenditure reliefs and pipeline tariffs. Proposals for early action to rationalise the existing system were set out in a Consultative Document published in May 1982.

2. The proposals were designed to deal with a new situation emerging in the North Sea for which the existing expenditure relief rules were not well suited. Early North Sea projects had generally involved more-or-less complete dedicated production systems - comprising offshore production and treatment, transport to shore, onshore storage and loading facilities etc. The pattern of development was reflected quite directly in the existing PRT structure ie the field basis and full front-end loaded relief for the assets dedicated to the field. However, there were indications that the pattern of development was beginning to change.

3. First, the substantial infrastructure of North Sea assets already in place was sized to serve the relatively large first-generation fields. Many of those assets were or were shortly to become under-used in the service of the fields for which they were built and would have spare capacity to take on other non-field uses. Secondly, it was generally expected that the next generation of North Sea fields would be smaller and would in many cases be located relatively close to infrastructure already in place. Some would possibly be uneconomic to develop without tying in to existing assets and others would be considerably more productive in resource terms if developed in that way. The likely result would be a significant growth in arrangements to share existing pipeline systems. It also seemed likely that in future some facilities might be built with potential for new uses later in asset life. The fiscal system needed to adapt to the these trends in North Sea development.

4. The main tax issues were <u>first</u> the treatment for PRT purposes of expenditure on assets, such as pipelines, which were not to be used exclusively over their life in or for the purchaser's own field, and <u>second</u> the treatment for tax purposes of various receipts, such as pipeline tariffs, arising from such assets.

5. On the first aspect it was decided to give full front-end PRT relief to an oil field for expenditure on assets to be used in connection with the field, even though they might at some future date be used in connection with other fields. Under the then existing rules relief on these long-term assets had to be restricted more or less severely not only when alternative use actually occurred, but if alternative use was anticipated or probable in future. At

worst relief might be restricted very severely - with front-end relief replaced by straight-line depreciation ("slow-train") - because future use simply could not be quantified at all. Although in practice restrictions had so far been made only on the emergence of actual alternative use, this would not have continued under existing rules given the likely increase in multiple use of pipelines. It was generally accepted by all concerned that a continuation of these rules would have both created damaging uncertainty and led to substantial fiscal disincentives to desirable forms of development.

6. On the second point, as a quid pro quo for the major extension of PRT relief involved in the first, it was decided to bring into the PRT net for the first time tariff (or disposal) receipts for the use (or sale) of the sort of assets to which the first proposal applied. The proposals were linked because if full PRT relief was to be given for assets even where these were used to generate income from other parties, it seemed right in principle and practice that the receipts to which the expenditure gave rise should also be charged to PRT - especially as they were already allowable deductions to the payers.

7. The industry welcomed the first proposal on the ground that it would help to secure full and efficient exploitation of oil and gas resources. They also for the most part accepted that the second proposal was a logical and not unreasonable corollary, but maintained that for various reasons the receipts should not be taxed in full. They also sought exemption on receipts under pre-May 1982 contracts.

8. On abatement, the industry's most persuasive argument was that there must be some compensation for diversion of effort from production and uninsurable risks of sharing their facilities; there could be loss of production through having two streams of oil/gas to manage, loss of value through mixing oil of different qualities from their own, or damage to the system. Owners had therefore to get a sizeable post-tax return; otherwise they would not let. But if tariffs were to be fully liable to the high rate of PRT this could mean pushing up tariffs to levels which would make development of new fields by the potential users uneconomic.

9. In considering the abatement question the crucial issue was whether the proposals without some modification risked having a damaging effect (as a result of upward pressure on tariffs or lack of sufficient incentive for asset owners) on development of smaller or more marginal fields. There was inevitably a great deal of uncertainty on the issue but Ministers concluded that, in the light of the case put by industry, there were grounds for some abatement of the full charge.

10. The twin objectives of any abatement allowance were

a. to recognise the unquantifiable costs and risks insofar as these were not borne by the user and to the extent that they were not effectively borne by the Exchequer;

b. to make it possible for the owner to charge lower tariffs than he would otherwise feel constrained to do, particularly for smaller and/or marginal users who might otherwise find levels of tariff a disincentive to development.

11. The method of abatement chosen was a throughput allowance (TRA) which exempted from PRT the first tranche of tariff receipts from each user field for each chargeable period. It was decided that there was no case for exempting from the new charge tariffs relating to pre-May 1982 agreements but it was agreed to ameliorate the charge in those cases by providing a higher TRA.

mjd 2/25Jn

RESTRICTED

FROM: J M G TAYLOR

DATE: 4 December 1987

MR CULPIN

cc Sir P Middleton
Sir T Burns
Mr Scholar
Miss Sinclair
Miss C Evans
Mr Call

Mr Battishill
Mr Isaac
Mr Painter
PS/IR

ASSOCIATION OF BRITISH CHAMBERS OF COMMERCE: BUDGET REPRESENTATIONS

The Association of British Chambers of Commerce have spoken to the Conservative back bench Finance Committee about their probable Budget representations. These are likely to say:

- a £1 billion PSBR would be deflationary, and £2-2½ billion would be better;

- there should 3 rates of personal tax: 25%, 30%, and 40%;

- the UEL should be abolished, and the LEL threshold phased out;

- company taxes should be "reduced";

- CGT should be abolished, at least for long-term gains (more than 2 years);

- to help small firms the limit on P11Ds should be raised, and Industrial Building Allowances reintroduced.

J M G TAYLOR