

PO-CH/NL/0361

PART B

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PO -CH

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PART B

1988 BUDGET SPEECH AND
STATEMENT

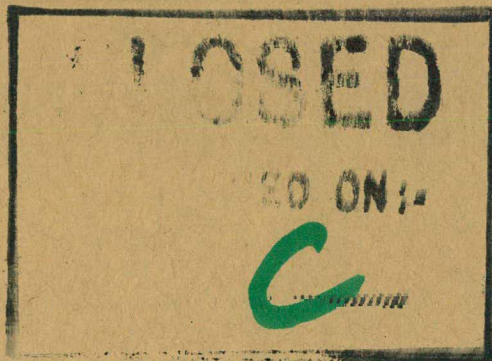
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PART B

PART B

DD's 28 years NAGY 24/11/95

26-2-88



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FROM: D I SPARKES
DATE: 19 FEBRUARY 1988

MR HUDSON

cc Mr Culpin
Miss Evans

BUDGET SPEECH: TAXATION SECTION

A few minor comments on your draft:

- to rev.* p2 para 4: The new single personal allowance will be renamed the "basic" or "standard" allowance (not yet known which).
- ✓ p13 para 1: Aren't the 500 start-ups a week the net rate?
- ✓ p14 para 1: I understand that the BES ceiling will be £½ million and that the only exception will be the private rented sector (not shipping).
- Good point* p17 para 4: Would it be possible to make more of the rebasing of companies' gains? It is the only thing we are doing for them and seems to cost the same as 1p off the CT rate.
- C said* p28 paras 1-4: Why does this section come before forestry rather than before income tax?
- ? p34 para 2: Is it worth saying "which adds to the tax-free capital gain"?
- Good pt but won't help.* p40 para 2: Would it be a good idea to make the desire to align capital gains/income taxation one of the reasons for cutting top rates? Thus at the end of para 2 you might add "Nor can capital gains possibly be taxed at the same rates as income under our present steeply graduated pattern of tax rates; the effect on incentives and enterprise would be disastrous". I am a little worried that unless you insert such a caveat, the Chancellor might be providing a hostage to fortune should a different Government decide to jack up top rates again, without decoupling income from gains.

D.I.
D I SPARKES

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Andrew Wilson . PUP
Chancellor's office - BY FAX

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A late entry.

Steve McNamara
14/2/88

FIRST DRAFT OF SPEECH

Section 482

I start with an important reform of the provisions governing company residence and migration under Section 482 of the Income and Corporation Taxes Act 1970.

The present rules are seriously out of date. They are discretionary, uncertain and can be exploited. In many other countries the definition of residence is much clearer. It commonly turns on the place of incorporation and companies are free to move their operations from one tax authority to another provided they pay any tax which may be due.

I therefore propose to sweep away these parts of Section 482. For the vast majority of companies, the test of residence for United Kingdom tax purposes will be simply whether they are incorporated here. The small minority of companies which are not incorporated in the United Kingdom but are centrally managed and controlled here will continue to be resident here. Companies wishing to migrate will be able to do so normally by changing the country of their incorporation or their place of central management and control and provide for the tax when they do so. This change will bring Britain much more into line with Europe and the rest of the world and will provide a clear framework which will relieve any uncertainties which may arise as a result of a case now before the European Court of Justice. There will be transitional provisions to prevent non-resident companies incorporated in the United Kingdom from becoming liable to United Kingdom tax. Further details on this and the main proposals are being made available in a Press Release.

At the same time I am taking steps to reduce the compliance burden created by the other provisions of Section 482 (subsections (1)(c) and (d)) which require companies to seek consent for transactions in shares of overseas subsidiaries. Revised General Consents under these provisions will be published, wider in scope than the present Consents and I expect them to reduce the number of applications by at least a half.

BUDGET SECRET: TASK FORCE LIST



Inland Revenue
CENTRAL DIVISION
Somerset House
London
WC2R 1LB

PWF
COPY NO 1 OF 6

Telephone 01.438

A P Hudson
Chancellor's Office - BY FAX

19 February 1988

Dear Andrew,

BUDGET SPEECH: TAXATION SECTION

During the lengthy phone call where I let you have most of our suggestions I agreed to write on a few points.

North Sea Oil Changes (page 5)

We suggest the following:

"Special considerations apply to the North Sea. While there is every sign that this sector is making an impressive recovery from the oil price collapse of 1986, my Rt Hon Friend the Secretary of State for Energy and I have continued to monitor closely the impact of the fiscal regime. Back in 1983 we abolished royalties for new offshore oilfields, in recognition of the different characteristics of those more recent oil developments. Since then a new generation of gas fields has also come into being. Many of these are highly profitable, and we see no reason for an overall reduction in tax. We consider, however, that some restructuring is needed.

Accordingly my Rt Hon Friend will shortly be bringing forward legislation to abolish royalties from 1 July for all Southern Basin and onshore fields developed after April 1982. At the same time I propose to reduce the PRT oil allowance for these fields [to 100,000 tonnes per chargeable period.]

This will mean an end to royalties for all future fields. Tax will be more closely related to profitability. The short term cost will be recouped over the longer term, but marginal fields will pay less, and highly profitable fields more. I believe this will help to keep up the pace of our oil and gas activity.

[In addition I propose to introduce a new capital gains relief for certain disposals of interests in oil licences and make a minor relaxation in the Petroleum Revenue Tax rules relating to tariff arrangements.]"

BUDGET SECRET: TASK FORCE LIST

Maintenance and Covenants (page 22)

We suggest retaining the present text to the end of the first full paragraph on page 23 and then continuing:

"I therefore propose to introduce a major reform of the tax arrangements for maintenance payments. In future - that is, for maintenance agreements and most Court Orders made on or after today - the person receiving such payments will not have to pay tax on them. A man paying maintenance to his divorced or separated wife - or a woman paying maintenance to her ex-husband - will get tax relief on the payments that are made, up to a limit equal to the single person's allowance. But there will be no tax relief for other maintenance payments.

This new system will be simpler all round, and will be more generous in many cases. The recipient does not have to pay tax and the limit on relief will, on past experience, cover the vast majority of payments to divorced or separated spouses. And if the recipient is working, she or he can set personal allowances fully against earnings, instead of having to use them up against the maintenance.

4 parents
Maintenance payments to children will not qualify for relief under the new rules. The ordinary married couple get no tax relief for maintaining their children. And single payments are already eligible for the additional personal allowance and for one-parent benefit.

I intend to protect fully those people who are either making or receiving payments under existing Court Orders or agreements, or under Court Orders already applied for before today and made by 30 June. For them, the existing rules will run on until April 1989, and special transitional arrangements thereafter will ensure that they can continue to enjoy at least the same amount of relief as they enjoy at present. In addition, I propose to exempt divorced and separated wives from tax on the first slice of their maintenance, up to the equivalent of the single person's allowance.

Similar considerations apply to payments made under deeds of covenant. Again, the tax arrangements are complicated. Again, there is no obvious case for giving tax relief for what are normally gifts from one person to another, simply because they are made under a particular form of legal agreement [some would say legal mumbo-jumbo]. And - whatever may have been the case in the past - there will be no need or justification for this kind of tax shelter in the new tax system which I shall be proposing to the House in a few minutes time.

With the exception of covenants to charities, where the reliefs which the Government has already extended will remain in place, I propose to take new covenants made on or after today out of the tax system altogether from the

BUDGET SECRET: TASK FORCE LIST

end of this tax year. The person receiving the payments will not have to pay tax on them, and the payer will not get relief.

The largest group of people affected will be parents of students, who have been able to use a covenant for their contribution to the maintenance grant. Those who have already made such a covenant will continue to benefit from it. The parental contribution of those students who start their studies in the next academic year will be assessed on a new separate scale reflecting the withdrawal of the tax relief on new covenants. This will rationalise support for students through the grants system; it will put right a perceived injustice as between students who receive support from their parents, rather than from the State. And it allows students to set their full tax allowance against vacation earnings or other income.

Taken together, my proposals on maintenance payments and covenants will bring a yield of £m25 in 1988/89, rising to £m85 the following year. They represent a major reform of one aspect of the personal tax system, which will in future be fairer, simpler and more rational.

Payroll Giving (page 24)

We suggest:

"The payroll giving scheme for charitable donations has now been running for nearly a year. I am glad that so many employers have already set up schemes, and I hope as many employees as possible will use them. In order to give further encouragement to charitable giving, and help the growth of this imaginative scheme, I propose to double the annual limit on donations under the scheme from £120 to £240."

Top Slicing Relief (page 35)

I suggest:

"Top slicing provisions are a vestige of when tax rates were high. I propose scrapping top slicing for large redundancy and other lump sum payments made after 5 April and increasing the exemption to £30,000. Top slicing relief for lease premiums and the like will also disappear."

LAPR (page 38)

We suggest inserting after the final full paragraph on page 38 the following:

"The rate of premium relief on life assurance policies taken out before 14 March 1984 has remained unchanged, at 15 per cent, since 1981, when the basic rate was 30 per cent. Following the reductions in basic rate which I have been able to make in successive Budgets, I now

BUDGET SECRET: TASK FORCE LIST


propose to reduce the rate of premium relief to [12.5 per cent]. But, to give life offices time to adjust, this change will not take effect until 6 April 1989."

Minor Personal Allowances (half way down page 39)

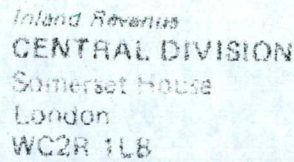
We suggest:

"The present tax system includes three minor allowances, for a housekeeper, for the services of a son or daughter and for a dependent relative. These allowances were all introduced over 50 years ago when social and economic circumstances were very different. Governments of both parties have not thought it appropriate to increase any of them for over 20 years. These allowances have now outlived their usefulness. They are a complication to the system, costing the Inland Revenue around 100 staff to administer but benefiting the vast majority of those who claim them by no more than around 50 pence per week. In view of the substantial increase in the personal allowances and the 2 pence reduction in the basic rate which I have just announced I have therefore decided that these three allowances should be abolished with effect from 1988-89."

Copies of this letter go to Mr Battishill, Mr Isaac, Mr Painter and Mr Beighton here.

Yours sincerely,


S J McMANUS



COPY NO 1 OF 6

A E Lesson

Chancellor

SEP 18 1988

Dear Arthur,

BUDGET DEFICIT

North Sea Oil Company

We request the following:

Maintenance and Covenants (page 22)

We suggest retaining the present text to the end of the first full paragraph of page 23 and then continuing:

end of this tax year. The person receiving the payments will not have to pay tax on them, and the payer will not get relief.

The largest group of people affected will be parents of students, who have been able to see a movement for their contribution to the education of their children. These are the already mentioned parents who have been able to benefit from their children's education. The parents who start to see a new way of thinking in their children are assessed for the new way of thinking. The new way of thinking of the former way of thinking. The new way of thinking support themselves. The new way of thinking right a support for the new way of thinking. And it is the new way of thinking. The new way of thinking against the new way of thinking.

Payroll Giving

We suggest:

For Slicing Relief You

I suggest:

440 (page 30)



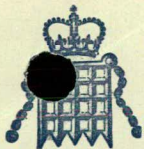
Minor Personal Allowances (Half way down page 39)

We suggest:

Copies of this report
for reference are as follows:

To a young
Sister

9 J Mc22803



H.M. CUSTOMS AND EXCISE

11th Floor
New Kings Beam House
22 Upper Ground
LONDON SE1 9PJ

Tel: 01-620 1313 Ext 5023

PHP

BUDGET SECRET - TASK FORCE LIST

ref: RA 108/88

Copy No. / of 7

FROM: P R H ALLEN

DATE: 19 February 1988

Mr Hudson ✓

cc: Mr Culpin
Miss Sinclair
Mr Michie
Mr Unwin
Mr Knox

BUDGET SPEECH: TAXATION SECTION

We have a few comments on the draft which you circulated on 17 February. These are attached. Many are purely of a drafting nature, but items 1, 4 and 5 raise more substantive issues.

RICHARD ALLEN

BUDGET SECRET - TASK FORCE LIST

1. Page 25, third paragraph, first sentence: I suggest replacing it with "The only change which I propose to the coverage of VAT is not extending it to books and newspapers, but legislating to tidy up the definition of which confectionery items are subject to tax".

Spk.
2. Page 25, third paragraph, last sentence: delete from "confirm" to the end of the sentence and replace by "tax all types of cereal bars".

X
3. Page 25, fourth paragraph, line 3: We suggest adding "during 1987" to make clear that this relates back only one year and not to the last duty increase.

X
4. Page 25, fourth paragraph, line 6 and Page 26 first line: We note that 4p and 7p (respectively) are very substantial roundings up. On previous occasions when increases were announced, roundings were to the nearest half penny. In these two cases, we consider that precedent should be followed.

X
5. Page 26, lines 3 to 6: If we wish to use "health" arguments elsewhere (even though not in the speech itself), this passage would be inconsistent. Moreover, since there is likely to be a strong reaction that not enough has been done in the "health" context, this would seem inappropriate. It would also embarrass the Chancellor's colleagues in the Lord President's Group on alcohol misuse.

6. Page 26, second paragraph, lines 1 and 2: delete "at £100 a year". This is only one of a number of relevant rates. "duty" should be "duties".

7. Page 26, second paragraph, line 3: after "derv" insert "above revalorisation" (or something to that effect). Because of the distance between this and the general statement (page 25, fourth paragraph, second sentence), the draft as it stands could mislead.

BUDGET SECRET - TASK FORCE LIST

8. Page 26, second paragraph, lines 7 and 8: delete "by simply exempting" and "from this year's duty increase" and replace by "by leaving" and "unchanged".
9. Page 26, second paragraph, last line: "ordinary" should precede "2-star".
10. Page 36, second paragraph, line 2: after "Committee" add "relating to Inland Revenue".

REF NO. **ACSA/14**
COPY NO. **1** OF **41**

**RECORD OF THE SIXTH BUDGET OVERVIEW MEETING:
AT 2.30PM ON MONDAY 22 FEBRUARY 1988**

Present: Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Byatt
Mr Monck (Item 4 only)
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr Sedgwick
Mr R I G Allen (Item 4 only)
Mr Pickford (Item 4 only)
Mr Riley (Item 4 only)
Miss C Evans
Miss J Simpson (Item 4 only)
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr P Lewis - IR (Item 3 only)
Mr McGivern - IR (Item 3 only)
Mr Prescott - IR (Item 3 only)
Miss Rhodes - IR (Item 3 only)

Mr Unwin - C&E
Mr Knox - C&E

Papers:

- (i) Budget Scorecard: Mr Culpin's minute of 18 February.

(ii) Deadline for Budget Decisions:

- (a) Mr McManus' note of 17 February
- (b) Mr P R H Allen's note of 19 February

(iii) Fringe Benefits:

- (a) Mr Keith's note of 17 February on Capital Allowances: Expensive Cars.
- (b) Mr Prescott's note of 18 February on Directors' Dining Rooms and Luncheon Vouchers.
- (c) Mr P Lewis' note of 18 February on Car Parking.

(iv) Presentation: Mr Culpin's minute of 19 February

Scorecard

2. The following points were raised:

- (i) The Chancellor asked for a note on a new income tax option, to replace the existing Option 1A. This would be identical to Option 1 in all respects except that the main personal allowances would increase by 10 per cent. It was agreed that slight variations on this could be considered: for example, the increase might be set at a convenient cash figure; or at a level which would give a married man on average earnings an extra £5 per week. The Revenue agreed to produce a note, for decision at the overview meeting on 29 February at the latest.
- (ii) After some discussion, it was agreed that the proposal to restrict the APA to one per couple should be introduced as planned in 1989.
- (iii) The Revenue agreed to provide a note on merging the MCA and APA into a common allowance paid either to married couples or to unmarried people with dependent children. The Chancellor invited suggestions for the name for such an allowance.

- (iv) The Revenue agreed to provide a note on alternative options for the CGT exempt amount. The note should start by considering what would be the appropriate level in 1990-91, when many taxpayers (ie married couples) would receive a double allowance; and then consider what steps might be appropriate to reach that figure. There was a strong case for reducing the exempt amount in 1988-89, since the benefits of rebasing started then.
- (v) There was some discussion about what might be said in the Budget about car scales for 1989-90. To announce a fixed increase now would effectively rule out a larger increase in next years' Budget. The options seemed to be either not to announce any figure now, with the consequence that an in-year Budget recoding would be needed for any increase in car scales; or to use a formulation such as "not less than 10 per cent", provided that gave the necessary legal cover for coding for a 10 per cent increase. The Revenue agreed to provide a note. The figuring in the scorecard and FSBR should follow the coding.
- (vi) An increase in the PEP ceiling from £200 per month to £250 per month (ie £2400 to £3000 per year) should be added as a late starter.
- (vii) It was agreed that the IHT threshold should be increased from £107,000 to £110,000; this would cost an additional £10 million in 1988-89 and £25 million in 1989-90.
- (viii) The Chancellor asked for a note on how many employees would be relieved from any tax on benefits in kind by the increase in the P11D limit (taking account also of the increase in car scales).

Budget Decisions

3. The following points were made:

- (i) The new income tax rates of 25 per cent and 40 per cent were confirmed; a final decision on thresholds would be taken at the overview meeting on 29 February.

- (ii) The MIR ceiling was confirmed at £30,000.
- (iii) It was agreed that the additional rate on trusts should be retained, and set at 10 per cent. The possibility of special relief of disaster funds should not be pursued.
- (iv) It was agreed that no action should be taken this year on a possible linkage between discretionary and all employee share schemes; but an announcement should be made in the Budget debates that we would be considering legislation in 1989.
- (vi) The corporation tax rates of 25 per cent and 35 per cent were confirmed.
- (vi) A submission was awaited on place of hearing by general commissioners.
- (vii) Decisions had already been taken separately on APA for incapacitated wives, BES, employee priority shares, Northern Ireland general commissioners and accelerated accruals of pensions. A further meeting on transitional arrangements for maintenance was to be held later that week.

4. Benefits in Kind

(a) Capital Allowances: Expensive Cars

There was considerable discussion about three possible options:

- (i) scrapping all capital allowances for cars (or just for expensive cars);
- (ii) keeping the £8,000 ceiling unchanged; and
- (iii) raising the £8,000 ceiling to £12,000.

Option (i) would remove compliance costs completely, but would sit very oddly with general tax principles. The arguments for

option (iii) were that it would reduce compliance costs, and provide a sweetener for the car industry; and since it was only a timing change, the cost would eventually disappear. On the other hand, we were helping on compliance costs in other ways; the effects on the motor industry should not be too large, given that 98 per cent of taxpayers with company cars benefitted from the package as a whole; and it seemed somewhat perverse to be reducing the cost in the hands of the employer at the same time as we were saying that car benefits remained significantly undertaxed.

5. A completely different option to provide some help to the motor industry would be to cut the rate of car tax. This would have the advantage of benefitting private as well as company purchasers. But it was very expensive, at around £110 million per percentage point off car tax. After further discussion, it was agreed that there should be no changes this year to either the capital allowance ceiling for expensive cars or to car tax. A cut in car tax should be reconsidered next year as a possible offset to a further increase in car scales.

(b) Directors' Dining Rooms

6. The following structure for a charge on Directors' Dining Rooms was agreed:

- (i) It should apply to exclusive canteens and dining rooms generally, rather than only to those exclusively for Directors and Senior Executives; the latter route had some attractions, but was arbitrary and would open up some difficult distinctions.
- (ii) In principle, MPs should be treated in the same way as others; but there could be difficulties if this required specific legislation to include them in the charge. It would also be necessary to consider carefully other difficult cases, such as the army and universities.

(iii) The charge should be based on a simple formula, but excluding the amount contributed to entertaining outside guests. There should not initially be any uplift to take account of other costs.

(iv) This charge and the withdrawal of the LV concession went together.

7. In discussion of the merits of the charge, it was generally felt that it would create considerable difficulties, and ones which would be very difficult to discover in advance. It was agreed that it should not be pursued further this year.

(c) Car Parking

8. After some discussion, it was agreed that the provision of car parking, both on and off the employer's premises, should be exempt from tax. This should be done by means of legislation in the Finance Bill.

Presentation

9. There was some discussion about whether the tables in the Inland Revenue press notice should stop at incomes of £50,000 or £70,000. There was a case for stopping at £50,000, in that the increase to £70,000 last year had been made specifically to show the humped pattern of percentage gains; and cutting the tables off at £50,000 might help in Budget Day presentation. But on the other hand, to go back to the lower figure could be counterproductive, and would certainly be rumbled very quickly. It was agreed that the tables should show figures up to £70,000.

10. Mr Corlett's note of 19 February on the history of covenanting for tax was very helpful for developing the presentation; it demonstrated how the existing system had grown up by accident.

11. The main positive points on cars were:

- (i) They were substantially undertaxed, and we were making the largest increase possible in a single year; and
- (ii) now that tax rates had been reduced so much, there was not the same incentive to find alternative ways of remunerating employees.

The increase in the P11D limit was simply an acknowledgement that we were making an exceptional increase in car scales this year; if the P11D limit had not been increased, a substantial number of people would have been pushed above the limit by the increase in car scales, and would have suffered significant losses. We should stick to the line that the P11D limit would be frozen at its new level, even if we left open how large the increase in car scales might be next year.

12. On home improvement loans, the presentation should not concentrate primarily on the abuse; it should instead make the point that the change focussed mortgage interest relief on its real intention: house purchase. We had found a more sensible restriction than many of those being urged on us.

13. There was considerable discussion of the line on forestry. It was important to play the environmental card, since otherwise it was difficult to justify the increase in grants - these were necessary to ensure that the Government's tree planting target was met. This did raise the difficulty that the revenues recouped from ending the major tax avoidance were being recycled back to those who engaged in forestry; but they would go to different types of people, including farmers in particular. There was a strong case for confining the new tree planting grant to a level equivalent to the benefit which an average rate taxpayer would get under the existing regime (rather than to the benefit a top rate tax payer would get); this was still under discussion with forestry

ministers. There was no need to hype up the presentation: the measure would inevitably attract plenty of attention on its own.

14. The Chancellor asked his ministerial colleagues to provide short bull-points on each of the items for which they were responsible, for discussion at the following week's overview meeting.

mpw

pp A C S ALLAN

Distribution:

Those present
PS/IR
Mr P R H Allen C&E
Mr Riley
Miss Sinclair

BUDGET CONFIDENTIAL

PHF

FROM: J. ANSON
23rd February, 1988.

MR. HUDSON

c.c. Chief Secretary
Sir P. Middleton
Mr. Scholar
Mr. Culpin
Mr. Burr
PS/IR

BUDGET SPEECH: FIRST DRAFT

I have discussed paragraph K.12 with Mr. Burr. He is discussing the new arrangements for student grants with DES and SED, and the paragraph may need further revision in the light of that. But in the meantime there are two points which arise anyway:

- (i) The penultimate sentence is not accurate as it stands. You will have noticed I left it out of the redraft I gave you the other day. I think the thought in it is a hangover from previous ideas of a wider package of changes which would also have subsumed the social security element. But that is not now included in the changes to be announced in the Budget, and we are not therefore, at this stage, concentrating all support through the grant system. But anyway I am not sure we would want to be taking credit for concentrating support through the grant system, when we hope shortly to announce a shift away from grant towards loans. The most I would want to claim is greater simplicity in that support will not be split between grant and tax.
- (ii) The final sentence needs to avoid implying that the existing students with covenants will also be allowed to use their full tax allowance against earnings etc.

BUDGET CONFIDENTIAL

I would suggest therefore replacing these two sentences with:

"The new arrangements will enable students to use their full tax allowance against vacation earnings or other income. [And they will be simpler because student support will no longer be split between grants and tax relief.]"

A handwritten signature in blue ink, appearing to be 'J. Anson', with a stylized 'A' and a checkmark-like flourish.

J. ANSON

conqueror

MI

don't tax
reading!

European Committee Against Taxing Books

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
The Treasury
Parliament Street
London
SW1

*Ch/ hand-delivered
at HM
mpw
24/2*
*Simple ack: 1 w
Tax: -*

please reply to/répondez svp

- ☐ Avenue du Parc III
1060 Bruxelles
Belgique
☎ 02 538 2167
- ☐ Ter Borchtlaan 75
B-2520 Edegem
België
☎ 03149 37 30
- ☐ The Society of
Authors
84 Drayton Gardens
London
SW10 9SB

23rd February 1988

Dear Chancellor

When you announce your Budget measures on 15th March, we urge you, once again, to give a commitment that books will not be taxed in the life time of this Parliament. This morning we are handing in petitions and bookmarks signed by 200,000 members of the public anxious that reading should not become subject to VAT.

The National Book Committee has of course submitted detailed arguments on the subject to the Treasury. We would like to emphasise very strongly that VAT on books would be extremely damaging to literacy, education, and research.

Reading is the basis of knowledge. Everyone will suffer if reading is taxed. Libraries, schools, universities and colleges would simply buy fewer books. This would hit hard certain groups such as the young, the elderly and the disabled, for whom books are particularly important. These are the people least able to afford the extra cost.

The Government is committed to retaining the zero rating of food, children's clothes and domestic heating and lighting. We trust that you will give a similar commitment to books.

Yours sincerely

Antonia Fraser

Lady Antonia Fraser

on behalf of the European Committee Against Taxing Books



FROM: A P HUDSON

DATE: 23 February 1988

MR PERETZ

BUDGET SPEECH, FIRST DRAFT: SECTIONS ON THE ECONOMY

... I attach Sections B-D of the speech which went to the Chancellor on Friday (19 February).

2. The Chancellor's only comment of substance on Monetary Policy was to wonder whether the benefits to the UK economy of exchange rate stability over the past year would be better dealt with in paragraph B20, where the Louvre is mentioned, rather than in Section C. Perhaps we can consider this in the course of the week. I shall be putting a revised draft of the whole speech to the Chancellor on Friday.

A P HUDSON

BUDGET SECRET: TASK FORCE LIST

COPY NO 5 OF 10

FROM: A P HUDSON

DATE: 24 February 1988

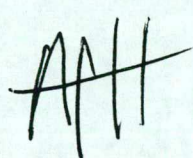
MR MONCK

cc Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Beighton IR
Mr McManus IR

BUDGET SPEECH: FORESTRY

Thank you for your comments on the previous draft of the Budget Speech, and for sending me a copy of your 22 February minute.

- ... 2. I attach a redraft of the relevant section for the speech. As the Chancellor asked, it is shorter and less 'macho'.
3. Please could I have any comments by close tomorrow (25 February).


A P HUDSON

FORESTRY

M8. First, the present tax treatment of forestry has been very widely criticised. It enables mostly top rate taxpayers to shelter other income from tax by offsetting it against losses from forestry, but also enables them to receive the proceeds from the eventual sale effectively tax-free.

M9. This is a misuse of the tax system. But I am satisfied that the special nature of forestry means that special tax arrangements are justified.

M10. I therefore propose to take woodlands out of the tax system altogether. As from today, and subject to transitional provisions, expenditure on woodlands will not be allowed as a deduction for income tax or corporation tax. And receipts from the sale of trees or timber will not be taxed.

M11. It is a measure of the absurdity of the present system that this exemption would in time bring a saving of £10 million. But to maintain Exchequer support at roughly its present level, I have agreed with my RHF's with forestry responsibilities that this money will be

x available for increased planting grants. The Forestry Commission will be announcing the details next week.

M12. The new system will be simpler, and will give the taxpayer better value for money. The new grant structure will also strengthen environmental protection, which I know is of concern to HMs on all sides of the House. [I hope all those involved will work together to get the new arrangements in place as soon as possible.]

BUDGET SECRET : TAX FORCE LIST

Copy No 1 of 5

PWP 38

FROM: E MCGIVERN
DATE: 24 FEBRUARY 1988

cc. Mr Beighton
Mr Reed

1. MR PAINTER 424-2
2. MR McMANUS

Andrew Harrison - by fax
Chancellor's office
25/2

SPEECH : FIRST DRAFT

Para E4

I suggest that in the third line we should refer to the CT rate as one of the lowest tax rates in the world, rather than the lowest.

Para G6 Lloyds

You already have a suggested redraft here.

Paras G26 to G31

You have seen Mr Painter's minute of 23 February. A further reason for not placing so much emphasis on the mobility of labour point is that Ministers have decided that property let on short fold assured tenancies will not qualify for BES relief. But some people will argue that these tenancies should be included to help people who want to move temporarily into rented accommodation whilst they are looking for permanent accommodation for their families. In the circumstances, I suggest some re-ordering of these paragraphs on the following lines:

Para G24 - no change

Para G25 - add at end - "And I am now proposing a major tax relief to help overcome the present shortage of accommodation in the private rented sector."

Renumber paras G27 and G28 as G26 and G27 respectively.

Add at the end of para G29 - "This relief will complement the Government's deregulation policy and help boost confidence in the private rented sector."

Para G30 - no change

BUDGET SECRET : TAX FORCE LIST

Copy No 1 of 5

New para G31 as follows

"In addition, for years, the shortage of private rented accommodation has been an obstacle to labour mobility.... [as per para G26]..... accommodation for their families. This new BES relief for rented property can play an important part here and help ensure that people can move to where the new jobs are."

Old Para G31 - Amend second sentence onwards as follows:

"As with the existing scheme, investment by an individual of up to £40,000 will qualify for relief at his marginal rate. And since this new scheme is designed to provide a 'kick start' relief to bring forward investment in the early years of the new deregulated housing regime, it will run until 1993. Further details are contained in a Press Release issued today by the Inland Revenue."

for

for E MCGIVERN

BUDGET CONFIDENTIAL



Inland Revenue
CENTRAL DIVISION
Somerset House
London
WC2R 1LB

PHF

Telephone 01 438 7221

A P Hudson Esq - FAX
Chancellor's Office
HM Treasury
Parliament Street
LONDON SW1P 3AG

24 February 1988

Dear Andrew,

BUDGET SPEECH - FIRST DRAFT

Paragraph G6 of this draft dealing with the Lloyds tax changes is too abbreviated. There is little point referring to two changes unless some indication is given of what they are. Without this there could be speculation about what the changes were (eg was there to be an improvement to - or abolition of - Lloyds Special Reserve Fund?). Furthermore, the present draft implies that this year's, quite important, changes in the administrative arrangements for assessment and collection are "minor" and solely related to last year's measure on reinsurance to close. Neither assertion is right or presentationally sensible.

So we suggest substituting the following redraft for paragraph G6 (as short as we can make it - and accurate):

A
~~"Third, Lloyds. I propose two changes. One will meet a~~
~~point Lloyds have raised on last year's legislation on~~
~~reinsurance to close. The second will reform and~~
~~simplify the administrative arrangements for taxing Lloyds~~
~~members. Both changes are intended to ensure that the~~
~~system for taxing Lloyds is effective but also takes~~
~~account of the special features of Lloyds."~~
simplifies

Yours sincerely,

Steve

S J McMANUS

These changes help

PWP 38

FROM: E McGIVERN
DATE: 24 FEBRUARY 1988

cc. Mr Beighton
Mr Reed

1. MR FAINTER 4/20-2
2. MR McMANUS

Andrew Harrison - by fax
Chancellor's office
25/2

SPEECH : FIRST DRAFT

Para E4

I suggest that in the third line we should refer to the CT rate as one of the lowest tax rates in the world rather than the lowest.

Para G6 Lloyds

You already have a suggested redraft here.

Paras G26 to G31

You have seen Mr Palmer's minute of 23 February. A further reason for not placing so much emphasis on the mobility of labour point is that Ministers have decided that property let on short hold assured tenancies will not qualify for BSS relief. But some people will argue that these tenancies should be included to help people who want to move temporarily into rented accommodation whilst they are looking for permanent accommodation for their families. In the circumstances, I suggest some re-ordering of these paragraphs on the following lines:

Para G24 - no change

Para G25 - add at end - "And I am now proposing a major tax relief to help overcome the present shortage of accommodation in the private rented sector."

Re-number paras G26 and G27 as G25 and G26 respectively.

Add at the end of para G29 - "This relief will complement the Government's deregulation policy and help boost confidence in the private rented sector."

Para G30 - no change

New para G31 as follows

"In addition, for years, the shortage of private rented accommodation has been an obstacle to labour mobility.... [as per para G26]..... accommodation for their families. This new SIS relief for rented property can play an important part here and help ensure that people see more of where the new jobs are."

Old Para G31 - Amended second sentence onwards as follows:

"As with the existing scheme, investment by an individual, or up to £1,000, will qualify for relief at his marginal rate. And now, this new scheme is designed to provide a 'top-up' relief to bring forward investment in the early years of the new category of rented property, which will run until 1993. Further details will be given in a Press Release issued today by the Inland Revenue."

for

E McCIVERN

PHF

A. F. BURTON, Esq. - F.A.I.
Chancellor's Office
HM Treasury
Parliament Street
LONDON S.W. 1

Dear Anna

A mind map with a central node 'A' in a circle. Three branches extend from 'A':

- Branch 1: 'to' followed by a horizontal line.
- Branch 2: 's' preceded by a horizontal line.
- Branch 3: 'simplifies' preceded by a horizontal line.

Y. ...

(7) CH. 1000000000

These changes help

BUDGET CONFIDENTIAL



FROM: A P HUDSON

DATE: 24 February 1988

MR MACE IR

cc Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Miss Sinclair

Mr Isaac IR
Mr McManus IR

BUDGET SPEECH: INDEPENDENT TAXATION

... I attach a redraft of Section F, taking account of the Chancellor's comments.

2. Please could I have any comments by close tomorrow (25 February).

3. We want to end with an upbeat wrap-up paragraph. Can anybody think of some thing better than the present Fl6?

A handwritten signature in black ink, appearing to be "A P HUDSON".

A P HUDSON

F. INDEPENDENT TAXATION

F1. The present system for the taxation of married couples goes back 180 years. It assumes that everything a married woman has, or earns for herself, belongs to her husband. So it taxes her income as if it were his. In the last part of the twentieth century, that is simply not acceptable.

F2. Year after year, there has been extensive consultation on this subject. The time has come to take action.

F3. I therefore propose a major reform, with three objectives. First, to give married women the same privacy and independence in their tax affairs as everyone else. Second, to end the tax penalties that can arise on marriage. And third, to ensure that the tax system continues to recognise marriage.

F4. I have decided to introduce, at the earliest possible date of April 1990, a completely new system of Independent Taxation.

F5. Under the new system, a husband and wife will be taxed independently, on the whole of their income. The married man's allowance and wife's earned income allowance will be abolished, and all taxpayers, male or

female, married or single, will start with the same personal allowance, which will be available against income of all kinds, whether from earnings or savings.

F6. Married women will pay their own tax, irrespective of their husbands' income, and they will have the chance to fill in their own tax return, when one is necessary. [Married women who wish to ask their husbands to continue to handle their tax affairs will, of course, be free to do so, provided they sign any tax returns themselves.]

F7. If nothing else were done, there would be no recognition of marriage and, all married couples would see a substantial fall in their tax threshold. I am therefore introducing a new married couple's allowance, equivalent to the difference between the married man's allowance and the single allowance. For simplicity, this new allowance will go in the first instance to the husband. But if he does not have enough income to cover it, his wife will be able to set any unused portion against her income.

F8. A husband and wife will also be taxed independently on their capital gains, with an annual exemption each, instead of one between them, as now. But transfers of capital between husband and wife will continue to be exempt from both capital gains tax and inheritance tax.

F9. This new system will give complete privacy and independence to married women, for the first time in the history of income tax. And it combines this with continuing recognition of marriage in the tax system. [Many couples will pay less tax, and none will pay more.]

F10. The new system will start considerably earlier than would have been possible for most of the other reforms that have been canvassed, in particular transferable allowances. The legislation will be in this year's Finance Bill.

Penalties on marriage

F11. I mentioned a few moments ago the tax penalties on marriage. It is clearly absurd that some couples should find themselves paying more tax, simply because they get married. I propose to put that right.

F12. Independent taxation by itself will remove the most common tax penalty on marriage - the taxation of a married woman's income from savings at her husband's top rate of tax. I am also introducing measures to tackle the other tax penalties, and these can take effect in advance of Independent Taxation.

F13. The biggest problem comes with mortgage interest relief. An unmarried couple can get twice as much relief

as a single person or a married couple, and that has attracted increasing - and justified - criticism. I am putting a stop to it from August this year. In future, the £30,000 limit on relief will be related to the house or flat, irrespective of the number of borrowers. This was the solution canvassed in the 1986 Green Paper on Personal Taxation, and it was generally welcomed. Existing mortgages, however, will be unaffected.

F14. A further anomaly is that an unmarried couple with two children can each claim the Additional Personal Allowance, which is intended for single parents. This can, again, give them more tax relief than a married couple in the same position. I therefore propose to restrict the Additional Personal Allowance to one per household. This will take effect from [April 1989].

F15. This Budget will therefore eliminate, for all practical purposes, the tax penalties which can arise on marriage.

F16. The reform I have described puts an end to the discrimination against married women in tax, which has been such a lengthy hangover from the last century. And it does so in a way which continues to recognise marriage, and eliminates the penalties against it.

BUDGET SECRET - TASK FORCE LIST

FROM: N MONCK

DATE: 25 February 1988

MR HUDSON

cc Mr Scholar
Mr Culpin
Mr Sedgwick
Mr A C S Allan

Mr McManus, IR

BUDGET SPEECH : SECTION G

I think the CBI lobby might be somewhat provoked by the last sentence of G2 and the "therefore" in the first sentence of G3. The lobby argues that if only the company sector were left with a higher proportion of their profits/cash flow to spend, the performance on fixed investment and spending on R & D and training etc would compare better with our main competitors. I suggest you might add one sentence (underlined) below, though I do not put enormous weight on it. The passage would then read:

"... the lowest corporation tax rate of any major European country.
... A crucial part of an environment in which company profits, leaving aside the oil sector, have risen to the highest level since 1973. This has produced a substantial financial surplus, despite the strong growth of business investment.

G3. I do not therefore propose any major changes to the corporation tax regime this year ..."


N MONCK

CONFIDENTIAL

FROM: MISS C EVANS
DATE: 25 FEBRUARY 1988

mp *J. G. Walker*
(spw)

MR A C S ALLAN

cc

Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Mr Scholar
Mr Odling-Smee
Mr Culpin
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr Pickford
Mr S Davies
Mr Hibberd
Miss Sinclair
Mrs Butler
Mr Mowl

Mr Riley
Mr R I G Allen
Mr Bottrill
Mr Hudson
Miss Simpson
Mr Dyer
Mr Allum
Mr Cropper
Mr Tyrie
Mr Call
Mr Rawlins
Mr Dight
Mrs Thorpe
Mr Cavanagh - CSO
Mrs Burnhams
Mrs Crane
PS/IR
Mr Calder - IR
Mr McManus - IR
PS/C&E
Miss French - C&E

1988 BUDGET TIMETABLE

... I attach the timetable for the last two weeks before the Budget.

C. Evans

MISS C EVANS

Week -2

CX DIARY & PARLIAMENT

FSBR & BUDGET

EXTERNAL EVENTS

Monday
29 February

Overview 7
Submission to Chancellor on
post-Budget fiscal projections
Chancellor's office circulate
revised Budget statement
Chapter 4 to printer

Balance of payments (Jan)
Full money published

Tuesday
1 March

Chapters 1, 2, 3 to printer

Wednesday
2 March

Chancellor's meeting with HMT and
separately Bank on MTFS
1st proof of Chapters 4, 5, 6
from printer & to Chancellor

Reserves published

Thursday
3 March

Chancellor comments on Chapters
4, 5, 6 proofs by noon
1st proof of Chapters 1, 2, 3
from printer & to Chancellor

Friday
4 March

Chancellor comments on Chapters
1, 2, 3 by noon
Revised Budget statement to Chancellor 1987 Balance of Payments (internal)
1st proof of Chapters 4, 5 6 returned
to printers

Saturday/Sunday
5-6 March

Chancellor works on Budget statement

Week -1

CX DIARY & PARLIAMENT

FSBR & BUDGET

EXTERNAL EVENTS

Week -1	CX DIARY & PARLIAMENT	FSBR & BUDGET	EXTERNAL EVENTS
Monday 7 March	ECOFIN	Chancellor's office circulate revised version of Budget Statement 1st proofs of Chapters 1, 2, 3 returned to printers	

Tuesday 8 March		Draft EPR supplement to Chancellor Draft notes for Queen & overseas posts to Chancellor	
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Wednesday 9 March		Chancellor comments on EPR, notes for Queen & posts Submission on list and presentation of press notices to Chancellor Submission on 1988-89 PSBR to Chancellor 2nd proof of FSBR (all chapters) from printers	PSBR internal 1987 GDP 1st estimate - internal
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Thursday 10 March	1st Order	EPR supplement to printer 2nd proof of FSBR returned to printers	1987 Balance of Payments published
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Friday 11 March		Final draft of Budget statement to Chancellor EPR proof to Chancellor Copy of Budget statement to PM Telegram for overseas posts: final draft to Chancellor Note for Queen: final draft to Chancellor Final version of Budget broadcast to Chancellor	
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Saturday 12 March		FSBR book proofs from printers and checked in HMT Chancellor comments on EPR proof by noon FSBR & EPR book proofs returned to printer Chancellor finalises Budget statement	
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Week 0	CX DIARY & PARLIAMENT	FSBR & BUDGET	EXTERNAL EVENTS
Monday 14 March	Audience with Queen	Budget speech copied FSBR read at press	
Tuesday 15 March	Budget Day	FSBR published	
Wednesday 16 March	Budget debate		PSBR published
Thursday 17 March	Budget debate		Unemployment figures published
Friday 18 March			

PWP

FROM: P N SEDGWICK
DATE: 25 FEBRUARY 1988

MR HUDSON

cc Sir T Burns
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr S Davies
Mr Mowl

BUDGET SPEECH 1ST DRAFT : PUBLIC SECTOR FINANCE

I have a few comments on your draft.

Paragraph D2

Will everyone realise that "last year" refers to financial year 1986-87?

Paragraph D5

Corporation tax receipts in 1987-88 are not especially above the 1987 FSBF forecast when compared with other taxes. The reduction in the basic rate in the 1987 budget - referred to in your second sentence - is irrelevant to the extent to which revenues are greater than expected at budget time. I suggest replacing the first two sentences by the following.

With the economy so buoyant receipts from income tax and VAT in the current financial year have been greater than expected. Corporation tax receipts, based on the higher than expected profits of a thriving and healthy company sector in recent years, have also outstripped expectations.

Paragraph 9

Shocks by their nature arise unexpectedly. They were, if anything, more a feature of the 1970s than 1980s so far. I would delete the last sentence.

Paragraph D12

The last sentence is not consistent with the available data on financial deficits for General Government - the only definition for which figures are available on a comparable basis. As the table below shows Japan appears to have had a lower deficit in 1987 and to be contemplating one of similar size as the UK's (consistent with the FSBR forecast) for 1988. Colin Mowl will let you know if a more favourable comparison for the UK emerges as we finish our figuring in the run up to the budget.

GENERAL GOVERNMENT FINANCIAL DEFICITS (per cent of GNP/GDP)

		1987	1988
HMT Estimate	UK	1.4	1.1
	(US	2.4	2.4
OECD December 1987	(Japan	1.2	1.1
	(Germany	1.7	2.3
	(France	2.8	2.7
	(Italy	10.3	10.3
	(Canada	4.4	3.3
	(M6	2.8	2.7

Paragraph D18

The first two sentences are not consistent with the latest OECD data (attached) which shows falling debt/income ratios for Japan in the last four years. You should be aware that the Japanese budget for fiscal year 1988-89 has a fall in debt interest payment.

P.N.S.
P N SEDGWICK

1) EZEM BER 1987.

the fiscal stance in 1987 is expected to be expansionary in the United Kingdom and Italy, neutral in Germany, and restrictive in the others. These trends are projected to continue in 1988 except in the United States where the structural budget balance (on the assumptions adopted) remains unchanged, in Italy where it shows a modest improvement, and in Germany where fiscal policy is set to become slightly expansionary. As for the smaller countries, worsening structural budget balances in 1987 in Finland and Norway are more than offset by improvements elsewhere.

Adjusting the projected structural budget balances for the effects of price changes⁷ does not modify fundamentally the assessment of the stance of fiscal policy in most countries. Some differences appear, however. In particular, fiscal policy in Italy is projected to be significantly more expansionary in 1987, on this inflation-adjusted basis, than suggested by the structural balances alone. On the other hand, fiscal policy appears slightly restrictive in Germany in 1987 taking into account the low rate of price increase. The adjusted indicators also suggest that the policy stance will be broadly neutral in Greece and Spain over 1987 and 1988 rather than restrictive as indicated by the changes to the structural balance.

In many countries, the present stance of fiscal policy reflects in part the concern of governments to limit and ultimately stop the growth in government debt. As can be seen from Table 15⁸ general government gross and net debt/GNP ratios are expected to keep rising in France, Canada and Italy over the projection period, albeit at a slower pace in the first two countries. A

significant slowdown in the growth of the ratio is projected for the United States in 1988, while in the United Kingdom the ratio should decline slightly. The Japanese debt ratio, which had stabilized after 1983, is projected to decline in 1988 on the basis of the policy assumptions adopted. By contrast, it is expected to rise in Germany this year and next. It is of course important to remember, particularly in the case of the last two countries, that rising pension costs associated with ageing populations stand to affect the debt outlook substantially over the medium term⁹.

Major developments in individual countries

In the United States the extent to which the Federal budget deficit for fiscal year (FY) 1988 – which begins 1st October 1987 – will be reduced from its projected FY 1987 level of about \$190 billion is uncertain. The Administration's January budget proposal seeks to meet the Gramm-Rudman-Hollings deficit target of \$108 billion by means of substantial expenditure reductions, asset sales, and some minor revenue increases. While they have not reached an agreement, the House and Senate have approved deficit-reducing proposals which would combine tax increases of about \$18 billion with expenditure cuts of the same magnitude, relatively equally divided between domestic and military spending. The size of the required policy changes depends on the estimate of the "current services" (i.e. with no policy changes). The Administration forecasts an FY 1988

Table 15
Gross and net public debt
Percentage of nominal GNP/GDP

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986 ^a	1987 ^b	1988 ^b
Gross debt of general government																
United States	40.6	39.6	42.6	42.5	40.8	39.0	37.2	37.7	37.1	41.1	44.0	45.1	48.5	50.5	51.6	52.2
Japan	17.0	18.0	22.4	28.0	33.4	41.9	46.9	52.0	57.0	61.1	66.9	68.4	69.4	69.1	69.5	68.8
Germany	18.6	19.6	25.0	27.0	28.5	29.9	30.7	32.5	36.3	39.5	40.9	41.7	42.3	42.4	43.2	44.4
France	25.1	24.7	25.8	24.7	25.2	26.3	26.2	25.0	25.9	28.3	29.8	32.6	34.6	36.4	38.3	39.9
United Kingdom	69.7	69.6	65.3	64.1	62.5	59.6	55.6	54.9	54.9	53.6	54.0	55.3	53.7	53.8	53.0	52.4
Italy	60.6	57.7	66.8	65.4	65.2	71.2	70.6	67.4	70.5	76.8	84.4	91.1	99.6	102.4	107.1	112.7
Canada	46.7	44.5	44.8	42.5	44.8	48.7	43.6	44.7	45.1	50.5	54.5	58.2	63.7	67.4	70.2	72.5
Total of above countries	36.8	36.3	39.2	39.9	40.2	41.2	40.7	41.7	42.9	46.5	49.7	51.4	54.0	55.4	56.6	57.4
Net debt of general government																
United States	22.9	22.0	24.4	24.1	23.0	21.0	19.4	19.5	18.8	21.4	24.0	25.1	26.8	28.8	29.9	30.6
Japan	-6.1	-5.4	-2.1	1.9	5.5	11.3	14.9	17.3	20.7	23.2	26.2	26.9	26.5	26.2	26.6	25.9
Germany	-6.7	-4.7	1.0	4.6	7.0	9.4	11.5	14.3	17.4	19.8	21.4	21.7	22.1	22.2	23.0	24.1
France	8.3	8.8	11.1	10.9	10.2	10.2	9.8	9.1	9.9	11.3	13.4	15.2	16.7	18.5	20.4	22.0
United Kingdom	57.5	54.9	57.4	56.8	55.8	53.3	48.6	48.0	47.2	46.4	47.1	48.5	46.9	46.9	46.1	45.5
Italy	52.1	49.2	59.9	60.9	60.7	63.9	63.7	61.8	66.8	73.4	80.6	87.8	96.3	99.2	103.9	109.5
Canada	2.7	1.1	4.4	5.3	7.7	10.6	10.7	11.5	10.7	16.9	20.4	24.7	30.3	34.0	36.7	39.0
Total of above countries	17.2	16.8	20.1	21.0	21.2	21.6	21.2	21.8	22.5	25.1	27.8	29.3	30.8	32.2	33.3	34.1

a) Partly estimated.

b) Forecasts.

Source: OECD.

BUDGET SECRET: TASK FORCE LIST

COPY NO. 8 OF 8

FROM: A P HUDSON

DATE: 25 February 1988

MR CULPIN

cc Mr Scholar
Mr Monck
Miss Sinclair
Mr A C S Allan

Mr McManus IR

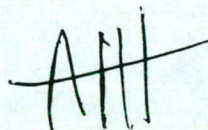
BUDGET SPEECH: SECTION G

... I attach a redraft of Section G of the Budget Speech.

2. We knew all along that this would not be one of the high points of the speech. But can you think of a better paragraph to round it off than the one I have at present?

3. I have taken out employee share ownership, because there may ... now be enough material for a short ownership section. I attach a shot at this, as well.

4. Please could I have any comments by close today (25 February) if possible.



A P HUDSON

G. BUSINESS TAXATION

G1. I turn now to business taxation.

G2. The major reform of business taxation, which I introduced in 1984, has given us the lowest Corporation Tax rate of any major European country. This has encouraged overseas companies to invest in Britain, and has improved the quality of investment by British firms. And it is a crucial part of an environment in which company profits, leaving aside the oil sector, have risen to the highest level since 1973.

G3. I do not therefore propose any major changes to the Corporation Tax regime this year. The main Corporation Tax rate for 1988-89 will be unchanged at 35 per cent.

G4. I have three changes to propose for businesses in particular sectors.

G5. First, North Sea companies are making an impressive recovery from the oil price collapse of 1986. Since reformed the tax regime for new offshore oil fields in 1983, a new generation of fields has come into being, in Southern Basin gas fields. Many of these are highly profitable, and there is no reason for an overall

reduction in tax. But I have decided to restructure the burden. My Rt. Hon. friend the Secretary of State for Energy will therefore shortly be bringing forward legislation to abolish royalties, from 1 July, for all Southern Basin and on-shore fields developed after April 1982. At the same time, I propose to reduce the PRT oil allowance for these fields to 100,000 tonnes per chargeable period.

G6. This reform will mean an end to royalties for all future fields. Tax will be more closely related to profitability. It will help to keep up the pace of our oil and gas activity, which will also benefit the offshore supplies industry.

G7. Second, Building Societies. The 1986 Building Societies Act gives Building Societies the power, to convert to become companies, if they wish. At present, however, they would face a heavy, and unintended, tax charge if they did so. I propose to rectify this.

G8. Third, I propose two changes to the tax arrangements for Lloyd's. One meets a point Lloyds have raised on last year's legislation on reinsurance to close. The second will simplify the administrative arrangements for taxing Lloyds members. These changes will help to ensure that the system for taxing Lloyds is effective but also taken account of the special features of Lloyds.

G9. British exporters have done extremely well in recent years, thanks to major improvements in efficiency and quality. But no exporter could honestly claim that his success hinged on the anomaly that the cost of entertaining overseas customers remains tax deductible, whereas business entertainment generally is not. And the same relief applied, of course, to importers entertaining overseas suppliers. There is absolutely no case for this special treatment. I therefore propose to simplify matters, by making all business entertainment non-deductible, for both Corporation Tax and VAT.

Section 482

G10. The very low rate of Corporation Tax gives companies every incentive to take risks and make profits. But we need to make sure that, once those profits are made, the due tax is paid. With this in mind, I have reviewed the provisions governing company residence and migration under Section 482 of the Income and Corporation Taxes Act 1970.

G11. The present rules are unclear and can be exploited. I propose a new regime which will be simpler and more objective.

G12. For the vast majority of companies, the residence test will be simply whether they are incorporated here.

The small number of companies which are not incorporated in the UK but are centrally managed and controlled here will also be deemed to be resident. Companies wishing to migrate will be able to do so, provided they change their place of residence under the new rules, and pay the tax they owe. This will end the need for companies to seek Treasury consent before they migrate, and the criminal penalty they face if they do not comply.

[G13. These measures will safeguard a very substantial amount of revenue.]

Small Businesses

G14. The encouragement of small businesses and new businesses - which are so vital a source of enterprise, innovation, and new jobs - has been a central theme of Government policy. And the rate of business start-ups, which has averaged 500 a week since 1979, net of those which fail, shows beyond any doubt the continuing vigour of this sector.

G15. Last year, I enabled small businesses to opt for cash accounting, or annual accounting, for VAT, or both. [Some X,000 businesses have done so, and the measures have been widely welcomed.] I have no further changes to propose this year. But I shall, as usual, be increasing the VAT registration threshold so that it remains at the

maximum permitted under European Community law. In 1988-89, the threshold will be £20,100.

G16. Many new and growing businesses used to find difficulty in raising equity finance. The Business Expansion Scheme, which we devised to meet that need, has now been running for nearly five years. It has been a great success, enabling new and expanding companies to raise £150 million a year, on average.

G17. The rapid growth of the venture capital market since 1983 means that companies seeking relatively large amounts of equity investment can now raise these readily. But smaller companies looking for more modest amounts can still run into difficulties.

G18. To improve the targeting of BES, I therefore propose to introduce a ceiling of half a million pounds on the amount a company can raise under the scheme. Investment will thus be better directed at the smaller enterprises and new businesses, particularly those at local level, which can still find it hard to raise finance in other ways. In the special circumstances of the shipping industry, however, the ceiling will be £X million.

G19. This measure is expected to save some £A million.

G20. I have one further announcement affecting the BES.

G21. One of the key reasons for our economic transformation has been the reform of the supply side of the economy.

G22. As to the labour market, there is still some way to go. The tax relief I introduced last year for profit-related pay will, in time, increase pay flexibility. And we also have to improve on labour mobility.

G23. If successful firms are to expand further, and if we are to build on the substantial reductions in unemployment, we have to ensure that people can move to where the new jobs are. For years, the shortage of private rented accommodation has been an obstacle to labour mobility. There have been increasingly frequent complaints from employers in the Midlands and the South that they can recruit the skilled workers they need from, for example, the North East, but that these workers cannot then take the jobs, because they cannot find suitable accommodation for their families.

G24. The Government's proposals to deregulate new rents are already going through the House. In future, any landlord will be able to let on the assured tenancy basis, at market rents, but with security of tenure protected.

G25. Deregulation will, in due course, itself increase the supply of housing for rent. But this will not happen overnight, and there is a case for a special incentive to speed up the process in the early years.

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G29. This change will reinforce the impact of deregulation, in reviving the private rented sector in this country.

G30. The measures I have announced will add to the attractions of Britain as a place to do business, for firms large and small. It is up to businesses to continue to take full advantage of the opportunities that they now have.

BUDGET CONFIDENTIAL

X. OWNERSHIP

X1. The spread of one of the most remarkable features of the 1980s. Encouraged by Government policy some [2½ million] families have bought their homes. And our new proposals for personal pensions, which come in to affect in July, will give a new dimension to pension ownership.

X2. But the most dramatic change has been in share ownership. In last year's Budget, I announced the results of a joint-Treasury/stock exchange survey of the number of shareholders in this country. This revealed that some 8½ million people - one adult in five - owned shares, about 3 times the number in 1979.

X3. A similar survey has been carried out this year. In spite of the stories about cashing in their gains on privatisation shares, and in spite of the stock market collapse, the figures show [that the number of shareholders has remained remarkably steady.]

X4. I have two proposals to announce today.

X5. First, Personal Equity Plans are off to a successful start. Over a $\frac{1}{4}$ of a million people took out plans in 1987, and subscribed nearly $\text{£}\frac{1}{2}$ billion between them. To give further encouragement to this form of investment, I propose to increase the limit from $\text{£}200$ a month $\text{£}250$ a month, [and to back date the change to 1 January, so that taxpayers can invest up to $\text{£}3,000$ in 1988.]

X6. Second, measures to encourage employee share ownership have featured in 7 out of the last 8 Budgets. As a result, the number of all-employee share schemes approved under the 1978 and 1980 Finance Acts has risen from 30 in 1979 to over 1400 today, involving well over 10,000 companies, and providing shares and options for well over $1\frac{1}{2}$ million employees. The shares and options have an initial market value of nearly $\text{£}3$ billion.

X7. At present, some subsidiaries and unquoted companies run into difficulties in trying to set up employee share schemes, because of the provisions of Section 79 of the 1972 Finance Act relating to employee shares obtained outside the approved schemes. I propose to relax those provisions which should open the way to more schemes.

COPY NO. 6 OF 8

FROM: A P HUDSON

DATE: 25 February 1988

MR MCMANUS - IR

cc Mr Scholar
Mr Culpin
Miss Sinclair
Mr Riley
Mr A C S Allan

BUDGET SPEECH: CAPITAL TAXES

... I attach a redraft of Sections H and J, incorporating the Chancellor's comments. The intention now is that these should come after Sections K and L, and therefore immediately before Income Tax.

2. The Chancellor has asked that the wording of paragraphs H4 to H6 should be checked particularly carefully. He notes that taxpayers will be able to use the actual acquisition cost of an asset, if that is higher than its 1982 value - a point which I have incorporated in H5. Is it therefore relevant to say, in H4, that pre-1982 ^SLosses will be exempt from tax?

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A P HUDSON

H. CAPITAL GAINS TAX

H1. I now turn to capital gains tax.

H2. Throughout my time in the House, I have argued that Capital Gains Tax should apply only to real gains, and not paper ones. The indexation provisions introduced by my predecessor in 1982, and which I extended in my 1985 Budget, mean that the relatively modest inflation element in gains since 1982 is not taxed. But for assets acquired earlier, the tax falls largely on purely nominal gains resulting from the rampant inflation of the 'seventies. In other words, we have indexed away the low inflation of recent years but not the high inflation of the 70s.

H3. In principle, the indexation provisions ought to be extended back to the inception of the tax in 1965. I have examined this possibility very closely. But I have to tell the House, with considerable regret, that I have concluded that it would simply not be practicable to extend indexation so far back. That would require information about the date, price and quantity of each acquisition and disposal since 1965. And in many cases, that information is simply not available.

H4. I have therefore decided that, for disposals on or after 6 April this year, capital gains [and losses?] arising before April 1982 will be exempt from tax altogether, for both individuals and companies.

H5. Taxpayers will, however, be able to use the actual acquisition cost of an asset, if that is higher than its 1982 value. So there is no question of taxpayers' losing from this measure.

H6. This Budget therefore ends once and for all the injustice of taxing inflationary gains. [It will enable taxpayers to realise investments that they have been forced to retain because they faced a high tax bill. And, in time, it should save companies [the equivalent of a penny off the rate of Corporation Tax].]

H7. Rebasing capital gains makes it easier to bring the taxation of gains closer to that of income. In logic, there is little difference between income and capital gains. Taxing them at different rates encourages people to base investment decisions on tax considerations, rather than economic ones. And it has lumbered the economy with much of the deadweight of a tax avoidance industry.

H8. I therefore propose a major reform. Capital gains will continue to be worked out as now, with the present

exemptions and reliefs. The principal private residence will remain tax-free, and the annual exempt amount will remain at its present level of £6,600. But the indexed gain will then be taxed at the income tax rate that would apply if it were the taxpayer's marginal slice of income.

H9. At present, with capital gains taxed at 30 per cent for everybody, basic rate taxpayers are taxed more heavily on gains than on income, whereas higher rate taxpayers face a lower rate of tax. In future, the rate on income and gains will be the same. [And I can reassure Hon. Members who are anxious to know what those rates will be that they will not have to contain their impatience much longer.]

H10. These changes will not take effect until 6 April. [The yield will be £X million in 1988-89.]

H11. Taxing capital gains at income tax rates makes for greater neutrality in the tax system. It is what we do already for companies. And it is already the practice in the USA and many other major countries. Investors will no longer waste so much time on tax planning.

H12. The saving on tax planning will be of particular benefit to small businessmen, who will be able to concentrate their energies on the real job of making profits. I have one other CGT measure that will help them further.

H13. Capital gains tax can be a fairly heavy burden when someone sells up on retirement, and this can be a disincentive to the entrepreneur. At present, retirement relief exempts the first £125,000 of the gain from tax. I now propose to extend it so that, on top of the exemption, half of any gain between £125,000 and £500,000 will also be completely free of tax.

H14. The changes I have announced, taken as a whole, represent the biggest reform of capital gains tax since its introduction in 1965. They will sharply reduce the damaging effects of the tax, while preserving the revenue from capital gains.

J. INHERITANCE TAX

J1. Small businessmen are also increasingly concerned with the burden of Inheritance Tax. There is less incentive to build up your business if you know that a lot of the proceeds will go in tax when you leave it to your children.

J2. I have already taken a number of steps to reduce this kind of effect. Two years ago, I abolished Capital Transfer Tax on lifetime gifts, and last year I made a large increase in the threshold for Inheritance Tax and reduced the number of rates from seven to four.

J3. Nonetheless, the yield of the tax has continued to mount, and this year is likely to pass the £1 billion mark. The tax is affecting more small businesses, and more ordinary people inheriting the family home.

J4. I therefore propose a reform of Inheritance Tax which will reduce the burden overall, keep more smaller estates out of Inheritance Tax, and make the system as simple as possible for those who still have to pay.

J5. In 1988-89, Inheritance Tax will be charged at a flat rate of 40 per cent. I shall thus have reduced the

number of rates from seven to one in two years. At the same time, the threshold will go up to £110,000, so that the burden is unambiguously lighter for all estates.

J6. Inheritance Tax thus becomes a flat rate tax, with a high threshold. This will reduce the number of estates liable to tax in 1988-89 by a quarter. Many more ordinary people will be able to inherit the family home free of tax. And for family businesses, the combination of 50 per cent business relief, and a tax rate of 40 per cent, means that the effective rate of tax is only 20 per cent, one of the lowest in the world.

[J7. The cost of the Inheritance Tax measures will be £X million in 1988-89. The tax system for estates which results will be simpler than at any time since [when?].]



COPY No SPJ/12/2 of 32

FROM: S P JUDGE

DATE: 25 February 1988

PRINCIPAL PRIVATE SECRETARY

cc PPS

PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr Anson
Sir Anthony Wilson
Mr Byatt
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Odling-Smee
Miss Sinclair
Mr R I G Allen
Mr Pickford
Miss Evans
Mr Cropper
Mr Tyrie
Mr Call
PS/Inland Revenue
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr McManus - IR
Mr Unwin - C&E
Mr Knox - C&E

BUDGET OVERVIEW MEETING: MONDAY, 29 FEBRUARY: PRESENTATION

I attach the Paymaster General's suggested bull points on the subjects for which he is responsible. This reflects a discussion he had earlier today with Mr Cropper and Mr Tyrie.

S P JUDGE
Private Secretary

BUSINESS AND HOUSING

1. CT rates

- a. Greatly increased yield is result of greatly improved profitability, to which 1984 reforms have made significant contribution;
- b. Small businesses helped by reduction in their rate to 25 per cent;
- c. CT rate lowest in Europe.

2. BES

- a. Over £700m raised through BES schemes in only five years;
- b. Ceiling will improve targeting of relief on entrepreneurial investment.

3. Business entertainment

- a. Removal of ridiculous anomaly;
- b. Simpler for businesses: all entertainment treated in same way for CT and VAT.

4. Section 482

- a. Replaces inappropriate [and draconian] criminal penalty with civil offence;
- b. Removes uncertainty. Tax treatment will depend on point of fact: companies will not have to get consent before emigrating;
- c. Protects revenue against evasion by future emigration.

5. ESOPs

- a. An idea whose year has not yet come;
- b. Need to keep Finance Bill short.

6. Private rented sector

- a. Kick start, to change attitudes;

- b. Signal of Government's commitment to private rental sector as flexible [adjunct/supplement/reinforcement] to home ownership;
 - c. More tenancies mean more tenants.
7. Profit-related pay
- a. Don't pull scheme up by its roots yet. Wait and see how it grows.
8. CGT retirement relief
- a. Encouragement to those [considering] entering unincorporated sector: know they will be able to realise gains [later] [more easily];
 - b. Avoids locking-in managers for life. Encourages infusion of new blood.
9. Inheritance tax
- a. Simplification of rates - four into one;
 - b. Consistent with IT rates [precedent];
 - c. Recognises reality of house prices in the South East.
10. MIR: residence basis
- a. Removes disincentive to marriage for those setting up their first home.
11. MIR: improvement loans
- a. Clear, growing and unacceptable level of abuse of this relief;
 - b. [selected audiences] Response to forceful report from the PAC.

25 February 1988

BUDGET SECRET: TASK FORCE LIST

COPY NO. 5 OF 8

FROM: A P HUDSON

DATE: 25 February 1988

MR CULPIN

cc Mr Scholar
Mr Monck
Miss Sinclair
Mr A C S Allan

Mr McManus IR

BUDGET SPEECH: SECTION G

... I attach a redraft of Section G of the Budget Speech.

2. We knew all along that this would not be one of the high points of the speech. But can you think of a better paragraph to round it off than the one I have at present?

3. I have taken out employee share ownership, because there may ... now be enough material for a short ownership section. I attach a shot at this, as well.

4. Please could I have any comments by close today (25 February) if possible.

A handwritten signature consisting of the letters 'A', 'P', and 'H' in a stylized, overlapping manner, followed by a horizontal line.

A P HUDSON

G. BUSINESS TAXATION

G1. I turn now to business taxation.

G2. The major reform of business taxation, which I introduced in 1984, has given us the lowest Corporation Tax rate of any major European country. This has encouraged overseas companies to invest in Britain, and has improved the quality of investment by British firms. And it is a crucial part of an environment in which company profits, leaving aside the oil sector, have risen to the highest level since 1973.

G3. I do not therefore propose any major changes to the Corporation Tax regime this year. The main Corporation Tax rate for 1988-89 will be unchanged at 35 per cent.

G4. I have three changes to propose for businesses in particular sectors.

G5. First, North Sea companies are making an impressive recovery from the oil price collapse of 1986. Since reformed the tax regime for new offshore oil fields in 1983, a new generation of fields has come into being, in Southern Basin gas fields. Many of these are highly profitable, and there is no reason for an overall

reduction in tax. But I have decided to restructure the burden. My Rt. Hon. friend the Secretary of State for Energy will therefore shortly be bringing forward legislation to abolish royalties, from 1 July, for all Southern Basin and on-shore fields developed after April 1982. At the same time, I propose to reduce the PRT oil allowance for these fields to 100,000 tonnes per chargeable period.

G6. This reform will mean an end to royalties for all future fields. Tax will be more closely related to profitability. It will help to keep up the pace of our oil and gas activity, which will also benefit the offshore supplies industry.

G7. Second, Building Societies. The 1986 Building Societies Act gives Building Societies the power, to convert to become companies, if they wish. At present, however, they would face a heavy, and unintended, tax charge if they did so. I propose to rectify this.

G8. Third, I propose two changes to the tax arrangements for Lloyd's. One meets a point Lloyds have raised on last year's legislation on reinsurance to close. The second will simplify the administrative arrangements for taxing Lloyds members. These changes will help to ensure that the system for taxing Lloyds is effective but also taken account of the special features of Lloyds.

G9. British exporters have done extremely well in recent years, thanks to major improvements in efficiency and quality. But no exporter could honestly claim that his success hinged on the anomaly that the cost of entertaining overseas customers remains tax deductible, whereas business entertainment generally is not. And the same relief applied, of course, to importers entertaining overseas suppliers. There is absolutely no case for this special treatment. I therefore propose to simplify matters, by making all business entertainment non-deductible, for both Corporation Tax and VAT.

Section 482

G10. The very low rate of Corporation Tax gives companies every incentive to take risks and make profits. But we need to make sure that, once those profits are made, the due tax is paid. With this in mind, I have reviewed the provisions governing company residence and migration under Section 482 of the Income and Corporation Taxes Act 1970.

G11. The present rules are unclear and can be exploited. I propose a new regime which will be simpler and more objective.

G12. For the vast majority of companies, the residence test will be simply whether they are incorporated here.

The small number of companies which are not incorporated in the UK but are centrally managed and controlled here will also be deemed to be resident. Companies wishing to migrate will be able to do so, provided they change their place of residence under the new rules, and pay the tax they owe. This will end the need for companies to seek Treasury consent before they migrate, and the criminal penalty they face if they do not comply.

[G13. These measures will safeguard a very substantial amount of revenue.]

Small Businesses

G14. The encouragement of small businesses and new businesses - which are so vital a source of enterprise, innovation, and new jobs - has been a central theme of Government policy. And the rate of business start-ups, which has averaged 500 a week since 1979, net of those which fail, shows beyond any doubt the continuing vigour of this sector.

G15. Last year, I enabled small businesses to opt for cash accounting, or annual accounting, for VAT, or both. [Some X,000 businesses have done so, and the measures have been widely welcomed.] I have no further changes to propose this year. But I shall, as usual, be increasing the VAT registration threshold so that it remains at the

maximum permitted under European Community law. In 1988-89, the threshold will be £20,100.

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BUDGET CONFIDENTIAL

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PWP

Copy 1 of 13

FROM: N MONCK

DATE: 25 February 1988

MR HUDSON

cc Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Burgner
Mr Culpin
Miss Sinclair
Mr Call

Mr Beighton, IR
Mr McManus, IR

BUDGET SPEECH : FORESTRY

I attach an amended version of your draft of 24 February.

2. I am not sure about M9 but I offer it as an alternative which is meant to be more specific about what is special about forestry without using the word 'justified' in a timeless way. "Major problems" is meant to include, silently, the present forestry policy which I hope is not unchangeable. I hope it also avoids implying that the new tax treatment is as favourable as the present one.

3. M11 slightly loosens the link with £10 million, and uses the "parallel" formulation which is in the draft of the FSBR. (We would incidentally end up with higher figures for tax and expenditure if we had to bring in higher grants for Farm Woodlands to meet Mr MacGregor). I think it helps to mention Mr Ridley.

4. M12 separates the point about simplifying the tax system from the advantages of switching to grants. I could probably offer another sentence or so on the environment if you had the space.

5. The point left out from my first redraft is the reference to "maintaining forestry policies". It is more prudent not to have it. But the Chancellor will have to consult Forestry Ministers to some extent about this passage and they may press for something at least as strong as that.

pp R. Jackson
N MONCK

BUDGET SECRET : TASK FORCE LIST

FORESTRY

M8. First, the present tax treatment of forestry has been very widely criticised. It enables mostly top rate taxpayers to shelter other income from tax by offsetting it against losses from forestry, but also enables them to receive the proceeds from the eventual sale effectively tax-free.

M9. This is a misuse of the tax system. But I am satisfied that special features of forestry - including the gap of 50 or 100 years between planting costs and the income from felling - mean that taxing it like other business activities would create major problems.

M10. I therefore propose to take woodlands out of the tax system altogether. As from today, subject to transitional provisions, expenditure on woodlands will not be allowed as a deduction for income tax or corporation tax. And receipts from the sale of trees or timber will not be taxed.

M11. It is a measure of the absurdity of the present system that this exemption would in time bring a saving of about £10 million. But to maintain Exchequer support at roughly its present level, I have agreed with my RHF's with responsibilities for Forestry and the Environment and there will be a parallel increase in planting grants under a new and improved scheme. The Forestry Commission will announce details [next week].

M12. These changes will make the tax system simpler and the archaic Schedule B will be abolished. Assistance in the form of grants will have several advantages. It will not discriminate in favour of higher rate taxpayers. It will strengthen environmental protection, which I know is of concern to HMs on all sides of the House. It will be better targetted and better value for money.

BUDGET SECRET: TASK FORCE LIST

COPY NO. 8 OF 8

FROM: A P HUDSON

DATE: 25 February 1988

MR MCMANUS - IR

cc Mr Scholar
Mr Culpin
Miss Sinclair
Mr Riley
Mr A C S Allan

BUDGET SPEECH: CAPITAL TAXES

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A P HUDSON

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H11. Taxing capital gains at income tax rates makes for greater neutrality in the tax system. It is what we do already for companies. And it is already the practice in the USA and many other major countries. Investors will no longer waste so much time on tax planning.

H12. The saving on tax planning will be of particular benefit to small businessmen, who will be able to concentrate their energies on the real job of making profits. I have one other CGT measure that will help them further.

H13. Capital gains tax can be a fairly heavy burden when someone sells up on retirement, and this can be a disincentive to the entrepreneur. At present, retirement relief exempts the first £125,000 of the gain from tax. I now propose to extend it so that, on top of the exemption, half of any gain between £125,000 and £500,000 will also be completely free of tax.

H14. The changes I have announced, taken as a whole, represent the biggest reform of capital gains tax since its introduction in 1965. They will sharply reduce the damaging effects of the tax, while preserving the revenue from capital gains.

J. INHERITANCE TAX

J1. Small businessmen are also increasingly concerned with the burden of Inheritance Tax. There is less incentive to build up your business if you know that a lot of the proceeds will go in tax when you leave it to your children.

J2. I have already taken a number of steps to reduce this kind of effect. Two years ago, I abolished Capital Transfer Tax on lifetime gifts, and last year I made a large increase in the threshold for Inheritance Tax and reduced the number of rates from seven to four.

J3. Nonetheless, the yield of the tax has continued to mount, and this year is likely to pass the £1 billion mark. The tax is affecting more small businesses, and more ordinary people inheriting the family home.

J4. I therefore propose a reform of Inheritance Tax which will reduce the burden overall, keep more smaller estates out of Inheritance Tax, and make the system as simple as possible for those who still have to pay.

J5. In 1988-89, Inheritance Tax will be charged at a flat rate of 40 per cent. I shall thus have reduced the

number of rates from seven to one in two years. At the same time, the threshold will go up to £110,000, so that the burden is unambiguously lighter for all estates.

J6. Inheritance Tax thus becomes a flat rate tax, with a high threshold. This will reduce the number of estates liable to tax in 1988-89 by a quarter. Many more ordinary people will be able to inherit the family home free of tax. And for family businesses, the combination of 50 per cent business relief, and a tax rate of 40 per cent, means that the effective rate of tax is only 20 per cent, one of the lowest in the world.

[J7. The cost of the Inheritance Tax measures will be £X million in 1988-89. The tax system for estates which results will be simpler than at any time since [when?].]

plw

FROM: N MONCK

DATE: 25 February 1988

MR HUDSON

cc Mr Scholar
Mr Culpin
Mr Sedgwick
Mr A C S Allan

Mr McManus, IR

BUDGET SPEECH : SECTION G

I think the CBI lobby might be somewhat provoked by the last sentence of G2 and the "therefore" in the first sentence of G3. The lobby argues that if only the company sector were left with a higher proportion of their profits/cash flow to spend, the performance on fixed investment and spending on R & D and training etc would compare better with our main competitors. I suggest you might add one sentence (underlined) below, though I do not put enormous weight on it. The passage would then read:

"... the lowest corporation tax rate of any major European country.
... ^Acrucial part of an environment in which company profits, leaving aside the oil sector, have risen to the highest level since 1973. This has produced a substantial financial surplus, despite the strong growth of business investment.

G3. I do not therefore propose any major changes to the corporation tax regime this year ..."

N

N MONCK

pwp

FROM: A J G ISAAC
25 February 1988cc Mr Lewis
Mr McManus
Mr Culpin
Mr Hudson

MR MACE

BUDGET SPEECH: INDEPENDENT TAXATION

1. I have little to comment on Mr Hudson's revised draft of Section F, dated 24 February.

Paragraph F6

2. I would be inclined to omit the sentence in square brackets. As I have commented on the draft press release, however, if the first half of the sentence is retained, we need to retain the second half.

Paragraph F9

3. As I have commented on the draft press release, we can say that "married couples generally will pay no more tax, and many couples will pay less". But the new system will be less favourable for (eg) breadwinner wives. Even allowing for transitional protection, we cannot substantiate a claim that no couple will pay less tax under the new system than they would have paid under the present one?

Paragraph F15

4. As the draft press release has explained, there are further major tax penalties on marriage, which are tackled elsewhere in the Budget - maintenance and covenants. This can easily be covered by something on the lines of "the measures which I am proposing [here and subsequently] in this Budget will eliminate". A minimum change might be to omit "therefore".

Paragraph F16

5. Taste and fancy, in rhetoric, is very much a personal thing. My offering to Mr Hudson's competition might be on the following lines: "These reforms will put and end to the discrimination against married women, and indeed against marriage itself, which have persisted - to the discredit of the tax system in this country - from the beginning of the nineteenth century to near the end of the twentieth." The new system will continue to recognise the reality that a married man and married woman share responsibilities within a marriage. But it will for the first time recognise that the married woman and the married man have a right to be treated alike, on the basis of equality, independence and privacy."

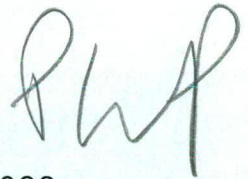
nearly
200 years
too long

cfe

A J G ISAAC

CONFIDENTIAL

FROM: P N SEDGWICK
DATE: 25 FEBRUARY 1988



✓
MR HUDSON

cc Sir T Burns
Mr Scholar
Mr Evans
Mr Odling-Smee
Mr R I G Allen
Mr Bottrill
Mr Hibberd
Mr Pickford
Mr Allum
Mr Dolphin
Mr Owen

BUDGET SPEECH : ECONOMIC BACKGROUND

I have a number of comments on and drafting suggestions for Part B of the version of the speech circulated on February 19.

The UK's growth record

2. Before dealing with detailed points I have some comments relevant to the treatment of the UK's recent growth performance in relation both to the its record in earlier periods and in comparison with other major economies. The record in recent years has been both impressive and considerably better than expectations at home and abroad. With such a record there is absolutely no need to make claims that are difficult or impossible to demonstrate, and it would be a great shame if in the aftermath of the budget we were forced to withdraw or qualify statements with elements of hyperbole in them. To determine which statements can be made with absolute confidence Peter Allum has prepared a paper for the Chancellor (which will be circulated today).

3. In the rest of this note I will not comment on all the statements on growth in your draft because Peter Allum's note will set out those that we can make with confidence. One caveat is, however, in order at this stage. With growth in 1987 very likely to be above 4 per cent we need to be wary in claiming that growth in recent years has been uniquely steady in comparison with earlier periods.

ailed pointsParagraph B3

In the fourth sentence you should note that the CSO have recently revised growth in 1984 down to 2.4 per cent. You should therefore say that growth has been "close to 2½ per cent or better".

4. The claim in the last sentence that in four out of the last five years UK growth has been the highest of the major European economies is only true if the definition of 'major' is more stringent than has been customary. For some reason the major European economies have been defined as

GDP in 1986 (\$b.)	
Germany	779
France	677
UK	653
Italy	653
Netherlands	172
Belgium	111

This list was presumably drawn up before Spain's entry into the EC. Spain's GDP was \$311b. in 1986. With Spain included UK growth has been the highest of the major European economies for two (rather than four) of the last five years. I suggest that you replace the final sentence by the following, which is consistent with the data.

In the last five years it has been [on average] the highest .

The alternative is (implicitly) to restrict the label "major" to Germany, France, the UK, and Italy. To say that the UK has grown more quickly than ~~the~~ other economies does not seem to amount to much.

Paragraph B4

Delete "investment" from the first sentence. The information currently available does not show investment growth in 1987 to be higher than expected at the time of the 1987 budget.

Paragraph B7

X I would prefer to replace "steady" with "satisfactory" in the first sentence.

Paragraph B8

✓ In the last sentence I would replace "in the 1980s" by "since the early 1980s". Chart 3.5 in the FSBR shows that the UK share of world trade in manufactures has been lower than in 1980 in the rest of the 1980s.

Paragraph B9

I suggest that you replace the existing paragraph with the following. This will almost certainly need to be redrafted again when we get the first true estimate of the invisibles surplus for 1987.

✓ Despite faster than expected domestic growth, the deficit on the current account of the balance of payments was £2½b. as I forecast this time last year, thanks to stronger than expected growth of exports .

Paragraph B11

✓ The forecast in Chapter 3 of the FSBR shows a slowdown in export growth. (See table 3.13.) You should therefore delete "healthy" in the second sentence.

✓ The final sentence about balanced growth being set to continue is odd when the preceding sentences discuss the deceleration in consumers' expenditure and the acceleration in investment. I would omit it.

Paragraph B12

I would replace this by the following.

✓ The non-oil economy, which is the main source of new jobs, should expand more rapidly, at 3½ per cent, than total GDP, though there is likely to be some easing of growth through the year. Unemployment should continue to fall, though the speed of this may well slow down from the record decline during 1987.

Paragraph B15

Until we get the revised figure for 1987, which may well have implications for 1988, the second sentence should be consistent with the current draft of Chapter 3 of the FSBR, ie with a current account deficit of c.£4½b. - 1 per cent of GDP.

Paragraph B16

I do not understand the final sentence. In addition I strongly advise against a reference to our net overseas assets, which Chapter 3 of the FSBR will show to have fallen sharply in 1987. It hardly makes sense to emphasise that we intend to draw them down further to finance a current account deficit. It is also a bit of a hostage to fortune to say "we will have no trouble financing" the current account deficit: claims such as this can easily come back to haunt us. I suggest redrafting the paragraph as follows.

This will be very much smaller than the external imbalances in the three largest economies. With the continuation of prudent policies and with the considerable international confidence in the UK economy we should be able to finance it.

Paragraph B17

Chart 3.10 of the FSBR shows that UK unit labour costs in manufacturing rose less than on average in the other major economies in 1982 and 1983, as well as (just) in 1987. You therefore need to delete the second half of the second sentence.

Paragraph B18 and B19

I suggest that you replace the existing versions with the following (agreed with Huw Evans).

The more serious dangers are in the world economic scene. GNP in the major seven industrialised countries probably rose by 3 per cent in 1987, close to my forecast in the budget last year. Healthy growth in North America, Japan and the UK offset sluggish performance in Continental Europe, especially Germany. The latest indications are that world activity remains fairly buoyant. But the stock market collapse is likely to dampen domestic demand in the US. GNP growth in the major seven countries may slow down to perhaps 2½ per cent in

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1988, but further turmoil in world equity and foreign exchange markets could lead to lower growth.

✓ The persistent large imbalances within the three industrialised countries still present a serious threat to sustained growth in the world economy. The budget deficit in the US is still much too large in relation to the rate of private saving there, and this has its counterpart in the US current account deficit. The current account surpluses of Japan, Germany and some other countries, notably Taiwan and South Korea also remain uncomfortably large. I believe that the steps....

P.N.J

P N SEDGWICK

(This page only) CONFIDENTIAL

Mr. Sedgwick

cc. Mr. Davies

Mr. Lord
Mr. Hudson

FROM: P N SEDGWICK
DATE: 25 FEBRUARY 1988

I've suggested the following drafting amendments to Mr. Hudson &

MR HUDSON meet your points on

cc Sir T Burns
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr S Davies
Mr Mowl

D12 & D18 :

D12 Add "except Japan" at end.

D18 Replace "see 1980" after "income" in second sentence. I do not think we need a worry about projecting of Japanese debt back next year.

BUDGET SPEECH 1ST DRAFT : PUBLIC SECTOR FINANCE 29/2

I have a few comments on your draft.

Paragraph D2

Will everyone realise that "last year" refers to financial year 1986-87?

Paragraph D5

Corporation tax receipts in 1987-88 are not especially above the 1987 FSBF forecast when compared with other taxes. The reduction in the basic rate in the 1987 budget - referred to in your second sentence - is irrelevant to the extent to which revenues are greater than expected at budget time. I suggest replacing the first two sentences by the following.

With the economy so buoyant receipts from income tax and VAT in the current financial year have been greater than expected. Corporation tax receipts, based on the higher than expected profits of a thriving and healthy company sector in recent years, have also outstripped expectations.

Paragraph 9

Shocks by their nature arise unexpectedly. They were, if anything, more a feature of the 1970s than 1980s so far. I would delete the last sentence.

342/2

BUDGET SECRET: TASK FORCE LIST

COPY NO. 3 OF 3

FROM: A P HUDSON

DATE: 25 February 1988

MR MICHIE

BUDGET SPEECH: TAXES ON SPENDING

Thank you for your help on this section of the Budget Speech this afternoon.

... 2. I attach the resultant redraft. Please could I have any comments as soon as possible. Please could you also fill in the blanks.

A handwritten signature in dark ink, appearing to be 'A P HUDSON', with a long horizontal stroke extending to the right.

A P HUDSON

L. TAXES ON SPENDING

L1. I now turn to the taxation of spending.

L2. The rate of Value Added Tax in 1988-89 will remain at 15 per cent.

X L3. I have one change to propose affecting the coverage of VAT. Confection^eary was brought in to VAT by the RHM for Leeds East in 1974, and the legal definition goes back further still to the days of purchase tax. It has worked less and less well over the years, as new products
X have come on to the market~~s~~. In particular, a recent
X case appears to suggest that chewy cereal bars were subject to VAT, whereas hard cereal bars were not. I propose to clarify the legislation so that both types are taxed. [Anything further on spectacles?]

L4. I propose to raise the excise duties as a whole broadly in line with inflation, but to make some modest adjustments within the total. The duty on cigarettes and hand-rolling tobacco will be increased, by the equivalent, including VAT, of four pence for a packet of 20 cigarettes. This will take effect from midnight on Thursday. The duty on a packet of 5 cigars will rise by 2 pence, but that on pipe tobacco will remain unchanged.

L5. As to the alcohol duties, I propose increases which, including VAT, will put a penny on the price of a pint of beer and cider, 3 pence on a bottle of table wine, and 6 pence of a bottle of sparkling wine. There will be no increase in the duty on spirits and fortified wines.

L6. Drinks known as 'coolers', which are mixtures of an alcoholic drink and a soft drink, have become more popular in recent years. The duty on those based on beer and wine is broadly in line with the duty on the basic product. But the duty on those based on spirits is higher than can be justified. I propose to reduce it by [something or other] from 6 o'clock tonight, and also to reduce the duty on non-alcoholic beer.

L7. I propose to leave the main rates of Vehicle Excise Duty unchanged. But I shall be introducing a new special tax class for a small category of very large and heavy vehicles. These juggernauts cause a significant amount of wear and tear on the roads, but currently pay a concessionary rate of duty. The excise duty for these vehicles will go up to £1600 this year [from what?], and next year to a level which corresponds with the maximum rate of duty paid by other heavy good vehicles. There will also be some minor adjustments to the rates of duty within the HGV classes.

L8. To recoup the revenue forgone by holding VED steady, I propose increases in petrol and derv over and above revalorisation, which, including VAT, will raise the price of petrol by about 6 pence a gallon, and that of derv by 5 pence a gallon.

x L9. It is clear that more widespread use of unleaded petrol can only be of benefit^{to}_h the environment. Unleaded petrol costs more to produce than leaded fuel. As a result, up to now, few cars have been converted to take the unleaded fuel and the petrol companies have done little to promote its use. This chain needs to be broken.

L10. To encourage wider use of unleaded fuel, I therefore reduced the duty on it by five pence a gallon, in my Budget last year. This went some way to offset the higher production costs. I now propose to complete the job, and to double the duty differential between leaded and unleaded petrol to 10 pence, by simply exempting unleaded petrol from this year's duty increase. This means that the pump price of unleaded petrol [is it 4 star or what?] should be no more than that of ordinary 2 star petrol. This removes the supposed bar to the use of unleaded petrol. I hope the petrol companies will respond by promoting it as it deserves.

L11. The changes on road fuels will take effect from 6
o'clock tonight.

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Copy No 1 Of 6

CHANCELLOR

FROM: A G TYRIE

DATE: 26 FEBRUARY 1988

cc Mr Hudson
Mr Cropper
Mr Call**BUDGET SPEECH**

Withful thinking. AMH

I have now had a chance to read through Andrew Hudson's draft of 19 February carefully. I think it is excellent. We are nearly there already! The attached Annex gives some detailed drafting points which you can probably leave Andrew to handle and many of which I think he's spotted.

I have one general point about the conclusion. As I have mentioned before, the speech is in danger of having a little too much finality about it. The rates, everything at 25% or 40%, give that impression, even though this is diluted a little by your commitment to 20 pence.

Might it be worth having a paragraph or two in the peroration which make three related points:

- i. The task of tax reform and simplification is by no means complete. The objectives of further simplicity, further reductions in taxation when they are prudent, and the further removal of distortions to economic activity will guide us in our third term and beyond.

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ii. It is increasingly accepted that these principles accord with the wishes of people and the needs of the economy.

They are in stark contrast to the principles which lay behind the tax system we inherited, driven by misplaced notions of social engineering, and a misunderstanding about the relationship between the tax system and productiveness of the economy. Those principles led to the hopeless complexity, the absurdly high rates, the distortions and the injustices of the tax system of a decade ago.

iii. The budget announces both tax reductions and tax reform. But these measures, important though they are, do not stand alone. They form part of and complement the further set of supply side measures set out in our Manifesto. Taken together these measures offer the best prospect of sustaining the virtuous circle in our third term and beyond: of reducing taxes while maintaining yield, and of reducing the burden on individuals and businesses which spur further investment and growth.

Contrast with '79 tax system worth thinking about, both the overall structure, and as it affects the man in the street: much lower rate/higher allowance; and much simpler (MIRAS, LAPP, composite rate for banks etc.)

pp Rg.
A G TYRIE
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~~BUDGET SECRET: BUDGET LIST ONLY~~**BUDGET SECRET
BUDGET LIST ONLY****NOT TO BE COPIED****ANNEX: SOME DETAILED SUGGESTIONS ON 19 FEBRUARY DRAFT**

(Underlinings are drafting suggestions)

For next draft?

B6. Third sentence 'and our supply side policies have reduced the burdens which held British industry and individual enterprise in check for far too long'.

Ditto?

B7. I would itemise the number of years over which new jobs have been created. I think it is five.

Done.

B11. Last sentence. I would either remove 'balanced growth is set to continue', or explain what is meant. At present it reads as if, despite a shift in the balance between consumption and investment, somehow, that same balanced growth is set to continue!

Next draft?

B13. Line 4. Rather than 'inflation ... crept up to just under 4.5%', I would say simply 'inflation ... rose to just under 4.5%'.

Dropped.

B16. Penultimate line. Rather than 'as British firms start to repeat their success as exporters' I would say 'as British firms build on their success as exporters ...'.

Done.

D3. Line 5. Instead of saying that the borrowing requirement has vanished I would point out that it has been replaced by the 'public sector debt repayment'.

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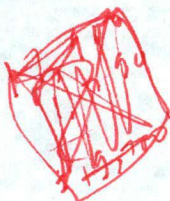
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Done. F7. Rather than say that we're abolishing the married man's allowance, I think it might be better to say that we are replacing it. During the election we made much of Labour's commitment to abolish the married man's allowance. I would have thought it better not to give them even a chink of light.

Done. G15. On Section 482 the main bull point to get across is that we are removing the criminal penalty.

? H2. At present the text reads 'I have argued that CGT should apply only to real gains, and not paper gains'. I think paper gains means accruals. I would replace the word paper with inflationary.

Done. K13. I would itemise the yield individually for maintenance payments and covenants. It is important to stress that we're not getting or losing much from the maintenance reform.

Recast M24. I would shorten this considerably. I don't think we can justify the removal of MIR for home improvement loans on the grounds that it is a kick in the teeth for double-glazers.

Now N 36

Para M38. If we raise the basic rate threshold by 10% we slip the higher rate move to £20,000 (also 10%) through on the rails, and make it a little less a sore thumb.

I'm still not happy with this para, anyway. An AGT says, as you said on Monday, if we can do 10%, presentation is easier.

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BUDGET SPEECH: NOT USED

P1. Mr Deputy Speaker, I have presented to the House an economic success story that would have been unimaginable a decade ago.

P2. That success owes much to the prudent policies I have reaffirmed today. And it owes much to the tax strategy we have pursued, year in year out, for the last nine years.

P3. It is a strategy with two elements: tax reduction and tax reform.

P4. For most people, most of the time, the main thing wrong with taxes is that they are too high. So we have reduced the basic rate of income tax from a third to a quarter. And I intend to go further.

P5. But essential as it is, tax reduction is not enough. There are areas of the tax system that are crying out for reform.

P6. In this Budget, I have swept away four higher rates of income tax and three rates of inheritance tax. I have abolished entirely the taxation of paper capital gains.

I have left no rate higher than 40 per cent in the whole of the personal tax system.

P7. I have announced the most far-reaching reform of the taxation of married women for 180 years. And I have done away with the tax penalties on marriage.

P8. I have taken the taxman out of relations between parents and students and, so far as possible, out of the divorce court.

P9. And I have abolished two more unnecessary taxes.

P10. The way of reform is always difficult. But it is the way to free the energies of the British people. We have done it before, and we have shown that it works.

BUDGET SPEECH : NOT USED

Q. CONCLUSION

Q1. Mr Deputy Speaker, in the first Budget of this Parliament, I have been able to repeat and indeed surpass the achievement of last year. Following a substantial increase in public spending last Autumn, I have reduced borrowing, so that the budget is in surplus and reduced tax rates.

Q2. Not so long ago, Governments were glad to be able to do two or even one of those things. To have done all three, for a second year in succession, is unprecedented.

Q3. Not so long ago, real growth was not even half the rate of inflation. This year, it has exceeded it. And unemployment has fallen faster than at any time since the War.

Q4. These achievements are based on the Government's sound financial policies, pursued over nine years, and the liberation of the economy, through lower and better taxes.

Q5. This Budget builds on these policies. It is a tax reform budget - and a balanced budget. I commend it to the House.

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COPY 2 OF 3

FROM: A.P. HUDSON

DATE: 26 February 1988

CHANCELLOR

BUDGET STATEMENT: SECOND DRAFT

1. I attach the second draft of the complete Budget Speech.
2. As we agreed, I have concentrated this week on the tax section. I have ~~not~~ done very little polishing on the ~~tax~~ sections B-D, and the Introduction and Conclusion are only cockshies. (Indeed, on the Economic Section, I haven't had time to argue the toss with Peter Sedgwick about some of his comments, which seem designed to make the speech as downbeat as possible!)
3. I haven't taken in your ~~view~~ point about "caution not meaning immobility", because I couldn't see quite how best to do it.
4. Section H (Covenants and Maintenance) is obviously more provisional than most. It's basically a Michael Scholar's draft now, and I enclose his minute which explains his thinking, plus John Lucas's characteristically prompt comments.
5. Very roughly this could be 1½ hours worth.
6. I've not copied this draft round, because it's clearly better to wait for your version after the weekend. Perhaps we can have a word on Monday about when we want comments by etc.

AHH

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Draft of 26 February

CHANCELLOR OF THE EXCHEQUER'S BUDGET STATEMENT**15 MARCH 1988****INDEX**

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J		TAXES ON SPENDING
K		OWNERSHIP
L		CAPITAL GAINS TAX
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N		INCOME TAX
P		PERORATION ON TAX REFORM
Q		CONCLUSION

A. INTRODUCTION

A1. As I present the first Budget of this Parliament, I am struck by the contrast with the settings for the initial budgets of our previous two parliaments.

A2. In 1979, we were faced with double-digit inflation that seemed endemic. We had not only to conquer that but also to restore the enterprise culture to a country which many thought had lost it forever.

A3. By 1984, our success against inflation was clear, and the first signs were showing through of the vigorous growth and rising employment that our supply side reforms had unlocked. The task was to turn this recovery into lasting economic success.

A4. Now in 1988, we are now entering our eighth successive year of steady growth, and the sixth in which this has been combined with low inflation. Last year saw the largest fall in unemployment since the war.

A6. These successes have not been achieved easily. They have required the resolute pursuit of firm financial policies, coupled with reforms to make the economy work better.

A6. I reaffirm those policies today.

A7. I shall begin, as usual, by reviewing the economic background to the Budget. I shall then deal with Monetary Policy, and the public finances this year and next. Finally, I shall propose a number of measures of tax reform, designed to build on the economic success that is already so evident.

A8. As usual, a number of press releases, filling out the details of my tax proposals, will be available from the Vote Office as soon as I have sat down.

B. THE ECONOMIC BACKGROUND

B1. I start with the economic background.

B2. 1987 will be remembered for the worldwide collapse in equity markets in October. Dramatic as that was last autumn, we can now begin to see it in a longer perspective. As I suggested at the time, its impact has been more limited than many people suggested. In many markets, the falls in share prices did little more than reverse the rapid rises that had taken place earlier in the year. And, business confidence does not seem to have been much affected.

B3. In spite of the dramas in the financial markets, the UK economy in 1987 built on and indeed surpassed the strong performance of previous years.

B4. The growth rate looks to be turning out to be something over 4 per cent. This is the best performance since 1973, and bettered only three times since the War. And whereas 1973 was a freak sudden spurt, that contained the seeds of its own undoing, 1987 can be seen as a year of slightly above-average growth within a steady upward trend. In each of the last five years, the growth rate has been close to $2\frac{1}{2}$ per cent or better - something we have not achieved since the War. During both the 1960s

and the 1970s, Britain's growth rate was the lowest of all the major European economies. During the 1980s, it has been the highest.

B5. Growth in 1987 turned out significantly faster than expected, [with exports, and consumer spending all rising faster than expected]. Inflation, however, turned out broadly as forecast in last year's Budget, averaging just over 4 per cent.

B6. 1987 was thus the first year since 1964 in which real growth exceeded retail price inflation - something many people thought the British economy would never see again.

B7. The plain fact is that the economy has been transformed. Our financial policies have given the private sector the room and confidence to expand. And our supply-side policies have reduced the burdens which held British industry in check for far too long. This has brought a step change in the efficiency, enterprise, and adaptability of all sectors of the economy.

B8. The combination of steady growth and low inflation, which eluded previous Governments for decades, has now been with us throughout the past five years. And in 1987, the rapid growth of new jobs, which has been going on for a number of years, fed through into a fall of half a million in the numbers of people out of work.

Unemployment fell in all regions. And the proportion of the workforce unemployed has fallen by a bigger margin than in any other major country.

B9. As I predicted a year ago, the performance of manufacturing industry was outstanding, with output up $5\frac{1}{2}$ per cent. Once again, the success of manufacturing was founded on a sharp improvement in productivity. Since 1979, output per head in manufacturing has gone up faster here than in any other major industrial country. We continued to lead the way in 1987 - a stark contrast to the 1960s and 1970s when in this, as in so much else, we were bottom of the league. British manufacturers have maintained their share of world trade since the early 1980s, after decades in which it fell constantly.

B10. Although growth in 1987 was significantly faster than I expected, the strong export performance means that the deficit on the current account of the balance of payments was [precisely in line with the forecast of £2½ billion], which I made this time last year. This largely reflects the extent to which growth in the UK outpaced other countries.

B11. Looking ahead to 1988, I expect another year of healthy growth with low inflation.

B12. Output is forecast to rise by 3 per cent, more or less in line with the steady trend of recent years.

Exports should continue to rise, though probably not as high as in 1987, when our non-oil exports grew by 7 per cent, and manufacturing exports by 9 per cent. Consumer spending is likely to grow rather more slowly than in 1987. By contrast, surveys suggest that business investment is set to be much stronger.

B13. The non-oil economy, which is the main source of new jobs, should expand more rapidly than total GDP, at a rate of $3\frac{1}{2}$ per cent. [There is likely to be some easing of growth through the year. Even so,] There is every prospect of that unemployment will continue to fall [though the speed of this may slow from the record decline in 1987].

B14. Whereas growth in 1988 is likely to turn out slightly stronger than I forecast in the Autumn Statement, inflation should be a little lower. Inflation, as measured by the RPI, crept up to just under $4\frac{1}{2}$ per cent in the third quarter of last year, but has since fallen back to under $3\frac{1}{2}$ per cent. These fluctuations largely mirror fluctuations in the mortgage rate, and the prospect is that the underlying inflation rate should stay at around 4 per cent during 1988.

B15. Our recent record of sustained low inflation is impressive, when compared with the UK's earlier experience at times of rapid growth. But many of our major competitors have still lower inflation rates, and

getting inflation down continues to be my top priority. Under the last Labour Government, inflation averaged over 15 per cent. In our first Parliament, we got it down to just over 11 per cent. In our second Parliament; it was a little under 5 per cent. I am determined to get it lower still in the third term, and, in due course, to eliminate it altogether.

B16. The UK is again likely to grow faster than most of the other major countries in 1988. In particular, growth in Europe, which is increasingly the most important market for UK exports, is likely to remain sluggish. With our surplus on oil trade falling as North Sea oil output falls, the current account deficit may increase to some £4½ billion in 1988, around 1 per cent of GDP.

B17. This will be very much smaller than the external imbalances elsewhere. With the continuation of prudent policies and with the considerable international confidence in the UK economy, we should be well able to finance it. The deficit will diminish, when the rates of growth here and overseas come back into line.

B18. The prospects both for exporters and for a further fall in unemployment, will depend crucially on employers keeping their costs firmly under control. Unit labour costs in manufacturing hardly rose at all in 1987, after three years of increasing significantly faster than our competitors. It is vital that employers do not let this

slip, and keep a tight grip on costs, and in particular pay costs.

B19. However, the more serious dangers lie in the world economic scene. Growth in the major seven countries was around 3 per cent in 1987, close to what I forecast in the Budget last year. Healthy growth in North America, Japan, and the UK offset a sluggish performance in Continental Europe, especially Germany. And the latest indications suggest that activity remains fairly buoyant, though the stock market collapse is likely to dampen demand in the US. I expect growth in the major seven countries to be around $2\frac{1}{2}$ per cent in 1988, slightly slower than this year.

B20. But the prospect of sustained growth is an uncertain one, given the persistent large imbalances within the world economy: the huge budget deficit in the United States; and the US current account deficit, which has its counterpart in the surpluses in Japan, Germany, and other countries. The steps that have been taken to reduce these imbalances are the right ones, and they are starting to bear fruit. But there is a long way to go. And there is the constant danger that the process of adjustment -which may well be slow - will be damaged either by further gyrations in the value of the dollar, or by a slide into protectionism.

B21. That is why I believe the best environment for a sustained reduction in the imbalances, and indeed for healthy growth in the world economy, is one of greater exchange rate stability. That is the best climate for companies, including, of course, British companies, to plan ahead and invest. And it saves them spending precious time on exchange rate management.

B22. I explained in a speech to the International Monetary Fund in Washington last September, and again in the House in January, the case for a flexible system of managed floating, and for making exchange rates the focus of policy co-ordination. The aim is greater stability in exchange rates, and in the dollar in particular, coupled with the ability to manage any changes that may be necessary in an orderly way. This was the objective of the Louvre agreement, and of the G7 agreement in December. And whereas the dollar fell over 30 per cent against the Deutschemark in the eighteen months before the Louvre agreement, it is now within [8 per cent] of the level at the time of the Louvre.

B23. Success in achieving these objectives depends, in the end, on countries' putting the right fiscal and monetary policies in place, and keeping them there. That process will be a great deal easier if it is conducted, as it has been, in a framework of international co-operation. I can assure the House that we shall be playing our full part.

B24. Provided there are no new shocks in the world economy, and that the risks at home are contained, there is every reason to expect that the combination of steady growth and low inflation, which we enjoyed throughout the last Parliament, will continue throughout this Parliament and beyond.

C. MONETARY POLICY

The job for the Government is to maintain the steady and cautious financial policies which we have now pursued for nearly nine years, and which have brought the British economy to the very strong position I have described. Sound money and strong public finances will again provide the essential framework for steady growth with low inflation, and will keep us in the best possible position to weather any shocks we may face, at home or abroad - just as in the past we were able to take in our stride [the Falklands conflict], the coal strike, and the collapse of the oil price.

C2. The Medium-Term Financial Strategy will continue to provide a framework for reducing the growth of money GDP, and hence inflation, over the medium term. It also provides businesses with the stability they need to plan ahead with confidence.

C3. The objectives of the MTFS will be achieved by maintaining firm monetary discipline, buttressed by a prudent fiscal stance.

C4. An important element in this is maintaining a stable exchange rate, with the rate against the Deutschmark of

particular importance. [Over the past year, this has given a new focus to monetary policy.] [We have achieved this over the past year, despite market pressures on sterling and despite renewed instability in the dollar towards the end of 1987.] This gives businesses the stability they have asked for. And it provides a firm anchor for bringing inflation down over the medium term.

C5. [For much of 1987, maintaining a stable exchange rate meant, in practice, resisting pressure for sterling to rise. But let me make absolutely clear that I would resist downward pressure, if that were to emerge in response to domestic cost pressures, with equal determination.]

C6. Achieving these objectives implies a reduction in monetary growth in the medium term. This is shown in the declining ranges shown for the narrowest measure of money, MO, in the MTFS. The target range for 1988-89 is [1-5 per cent, as shown in last year's MTFS] OR [2-6 per cent, the same as for last year, with a 1-5 per cent illustrative range for 1989-90]. I shall also continue to take account of the growth of the broad money and liquidity, particularly those that include the liabilities of building societies as well as banks. But as last year, there will be no explicit target. [Possible reference to revised funding rule.]

C7. Short-term interest rates remain the essential instrument of monetary policy. I will continue to vary them as necessary, on a continuous assessment of monetary conditions, to ensure that inflationary pressures are not accommodated.

C8. A firm monetary policy has brought inflation down to a level not seen for 20 years, and kept it there. Progress towards the ultimate objective of stable prices is unlikely to be steady, and its timing cannot be predicted - not least because it depends in part on events beyond our shores. [But by setting the strategic objectives we have, and operating policy to meet them, we are certain to achieve that goal.]

C9. The essence of the policy I have described is non-accommodation. If businesses allow their costs to rise too fast, I shall not allow sterling to fall to enable them to remain competitive. That would be a surrender to inflation. The track record shows that we are ready to take prompt action whenever it is necessary to do so. That policy has stood us in good stead. I reaffirm it today.

D. PUBLIC SECTOR FINANCES

D1. As I have said, a firm monetary policy has to be buttressed by a prudent fiscal stance.

D2. At one time, it was regarded as the hallmark of good housekeeping for a Government not to spend more than it raised in taxes. Over the years, less and less attention was paid to this, until, in 1975-76, the last Labour Government borrowed what, in today's terms, would amount to [nearly £40,000 million.]

D3. This profligacy not only forced us to ask the IMF to bail us out. It also stored up an enormous burden of debt interest, for which the nation is still paying the bill.

D4. That is why, when we came to office, one of our main objectives was to bring down Government borrowing. We have reduced the Public Sector Borrowing Requirement from around 5 per cent of GDP at the start of the 1980s, to around 3 per cent by 1983, and to 1 per cent in 1986-87. Today, I am able to report to the House that I have brought this process to its logical conclusion - a balanced budget.

D5. The budget in 1987-88 looks, in fact, to have been in surplus by some £3 billion - something achieved on only one previous occasion since the early 1950s. Instead of a public sector borrowing requirement, we have a public sector debt repayment, instead of the PSBR, the PSDR. Even excluding privatisation proceeds altogether, the PSBR of [$\frac{1}{2}$ per cent of GDP] is also lower than in all but one year since the early 1950s.

D6. This is an excellent outcome. It is the fruit of a consistently cautious fiscal stance, eight years of firm control of public spending; and the strong and vigorous economy that has resulted. It is thus not a one-off achievement in an exceptional year, but something we can be confident of holding on to.

D7. Corporation Tax receipts, based on the buoyant profits of a thriving and healthy company sector, are ahead of forecast. Revenues from Income Tax and VAT have also been greater than expected. And North Sea revenues are up because the oil price was higher than expected.

D8. The continued strength of the economy has also helped to ensure that public spending has remained within plans. Lower unemployment has kept down social security spending. The trading performance of the nationalised industries has improved. And the capital receipts of local authorities and new towns have been buoyant. So I now estimate that the planning total for 1987-88 will be

[£147.4] billion, about £1 billion lower than projected in the Public Expenditure White Paper in January.

D9. Looking ahead to 1988-89, I have to remind the House that I have already announced, in the Autumn Statement, an increase of over £4½ billion in public expenditure programmes. This has enabled us, in particular, to increase our plans for spending on the Health Service by £700 million, on education and science by over £600 million, and on law and order by over £350 million, while ensuring that public spending continues to fall as a percentage of GDP. I also announced a corresponding increase of £6 billion in programme spending in 1989-90.

D10. I also need to have regard to the tax burden. The buoyancy of the tax revenues means that, leaving aside the oil sector, total taxes and national insurance contributions have risen as a share for GDP for two years in succession. The tax burden thus remains at much the same level as it was 3 or 4 years ago, and nearly 4 percentage points higher than when we took office.

D11. But strong as the case is for lower taxes, the factor that has weighed most heavily with me in setting the PSBR for the coming year is the need to maintain a prudent and cautious fiscal stance. [This buttresses a sound monetary policy in keeping downward pressure on inflation. It creates more room for the private sector to borrow, invest, and grow. It leads to permanently

lower debt interest payments, so represents an investment for future years. And it gives room for manoeuvre in the event of shocks.]

D12. I have therefore decided to provide for a budget surplus, a PSDR, of £3 billion, the same as this year's expected outturn.

D13. A balanced budget is a sound discipline for the medium term, too. I have therefore projected a PSBR of zero in the remaining three years of the MTFS. This is equivalent to a PSBR, excluding privatisation proceeds, of 1 per cent of GDP, [the level which I said last year was the appropriate destination for policy]. I have been able to reach that destination earlier than I expected. [As privatisation receipts reduce, as they are bound to do, I intend to stick to a PSBR of zero as the norm. Inevitably, there will be fluctuations, on either side, but these should be kept to within 1 per cent of GDP.]

D14. A balanced budget represents security for the present and an investment for the future. No other major industrial country is in balance, let alone in surplus. And even if we had no privatisation proceeds at all, our budget deficit would still be lower than in all the major seven countries, except Japan.

D15. I have to tell the House, however, with considerable regret, that the prudent fiscal stance I have adopted for

1988-89 means that there will be no scope at all for reducing the tax burden next year. I therefore expect taxes, outside the oil sector, to remain steady as a share of national income.

D16. However, the strength of the economy means that I shall still have some room to reduce tax rates.

D17. The plain fact is that sound policies, pursued consistently over a number of years, have established a virtuous circle in our public finances.

D18. The reductions we have achieved in borrowing and public spending as a share of GDP, coupled with lower tax rates, have created the room for the private sector to expand. This expansion has generated higher output, higher profits, and higher incomes, and hence higher tax yields. This in turn has created scope for lower borrowing, and lower tax rates -indeed, the latter become necessary simply to prevent the tax burden rising, because of the buoyancy of revenues. And so the circle goes on.

D19. On the expenditure side, lower borrowing has reduced the debt interest we have to pay. Debt interest now accounts for over half a percentage point of GDP less than it did only three years ago. This is equivalent to a saving of nearly £3 billion each year. And the pattern of borrowing I have set out in the MTFs should bring ~~of~~ a

further saving of £2½ billion a year, by 1990-91. This means that, within any given total for public spending, there can be higher spending on programmes. And the continuing search for value for money - the equivalent in the public sector of the supply-side reforms in the private sector - means that more can be achieved for a given amount of spending.

D20. No other major country has achieved falling debt interest payments. They have all seen increases in public sector debt relative to national income over the 1980s, compared with our falling debt income ratio. [In one or two cases there is a risk of a vicious circle developing: more borrowing raises interest payments, and hence more borrowing still is needed just to service the debt. Our virtuous circle stands in sharp contrast.]

D21. This virtuous circle is a cause for satisfaction. But it is certainly no cause for complacency. It took several years to repair the damage done to the public finances by previous governments. But it would take next to no time to slip out of the virtuous circle, if we were ever to abandon the policies that put us there.

D22. This Government has consistently pursued prudent financial policies for the best part of a decade. And the plans I have just announced, which now extend well into the next decade, enshrine the epitome of financial prudence - the balanced budget.

E. TAX REFORM

E1. Sound finance is the essential foundation for a successful economy. But by itself, it cannot create economic growth or more jobs. That depends on markets that work properly, on businesses that show enterprise and take risks, and on the hard work and effort of the individuals who work for them.

E2. That is why the reforms we have made - and are continuing to make - of the supply side of the economy are so crucial. Privatisation, and reducing the burdens on businesses, have played a vital part in the transformation of the British economy. And so has tax reform.

E3. Nine years ago, in the first Budget of this Government's period in office, my predecessor set this country on the right road - the road of tax reduction and tax reform. He ended the penal taxation of incomes and started us on the way to an acceptable basic rate.

E4. The British people responded as we always knew they would. And the evidence is there for all to see: the richest 5 per cent of taxpayers now contribute a higher proportion of income tax revenues than when they were taxed at penal rates.

E5. Four years ago, in the first Budget of the second Parliament of this Government, I turned my attention especially to business taxation. I announced a radical overhaul of the taxes on companies.

E6. And they, too, responded as we always knew they would. British business, indeed, has never looked back. I gave companies one of the lowest tax rates in the world, and they responded with the best performance for the best part of a generation.

E7. The reforms I introduced in my first Budget are now being emulated around the world.

E8. Today, I have further improvements to make in business taxation. But the main structure has stood us in good stead, and I intend to leave well alone.

E9. The main focus of the reforms I shall announce today is on personal taxes.

E10. And first the taxation of married women.

F. INDEPENDENT TAXATION

F1. The present system for the taxation of married couples goes back 180 years. It taxes a married woman's income as if it belonged to her husband. In the last part of the twentieth century, that is simply not acceptable.

F2. There has been extensive consultation on this subject. The time has come to take action.

F3. I therefore propose a major reform, with three objectives. First, to give married women the same privacy and independence in their tax affairs as everyone else. Second, to end the tax penalties that can arise on marriage. And third, to ensure that the tax system continues to recognise marriage.

F4. I have decided to introduce, at the earliest possible date of April 1990, a completely new system of Independent Taxation.

F5. Under the new system, a husband and wife will be taxed independently, on the whole of their income. The married man's allowance and wife's earned income allowance will go, and all taxpayers, male or female, married or single, will start with the same personal

allowance, which will be available against income of all kinds, whether from earnings or savings.

F6. Married women will pay their own tax, irrespective of their husbands' income, and they will be able to fill in their own tax return, when one is necessary. [Married women who wish to ask their husbands to continue to handle their tax affairs will, of course, be free to do so, provided they sign any tax returns themselves.]

F7. If nothing else were done, there would be no recognition of marriage and, all married couples would see a substantial fall in their tax threshold. I am therefore introducing a new married couple's allowance, equivalent to the difference between the married man's allowance and the single allowance. This new allowance will go in the first instance to the husband, so that his tax threshold does not fall. But if he does not have enough income to use it in full, his wife will be able to set any unused portion against her income.

F8. A husband and wife will also be taxed independently on their capital gains, with an annual exemption each, instead of one between them, as now. But transfers of capital between husband and wife will continue to be exempt from both capital gains tax and inheritance tax.

F9. This new approach will give complete privacy and independence to married women, for the first time in the history of income tax. And it combines this with continuing recognition of marriage in the tax system.

F10. The new system will start considerably earlier than would have been possible for most of the other reforms that have been put forward, in particular transferable allowances. The legislation will be in this year's Finance Bill.

Penalties on marriage

F11. I mentioned a few moments ago the tax penalties on marriage. It is clearly absurd that some couples should find themselves paying more tax, simply because they get married. I propose to put that right.

F12. Independent taxation by itself will remove the most common tax penalty on marriage - the taxation of a married woman's savings income at her husband's tax rate. I am also introducing measures to tackle the other tax penalties, and these can take effect in advance of Independent Taxation.

F13. The biggest problem comes with mortgage interest relief. An unmarried couple can get twice as much relief as a single person or a married couple, and that has

attracted increasing - and justified - criticism. I am putting a stop to it from August this year. In future, the £30,000 limit on relief will be related to the house or flat, irrespective of the number of borrowers. This was the solution put forward in the 1986 Green Paper on Personal Taxation, and it was generally welcomed. Existing mortgages, however, will be unaffected.

F14. A further anomaly is that an unmarried couple with two children can each claim the Additional Personal Allowance, and thus get more tax relief than a married couple in the same position. I therefore propose to restrict the Additional Personal Allowance to one per couple. This will take effect from April 1989.

F15. This Budget will eliminate, for all practical purposes, the tax penalties which can arise on marriage.

F16. The reform I have described gives married women privacy and independence in tax for the first time. And it does so in a way which continues to recognise marriage, and eliminates the penalties against it.

G. BUSINESS TAXATION

G1. I turn now to business taxation.

G2. The major reform of business taxation, which I introduced in 1984, has given us the lowest Corporation Tax rate of any major European country. This has encouraged overseas companies to invest in Britain, and has improved the quality of investment by British firms. And it is a crucial part of an environment in which company profits, leaving aside the oil sector, have risen to the highest level since 1973. This has left companies in a very healthy financial position, despite the strong growth of business investment.

G3. I do not therefore propose any major changes to the Corporation Tax regime this year. The main Corporation Tax rate for 1988-89 will be unchanged at 35 per cent.

G4. I have three changes to propose for businesses in particular sectors.

G5. First, North Sea companies are making an impressive recovery from the oil price collapse of 1986. Since we reformed the tax regime for new offshore oil fields in 1983, a new generation of fields has come into being, in

the Southern Basin and onshore. Many of these are highly profitable, and there is no reason for an overall reduction in tax. But I have decided to restructure the burden. My Rt. Hon. friend the Secretary of State for Energy will therefore shortly be bringing forward legislation to abolish royalties, from 1 July, for all Southern Basin and on shore fields developed after April 1982. At the same time, I propose to reduce the PRT oil allowance for these fields to 100,000 tonnes per chargeable period.

G6. This reform will mean an end to royalties for all future fields. Tax will be more closely related to profitability. It will help to keep up the pace of our oil and gas activity, which will also benefit the offshore supplies industry.

G7. Second, Building Societies. The 1986 Building Societies Act gives Building Societies the power, to convert to become companies, if they wish. At present, however, they would face a heavy, and unintended, tax charge if they did so. I propose to rectify this.

G8. Third, I propose two changes to the tax arrangements for Lloyd's. One meets a point Lloyds have raised on last year's legislation on reinsurance to close. The second will simplify the administrative arrangements for taxing Lloyds members. These changes will help to ensure

that the system for taxing Lloyds is effective but also takes account of the special features of Lloyds.

G9. British exporters have done extremely well in recent years, thanks to major improvements in efficiency and quality. But no exporter could honestly claim that his success hinged on the anomaly that the cost of entertaining overseas customers remains tax deductible, whereas business entertainment generally is not. And the same relief applied, of course, to import agents entertaining overseas suppliers. There is absolutely no case for this special treatment. I therefore propose to simplify matters, by making all business entertainment non-deductible, for tax purposes.

Section 482

G10. The very low rate of Corporation Tax gives companies every incentive to take risks and make profits. But we need to make sure that, once those profits are made, the due tax is paid. With this in mind, I have reviewed the provisions governing company residence and migration under Section 482 of the Income and Corporation Taxes Act 1970.

G11. The present rules are discretionary, uncertain, and can be exploited. I propose a new regime which will be simpler and more objective.

G12. For the vast majority of companies, the residence test will be simply whether they are incorporated here. The small number of companies which are not incorporated in the UK, but are centrally managed and controlled here, will also be deemed to be resident. Companies wishing to migrate will be able to do so, provided they pay their tax first. This will end the need for companies to seek Treasury consent before they migrate, and the criminal penalty they face if they do not comply.

[G13. These measures will safeguard a very substantial amount of revenue.]

Capital Duty and Unit Trust Instrument Duty

G14. I have one proposal to announce affecting the cost of finance for companies

G15 At present, companies have to pay a 1 per cent duty whenever they raise new capital - whenever, for example, a new company is formed or an existing company makes a rights issue. This is anomalous on two counts. It is a burden on companies who need to secure external finance for expansion. And it discriminates against risk capital as compared with debt finance and bank borrowing.

G16 Capital Duty was originally imposed at the behest of the European Community, and until recently we were not at

liberty to modify it. Happily, the position has now changed, and I propose to abolish this duty with effect from [today].

G17 At the same time, I propose to get rid of the Unit Trust Instrument Duty, a similar impost, which is levied at the ^{rate} ~~rate~~ of $\frac{1}{4}$ per cent on all property put into a unit trust. I know the industry will welcome this minor relief, and I trust the benefit will be fully reflected in lower charges to investors.

G18. The cost of abolishing these two duties will be of the order of £100 million in 1988-89. They bring the number of taxes I have abolished up to six.

Small Businesses

G19. The encouragement of small businesses and new businesses - which are so vital a source of enterprise, innovation, and new jobs - has been a central theme of Government policy. And the rate of business start-ups, which has averaged 500 a week since 1979, net of those which fail, shows beyond any doubt the continuing vigour of this sector.

G20. Last year, I enabled small businesses to opt for cash accounting for VAT, to help with cash flow problems, and for annual accounting, to ease the burden of

form-filling. These measures have been widely welcomed, and I have no changes to propose this year. But I shall, as usual, be increasing the VAT registration threshold so that it remains at the maximum permitted under European Community law. In 1988-89, the threshold will be £22,100.

G21. Many new and growing businesses used to find difficulty in raising equity finance. The Business Expansion Scheme, which we devised to meet that need, has now been running for nearly five years. It has been a great success, enabling new and expanding companies to raise £150 million a year, on average.

G22. The rapid growth of the venture capital market since 1983 means that companies seeking relatively large amounts of equity investment can now raise these readily. But smaller companies looking for more modest amounts can still run into difficulties.

G23. To improve the targeting of BES, I therefore propose to introduce a ceiling of half a million pounds on the amount a company can raise under the scheme. Investment will thus be better directed at the smaller enterprises and new businesses, particularly those at local level, which can still find it hard to raise finance in other ways. In the special circumstances of the shipping industry, however, the ceiling will be £[10] million.

G24. This measure is expected to save some £25 million a year.

G25. I have one further announcement affecting the BES.

G26. One of the key reasons for our economic transformation has been the reform of the supply side of the economy.

G27. As to the labour market, there is still some way to go. The tax relief I introduced last year for profit-related pay will, in time, help to increase pay flexibility. But if successful firms are to expand further, and if we are to build on the substantial reductions in unemployment, we have to ensure that people can move to where the new jobs are.

G28. For years, the shortage of private rented accommodation has been an obstacle to labour mobility. There have been increasingly frequent complaints from employers in the Midlands and the South that they can recruit the skilled workers they need from, for example, the North East, but that these workers cannot then take the jobs, because they cannot find suitable accommodation for their families.

G29. The Government's proposals to deregulate new rents are already going through the House. In future, any

landlord will be able to let on the assured tenancy basis, at market rents, but with security of tenure protected.

G30. Deregulation will, in due course, itself increase the supply of housing for rent. But this will not happen overnight, and there is a case for a special incentive to speed up the process in the early years.

G31. I therefore propose to extend the BES to include companies specialising in the letting of residential property on an assured tenancy basis.

G32. The BES is well suited to this area. Since full relief is given immediately, it should bring forward new investment straightaway, meeting the objective of stimulating interest in the early years. And we are building on success.

G33. I have decided to provide a higher ceiling of £10 million for this type of investment. But since the relief is specifically designed to provide an extra stimulus in the early years of the new regime, it will run for investments made until [April 1993]. The cost will depend on take-up, but may be some £40 million a year.

G34. This change will reinforce the impact of deregulation, in reviving the private rented sector in this country.

G35. The measures I have announced will add to the attractions of Britain as a place to do business, for firms large and small. It is up to businesses to continue to take full advantage of the opportunities that they now have.

H. COVENANTS AND MAINTENANCE

H1. I turn now to an important area of personal taxation which is ripe for reform and simplification: the taxation of payments made under deeds of covenant and maintenance payments.

H2. These payments are simply particular ways of transferring income from one person to another. Most transfers take place within families -pocket money from a parent to a child, for example -and are rightly and properly wholly outside the scope of the tax system. But, over the years, the Inland Revenue has been increasingly brought into this area, for reasons which have little to do with logic and much to do with history and accident.

H3. This involvement of the Revenue in transactions which, in principle, should be none of their concern has introduced a new knot of complexity, much of it quite unnecessary, into the tax system. The reforms I am proposing today will greatly simplify all this; will remove some lesser-known, but nonetheless offensive, tax penalties on marriage; will reduce the burden of tax on those recipients of maintenance least able to bear it; will reduce the pressure on the Courts; and will improve the incentive to work both for students and for separated and divorced women.

H4. First, covenants. With the exception of covenants to charities, I propose to take all new covenants made on or after today out of the tax system altogether. Those receiving these payments will not be liable to tax on them and those making the payments will get no tax relief on them. Existing covenants will be unaffected by this change.

H5. The largest group of people affected will be students, and their parents, many of whom currently choose to make their contributions to the maintenance grant by covenant. Those who have already made such covenants will continue to benefit from them. For students who begin their studies in the next academic year, the parental contribution to the maintenance grant will be assessed on a new, more generous, scale, reflecting the withdrawal of the tax relief on new covenants. My rhf the Secretary of State for Education and Science will be announcing the new scale later today.

H6. This reform will remove a wholly unnecessary complication from the tax system. Making the deed of covenant, and filling in the Revenue's forms, took much time and effort for the taxpayer and student alike; and a technical mistake could render the covenant legally void, and deny the recipients their tax relief altogether. The procedures were complicated and wasteful: local authorities had first to compute parental income for the means tested grant; then

restrict the student grant accordingly; parents then made their covenants; the Revenue checked the student's income; then, finally, on receipt of the necessary claim forms, sent the tax repayments to the students.

H7. It would be difficult to devise a more convoluted way of getting money in to the hands of students.

H8. My proposals sweep all these complications away, but retain the same overall level of support for students. They also greatly improve students' incentives to take part-time or holiday jobs: soon, when the old system has run out, no student will find that his or her personal allowance has all been used up by covenanted income so that tax has to be paid on the first pound of income he or she earns.

H9. Similar considerations apply to maintenance payments. The present arrangements are complex and cumbersome, and mean that the Revenue have to send tax returns to divorced and separated people whose tax affairs would otherwise be very simple. Again, there is no reason in principle why the tax system should be involved in the making of these transfers of income other than to recognise the expense of maintaining two households, where a marriage breaks down.

H10. So I am proposing that in future ex-wives or husbands receiving payments under maintenance agreements

will not have to pay any tax whatever on them. Ex-husbands or wives making these payments will, on the other hand, get tax relief on the payments that are made, up to a limit equal to [the married couple's allowance]. But, above that limit relief will stop, and there will no longer be tax relief at all for other kinds of maintenance payments.

H11. This new system will be much simpler for all concerned. It will reduce the tax burden of those who are least able to bear it, since the great majority of those who receive maintenance payments, and who will be wholly relieved of tax on these payments, are at the lower end of the income scale; and because I have set the limit on tax relief for payers at a level which will mean that the great majority of payments to divorced or separated spouses will continue to enjoy tax relief.

H12. These changes will also remove tax penalties on marriage which have given offence to many. Tax relief greatly in excess of that which is available to a married couple will no longer be available to a divorced couple who make very large income transfers between themselves; [nor will it be possible to make artificial tax-relieved transfers to their children under 18 - a privilege at present available to the non-married but not to the married.]

H13. The new provisions will protect people who are either making or receiving payments under existing Court Orders or agreements. The same protection will run for people who have already applied for Court Orders, provided these are made by 30 June.

H14. My proposals on covenants will bring a tax yield of £25 million in 1988-89 rising to £85 million the following year. The additional expenditure on student grants will be £X million in 1988-89 and £X million in the following year. My proposals on maintenance payments should be [revenue neutral] [bring a small yield in 1988-89 and 1989-90].

H15. Covenants to charities will be entirely unaffected. Indeed, I have a new measure to help charities further. The payroll giving scheme has now been running for nearly a year. I am glad that so many employers have already set up schemes, and I hope as many employees as possible will take advantage of them. In order to give further encouragement to charitable giving, and to assist the growth of the payroll giving scheme, I propose to double the limit on donations under the scheme from £10 a month to £20 a month.

J. TAXES ON SPENDING

J1. I now turn to the taxation of spending.

J2. The rate of Value Added Tax in 1988-89 will remain at 15 per cent.

J3. I have one change to propose affecting the coverage of VAT. Confectionery was brought in to VAT by the RHM for Leeds East in 1974, and the legal definition goes back further still to the days of purchase tax. It has worked less and less well over the years, as new products have come on to the market. In particular, recent cases before VAT tribunals ^{have} appeared to suggest that some chewy cereal bars ~~were~~ are subject to VAT, whereas hard cereal bars ~~were~~ are not. I propose to clarify the legislation so that both types are taxed. [Anything further on spectacles?]

J4. I propose to raise the excise duties as a whole [broadly in line with inflation] but to make some modest adjustments within the total. The duty on cigarettes and hand-rolling tobacco will be increased, by the equivalent, including VAT, of three pence for a packet of 20 cigarettes. This will take effect from midnight on Thursday. The duty on a packet of 5 cigars will rise by 2 pence, but that on pipe tobacco will remain unchanged.

J5. As to the alcohol duties, I propose increases which, including VAT, will put a penny on the price of a pint of beer and cider, 4 pence on a bottle of table wine, and 6 pence of a bottle of sparkling wine. There will be no increase in the duty on spirits and fortified wines.

J6. Drinks known as 'coolers', which are mixtures of an alcoholic drink and a soft drink, have become more popular in recent years. The existing duty structure caters satisfactorily for products based on wine, but discriminates against those based on beer and spirits. I propose, therefore, to introduce a new duty band for these low strength products. I also propose to abolish the minimum duty charge on beer, which will reduce the duty on beers with a low alcohol content.

J7. I propose to leave the main rates of Vehicle Excise Duty unchanged. But I shall be introducing a new special tax class for a small category of very large and heavy vehicles. These juggernauts cause a significant amount of wear and tear on the roads, but currently pay a concessionary rate of duty. The excise duty for these vehicles will go up to £1600 this year, from £130, and next year to a level which corresponds with the maximum rate of duty paid by other heavy good vehicles. There will also be some minor adjustments to the rates of duty within the HGV classes.

J8. To recoup the revenue forgone by holding VED steady, I propose increases in petrol and derv over and above revalorisation, which, including VAT, will raise the price of petrol by about 6 pence a gallon, and that of derv by 5 pence a gallon.

J9. It is clear that more widespread use of unleaded petrol can only be of benefit to the environment. Unleaded petrol costs more to produce than leaded fuel and this is reflected in the pump price.

J10. To encourage wider use of unleaded fuel, I therefore reduced the duty on it by five pence a gallon, in my Budget last year. This went some way to offset the higher production costs. I now propose to complete the job, and to double the duty differential between leaded and unleaded petrol to 10 pence, by simply exempting unleaded petrol from this year's duty increase. This means that the pump price of unleaded petrol should be no more than that of ordinary 2 star petrol. This removes the bar to the use of unleaded petrol. I hope the petrol companies will respond by promoting it as it deserves.

J11. The changes on road fuels will take effect from 6 o'clock tonight.

K. OWNERSHIP

K1. The spread of ownership has been one of the most remarkable features of the 1980s. Encouraged by Government policy, some 2½ million families have bought their homes. And our new proposals for personal pensions, which come in to effect in July, will give a new dimension to pension ownership.

K2. But the most dramatic change has been in share ownership. In last year's Budget, I announced the results of a joint Treasury/Stock Exchange survey of the number of shareholders in this country. This revealed that some 8½ million people - one adult in five - owned shares, about three times the number in 1979.

K3. A similar survey has been carried out this year. In spite of the stories of people cashing in their gains on privatisation shares, and in spite of the stock market collapse, the figures show that the number of shareholders has actually risen slightly to [very nearly 9 million].

K4. I have two proposals to announce today.

K5. First, Personal Equity Plans are off to a successful start. Over a quarter of a million people took out plans in 1987, and subscribed nearly £½ billion between them. To give further encouragement to this form of investment, I propose to increase the limit for 1988 from £2,400 to £3,000.

K6. Second, measures to encourage employee share ownership have featured in seven out of the last eight Budgets. As a result, the number of all-employee share schemes approved under the 1978 and 1980 Finance Acts has risen from 30 in 1979 to over 1400 today, involving well over 10,000 companies, and providing shares and options for well over 1½ million employees. The shares and options had an initial market value of nearly £3 billion.

K7. Following consultation, I propose to relax the provisions of Section 79 of the 1972 Finance Act, relating to employee shares obtained outside the approved schemes, so as to encourage the spread of these schemes.

L. CAPITAL GAINS TAX

L1. The changes we have made in the capital taxes has removed a number of disincentives to the spread of ownership. I have a number of further proposals on the capital taxes today.

L2. Throughout my time in the House, I have argued that Capital Gains Tax should apply only to real gains, and not paper ones. The indexation provisions introduced by my predecessor in 1982, and which I extended in my 1985 Budget, mean that the relatively modest inflation element in gains since 1982 is not taxed. But for assets acquired earlier, the tax falls largely on purely nominal gains resulting from the rampant inflation of the 'seventies. In other words, we have indexed away the low inflation of recent years but not the high inflation of the 70s.

L3. In principle, the indexation provisions ought to be extended back to the inception of the tax in 1965. I have examined this possibility very closely. But I have to tell the House, with considerable regret, that I have concluded that it would simply not be practicable to extend indexation so far back. That would require information about the date, price and quantity of each

acquisition and disposal since 1965. And in many cases, that information is simply not available.

L4. I have therefore decided that, for disposals on or after 6 April this year, capital gains arising before April 1982 will be exempt from tax altogether, for both individuals and companies.

L5. Taxpayers will, however, be able to use the actual acquisition cost of an asset, if that is higher than its 1982 value and thus produces a smaller gain. So there is no question of taxpayers' losing from this measure.

L6. This Budget therefore ends once and for all the injustice of taxing inflationary gains. It will thus enable taxpayers to realise investments that they have been forced to retain because they faced a high tax bill.

L7. Rebasing capital gains makes it easier to bring the taxation of gains closer to that of income. In logic, there is little difference between income and capital gains. Taxing them at different rates encourages people to base investment decisions on tax considerations, rather than economic ones. And it has lumbered the economy with much of the deadweight of a tax avoidance industry.

L8. I therefore propose a major reform. Subject to the new base date, capital gains will continue to be worked out as now, with the present exemptions and reliefs. The principal private residence will remain tax-free, and the annual exempt amount will remain at its present level of £6,600. But the indexed gain will then be taxed at the income tax rate that would apply if it were the taxpayer's marginal slice of income.

L9. At present, with capital gains taxed at 30 per cent for everybody, basic rate taxpayers are taxed more heavily on gains than on income, whereas higher rate taxpayers face a lower rate of tax. In future, the rate on income and gains will be the same. And I can reassure Hon. Members who are anxious to know what those rates will be that they will not have to contain their impatience much longer.

L10. These changes will not take effect until 6 April.

L11. Taxing capital gains at income tax rates makes for greater neutrality in the tax system. It is what we do already for companies. And it is already the practice in the USA and many other major countries. Investors will no longer waste so much time on tax planning.

L12. The saving on tax planning will be of particular benefit to small businessmen, who will be able to

concentrate their energies on the real job of making profits. I have one other CGT measure that will help them further.

L13. Capital gains tax can be a fairly heavy burden when someone sells up on retirement, and this can be a disincentive to the entrepreneur. At present, retirement relief exempts the first £125,000 of the gain from tax. I now propose to extend it so that, on top of the exemption, half of any gain between £125,000 and £500,000 will also be completely free of tax.

L14. I also propose to extend CGT rollover relief to a group of items which, I venture to suggest, will not be grouped together in any other context. They are satellites, spacecrafts, milk, and potatoes.

L15. The changes I have announced, taken as a whole, represent the biggest reform of capital gains tax since its introduction in 1965. They will sharply reduce the damaging effects of the tax, while ensuring that capital gains remain properly taxed.

[L16. Allowing for likely behavioural responses to these changes, the overall effect is expected to be an additional yield of £45 million in 1988-89, and a cost of £290 million in 1989-90.]

M. INHERITANCE TAX

M1. Small businessmen are also increasingly concerned with the burden of Inheritance Tax. There is less incentive to build up your business if you know that a lot of the proceeds will go in tax when you leave it to your children.

M2. I have already taken a number of steps to reduce this kind of effect. Two years ago, I abolished Capital Transfer Tax on lifetime gifts, and last year I made a large increase in the threshold for Inheritance Tax and reduced the number of rates from seven to four.

M3. Nonetheless, the yield of the tax has continued to mount, and this year is likely to pass the £1 billion mark. The tax is affecting more small businesses, and more ordinary people inheriting the family home.

M4. I therefore propose a reform of Inheritance Tax which will reduce the burden overall, keep more smaller estates out of Inheritance Tax, and make the system as simple as possible for those who still have to pay.

M5. In 1988-89, Inheritance Tax will be charged at a flat rate of 40 per cent. I shall thus have reduced the

number of rates from seven to one in two years. At the same time, the threshold will go up to £110,000, so that the burden is unambiguously lighter for all estates.

M6. Inheritance Tax thus becomes a flat rate tax, with a high threshold. This will reduce the number of estates liable to tax in 1988-89 by a quarter. Many more ordinary people will be able to inherit the family home free of tax. And for family businesses, the combination of 50 per cent business relief, and a tax rate of 40 per cent, means that the rate of tax is, in effect, only 20 per cent, one of the lowest among the major economies.

M7. The cost of the Inheritance Tax measures will be £100 million in 1988-89.

N. INCOME TAX

N1. Finally, income tax.

N2. I have followed with interest the press speculation about the size of the so-called giveaway that would come in this Budget, through lower taxes in general, and lower income tax in particular. Of course, the Government has no money of its own to give away. Any tax reductions are a question of taking less.

N3. There has also been a lot of speculation about the trade-off between tax cuts and public spending increases. There is no such trade-off. The plain fact is that if you have a successful economy, you can, over time, have both. And if you have a feeble economy, you can have neither.

N4. The way to a strong economy is to boost incentives and enterprise. And that means keeping income tax as low as possible.

N5. Income tax has been cut in each of the last six Budgets - [the first time this has ever occurred.] And the strength of the economy over that period speaks for itself.

N6. However, reforming Income Tax is not simply a matter of cutting the rate. I also have to look at all the various allowances and reliefs to check that they are still justified.

N7. With this in mind, I have a number of proposals to announce.

FORESTRY

N8. First, the present tax treatment of forestry has been very widely criticised. It enables mostly top rate taxpayers to shelter other income from tax by offsetting it against losses from forestry, while the proceeds from the eventual sale are effectively tax-free.

N9. This is a misuse of the tax system. But I am satisfied that special features of forestry - including the gap of up to 100 years between planting costs and the income from felling - mean that simply taxing it like any other business would create major problems.

N10. I therefore ^{re}~~prop~~ose to take commercial woodlands out of the tax system altogether. As from today, subject to transitional provisions, expenditure on these woodlands will not be allowed as a deduction for income tax or corporation tax. And receipts from the sale of trees or timber will not be taxed.

N11. It is a measure of the absurdity of the present system that this exemption, by itself, would in time bring a saving of about £10 million. But to maintain Exchequer support at roughly its present level, and to improve its effectiveness, I have agreed with my RHF's with responsibilities for Forestry and the Environment that there will be a parallel increase in planting grants under a new system. The Forestry Commission will announce the details [next week].

N12. These changes will make the tax system simpler, and the archaic Schedule B will be abolished. Assistance in the form of grants will have several advantages. It will not discriminate in favour of higher rate taxpayers. It will strengthen environmental protection, which I know is of concern to HMs on all sides of the House. It will be better targeted and better value for money. And the new regime will give the industry a sound and stable basis for future planting.

N13. The provision of benefits in kind has continued to spread over recent years.

N14. In spite of the increases we have made over the years, it is widely recognised that company cars are still massively undertaxed. Independent studies, based on figures from the AA, show that a typical company car, such as a 1.6 Sierra, is worth at least £3,000 a year to the employee. But the scale charge is only £700.

N15. This cannot possibly be justified. Indeed, the scale of the undertaxation is so great that it cannot be put right in a single year. But in a Budget when I am able to reduce tax rates, there is a strong case for a step change in the taxation of these benefits. I therefore propose to double the car scales for 1988-89.

N16. This increase subsumes the 10 per cent increase which I had already announced for 1988-89. [For 1989-90, I propose a further increase of 10 per cent, bringing the total extra yield from cars to £280 million. Even with these increases, the benefit will remain undertaxed.]

N17. The scales for the taxation of car fuel adequately reflect the value of the benefit, and I propose to leave them unchanged. [But, for simplicity, I propose to exempt car parking benefits from tax. Most are in practice already exempt on de minimis grounds.]

N18. In principle, everybody should pay tax on benefits in kind. But for practical reasons, most benefits are taxed only on directors, and employees whose earnings, including benefits, are above £8,500. This threshold has remained unchanged for many years. In the special circumstances of this year, a modest increase is justified. Otherwise, tens of thousands of people, on well below average earnings, would be taxed on their benefits for the first time, as a result of the higher scale charge for cars. I therefore propose to increase

the limit to £10,000. I do not intend to increase it again.

N19. The encouragement of home ownership remains one of the fundamental objectives of this Government. Mortgage interest relief has a crucial role to play in achieving that aim, and will, of course, remain in place.

N20. Indeed, I believe it is right to concentrate the relief on helping people to buy their own homes rather than improving properties they already own. I propose, therefore, to end tax relief for new home improvement loans taken out after 5 April. Most of these loans are used for installing fittings, such as double glazing or central heating, which simply add to the value of the property. Abolishing this relief will also remove ^{the} scope for its abuse, which, as the House will recall, was the subject of a recent report from the Public Accounts Committee.

N21. [I also propose further to concentrate mortgage interest relief on the person buying his or her own home, and to simplify the system, by ending relief for new loans for the purchase of a home for a dependent relative, or a divorced or separated spouse. Relief will, of course, still be available if the relative or spouse makes the payments directly.]

N22. Among the legacies of the years of penal top tax rates is the complicated special relief for large redundancy payments. This is no longer justified. I therefore propose a major simplification, increasing the exemption limit for these payments from £25,000 to £30,000, but abolishing the additional relief for larger amounts. By the same token, top slicing relief for lease premiums and the like will also disappear.

N23. I have a few changes to propose this year following from the recommendations of the Keith Committee. Most are designed to improve compliance, and to help the Revenue to uncover taxpayers who do not declare all their income, particularly where large amounts of tax are being lost. This measure is expected to yield £10 million in 1988-89, and more in later years. However, I propose a number of relaxations to the VAT enforcement regime, which will make life easier for businesses, while safeguarding tax revenue. Some of the penalties will be reduced from midnight tonight.

N24. Finally, I turn to income tax itself.

N25. In 1979, my predecessor announced:

"Our long-term aim should surely be to reduce the basic rate of income tax to no more than 25 per cent."

I have reaffirmed that aim on a number of occasions, and it was a key part of our Manifesto at the last Election.

N26. In my 1984 Budget I was able to redeem a Manifesto pledge at the first opportunity, by abolishing the National Insurance Surcharge. Today, I can again redeem a pledge without delay.

N27. The basic rate of income tax for 1988-89 will be 25 pence in the pound. The small companies' rate of corporation tax will also come down to 25 per cent.

N28. This reduction means that the basic rate of income tax, and the small companies' corporation tax rate, will be at their lowest level since the War.

N29. When I reduced the basic rate of tax by twopence in the pound last year, Rt. Hon. and hon Members opposite predicted that this would merely be temporary, and would be reversed - indeed would have to be reversed - after a General Election. Speaking in this House on 20 January last year, the RHM the Deputy-Leader of the Labour Party said:

"I must advise the Chancellor of something that he already knows: whichever party wins the general election, the tax cuts that he makes in this Budget will be reversed."

So far from the tax reductions in the 1987 Budget being reversed, the strength of the economy, and the buoyancy of tax revenues, mean that further reductions are necessary, simply to prevent the tax burden from rising.

N30. When they were last in office, the Labour Party introduced, ten years ago, an income tax rate of 25 per cent. It was a reduced rate, which was the marginal rate for less than 15 per cent of tax payers. By contrast, 25 pence in the pound will now be the marginal rate for over 95 per cent of taxpayers.

N31. With the basic rate at this lower level, I am taking the opportunity to simplify the system by abolishing three minor personal allowances which have been unchanged, in cash terms, since 1960: the housekeeper allowance, the dependent relative allowance, and the son's and daughter's services allowances. These are relics of a bygone age, and each allowance is worth, at most, 70 pence a week to a basic rate taxpayer.

N32. Life Assurance premium relief remains in place for policies taken out before the 1984 Budget. It has traditionally been given at half the basic rate of income tax. I therefore propose to reduce it to $12\frac{1}{2}$ per cent. But, to give life offices time to adjust, this change will not take effect until 6 April 1989.

N33. Over our period in office, we have increased the basic income tax allowances by 22 per cent more than inflation, taking $1\frac{1}{4}$ million people out of tax altogether. For 1988-89, statutory indexation provides for an increase in allowances of 3.7 per cent. I have decided to raise allowances by [twice as much].

N34. [This means that the single person's allowance will go up by £180 to £2,605 and the married man's allowance by £300 to £4,095. The single age allowance will rise by £220 to £3,180 and the married age allowance by £360 to £5,035. The higher allowances for taxpayers aged 80 and over, which I introduced in the last Budget, will also be increased by [twice the indexation amounts]. The age allowance income limit becomes £10,600.]

N35. The increases I have just announced mean that the basic personal allowances will be fully 25 per cent higher, in real terms, than they were in 1978-79, Labour's last year. The married man's tax threshold will be at its highest level for nearly half a century.

N36. Since 1983-84, the number of people paying higher rate tax has increased by over 50 per cent. This damages incentives for middle managers and others at that level of income. I therefore propose to raise the higher rate threshold by just over 10 per cent, to £20,000 of taxable income.

N37. There has been no cut in the higher rates themselves since that made by my predecessor in his first Budget, in 1979. This removed the worst effects of the absurd rates that had applied under the Labour Government and were penalising enterprise and driving talented and successful people to work abroad.

N38. In spite of that reform, the higher rates can still act as a disincentive. For example, the self-employed businessman earning £20,000 or £25,000 a year who decides to expand his business can quickly find himself paying tax at 60 per cent, if he is successful.

N39. A healthy economy cannot afford disincentives of this sort. And the need to attract and retain talented entrepreneurs and managers applies just as much now as it did in 1979. All the major industrial countries have reduced their top rates of tax in recent years. Australia, New Zealand, and India - which all have socialist governments - have done the same. Having started the process, we must not be left behind. Whereas in 1979, our 60 per cent was among the lower of the top rates, it is now among the higher ones.

N40. I have therefore decided to abolish all the higher rates of tax above 40 per cent.

M41. There will be a consequential reduction in the additional rate which applies to the income of discretionary trusts and for certain other purposes, from 18 per cent to 10 per cent.

N42. These measures will cost [£785 million] in the coming year, and [£1,680 million] in 1989-90. [But this does not take into account behavioural effects.] And it is important to note that in spite of the cuts we made in

1979, the higher rates now yield almost twice as much revenue in real terms, as they did in Labour's last year, and higher rate taxpayers pay a significantly higher share of the total yield of income tax.

N43. Even after the changes I have announced, the top 5 per cent of taxpayers will still pay around 27 per cent of the total yield of income tax compared with 24 per cent in 1978-79.

N44. We have now reduced the basic rate of income tax from $\frac{1}{3}$ to $\frac{1}{4}$. I do not intend to stop there. My aim now is to get it down to $\frac{1}{5}$ - a rate of 20 pence in the pound - as soon as I prudently can.

N45. These changes mean that income tax is being reduced at all levels, with increases in both the personal allowances and the higher rate threshold, and reductions in both the basic and higher rates. The tax reduction for a married man on average earnings in 1988-89 will be [nearly] £5 a week. The changes will take effect under PAYE on the first pay day after 14 June. They will cost £00 billion in 1988-89 over and above the cost of statutory indexation.

N46. The total cost of all the measures in this year's Budget, again on an indexed basis, is £00 billion.

P. PERORATION ON TAX REFORM

P1. Mr Deputy Speaker, I have presented to the House an economic success story that would have been unimaginable a decade ago.

P2. That success owes much to the prudent policies I have reaffirmed today. And it owes much to the tax strategy we have pursued, year in year out, for the last nine years.

P3. It is a strategy with two elements: tax reduction and tax reform.

P4. For most people, most of the time, the main thing wrong with taxes is that they are too high. So we have reduced the basic rate of income tax from a third to a quarter. And I intend to go further.

P5. But essential as it is, tax reduction is not enough. There are areas of the tax system that are crying out for reform.

P6. In this Budget, I have swept away four higher rates of income tax and three rates of inheritance tax. I have abolished entirely the taxation of paper capital gains.

I have left no rate higher than 40 per cent in the whole of the personal tax system.

P7. I have announced the most far-reaching reform of the taxation of married women for 180 years. And I have done away with the tax penalties on marriage.

P8. I have taken the taxman out of relations between parents and students and, so far as possible, out of the divorce court.

P9. And I have abolished two more unnecessary taxes.

P10. The way of reform is always difficult. But it is the way to free the energies of the British people. We have done it before, and we have shown that it works.

Q. CONCLUSION

Q1. Mr Deputy Speaker, in the first Budget of this Parliament, I have been able to repeat and indeed surpass the achievement of last year. Following a substantial increase in public spending last Autumn, I have reduced borrowing, so that the budget is in surplus, and reduced tax rates.

Q2. Not so long ago, Governments were glad to be able to do two or even one of those things. To have done all three, for a second year in succession, is unprecedented.

Q3. Not so long ago, real growth was not even half the rate of inflation. ^{Last} ~~This~~ year, it ~~has~~ exceeded it. And unemployment has fallen faster than at any time since the War.

Q4. These achievements are based on the Government's sound financial policies, pursued over nine years, and the liberation of the economy, through lower and better taxes.

Q5. This Budget builds on these policies. It is a tax reform budget - and a balanced budget. I commend it to the House.