

PO-CH/NL/0416

PART A

Part. A.

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Begins : 26/1/88
Ends : 29/3/88

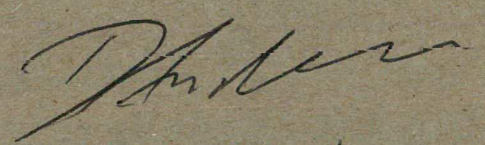
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PO CH/NL/0416
PART.A.

Chancellor's (Lawson) Papers:
Capital Allowances for Regional
Investments Grants.

PO CH/NL/0416
PART.A.

DD's: 25 year



24/1/96



the department for Enterprise

CONFIDENTIAL

The Rt. Hon. Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

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

Urgent
admin work

Department of
Trade and Industry

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/26/1

CH/EXCHEQUER	
REC.	26 JAN 1988
ACTION	FST
COPIES TO	

Direct line 215 5147
Our ref
Your ref
Date **26** January 1988

Dear Nigel,

As part of the DTI's Enterprise Initiative, grants will be available from April to independent firms with fewer than 25 employees in Development Areas (DAs) towards the cost of fixed assets which form part of an investment project.

We have of course announced the termination of Regional Development Grants (RDGs) and this new scheme represents the only replacement by way of investment support in DAs. There will be much concern in Parliament and in the regions at the ending of RDG and I expect the detail of the new scheme to be scrutinised closely. One important aspect is the tax treatment of the new grants.

RDGs are excluded from the provisions of Section 84(1) and 95(6) of the Capital Allowances Act 1968 and do not therefore reduce the cost of assets for capital allowance purposes. I believe that we should be prepared to allow the new grants the same tax status particularly as they are confined to the very small firm which needs simplicity in planning investment. We have set the grant at 15% because it is the lowest credible figure for a fixed - rate grant scheme. It is the same rate which applied to RDG. But the value of the new grant to some applicants will be substantially reduced over the period of the allowances unless period of the allowances unless we make comparable provision for tax treatment.

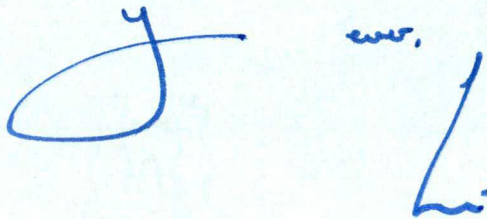
JA6ACJ

Grants for investment projects under Business Improvement Services (BIS), which might also be cited as a precedent, did not benefit from any special tax status. But the level of grant was higher (20%) and it could be given in addition to RDG.

The cost will depend on the take-up of the new grant and the tax position of the companies receiving it. It cannot be readily predicted but it will certainly be small compared with the cost of the similar provision for RDG. The new grants will not be automatic like RDG and the provision for the scheme in England is £9m for 1988-89, rising to £37m in 1990-91 when the scheme should have reached 'steady state'. By contrast the forecast for expenditure on RDG in that year, had it continued, was some £150m, and even this is far below the level of RDG expenditure a few years ago.

Special tax status for the new scheme will require provision in the Finance Bill and I am conscious that there will be the usual pressure for the inclusion of items in the Bill. However I do see this particular provision - which will merely confirm the existing tax regime but for a much smaller scheme - as important to the convincing presentation of our changes in regional policy. Committee stage for the Bill terminating RDG is due to begin on 9 February. I would like us to be in a position then to say what the tax treatment of the new grant will be.

I am copying this letter to Malcolm Rifkind and Peter Walker.



KENNETH CLARKE

SMALL FIRMS
GRANTS

ps3/60T

CONFIDENTIAL



FROM: J M G TAYLOR
DATE: 27 January 1988

pp

PS/FINANCIAL SECRETARY

GRANTS TO INDEPENDENT SMALL FIRMS IN DEVELOPMENT AREAS

The Chancellor of the Duchy's letter of 26 January has been passed to your office for action. The Chancellor has said that he would like urgent advice on this. I should be most grateful if you could arrange for this to be provided.

hgw

pp J M G TAYLOR

PWP

CONFIDENTIAL



SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

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

CH/EXCHEQUER	
REC.	29 JAN 1988 <i>29/11</i>
ACTION	FST
COPIES TO	

*BF 3/2
to M*

29 January 1988

Dear Chancellor,

I have just seen Kenneth Clarke's letter to you of 26 January, and understand that you and David Young are planning to discuss the tax treatment of the proposed Regional Investment Grant (RIG) at a meeting today.

I share Kenneth's view that the tax treatment of the proposed RIG should be the same as the present tax treatment of Regional Development Grant. Kenneth cited a number of reasons in his letter, and I would only add that, in the context of the passage through Parliament of the Regional Development Grant (Termination) Bill, it will become very difficult to present our new instruments of regional policy not as cost cutting measures but as an effective replacement for their predecessors if the value of RIG to the investor is in this way to be reduced below the value of an equivalent RDG. I therefore hope that you will find it possible to include the appropriate provision in the Finance Bill, and will agree that, if the matter comes up in the Committee stage of the Regional Development Grant (Termination) Bill, we shall then be able to make an unequivocal statement of our intentions.

I am copying this letter to Kenneth Clarke and Peter Walker.

*Yours sincerely
Lynn Shankland*

pp MALCOLM RIFKIND

*(Approved by the Secretary of State
and signed in his absence)*

CONFIDENTIAL



Inland Revenue

Policy Division
Somerset HouseFrom: M A KEITH
Date: 2 February 1988

1. FINANCIAL SECRETARY
2. CHANCELLOR OF THE EXCHEQUER

CAPITAL ALLOWANCES: NEW SCHEME OF GRANTS UNDER DTI ENTERPRISE INITIATIVE : CHANCELLOR OF DUCHY'S LETTER OF 26 JANUARY

1. Under a new incentive scheme to be introduced in Development Areas (DAs) from the beginning of April, firms with fewer than 25 employees will be able to apply for

- (a) investment grants of 15% (up to a maximum of £15,000) towards the costs of fixed assets which form part of an investment project (Regional Investment Grant - RIG);
- (b) innovation grants of 50% (up to a maximum of £25,000) to support product and process development.

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Burgner
Mr Culpin
Mr Waller
Miss Sinclair
Mr N R Williams
Mr A M White
Mr Riley
Mr Cropper
Mr Call
Mr Jenkins (OPC)

Mr Painter
Mr McGivern
Mr Deacon
Mr Pearson
Mr Keith
Mr Elmer
PS/IR

2. In his letter of 26 January, the Chancellor of the Duchy, comments that with the termination of Regional Development Grants (RDGs), the new scheme represents the only replacement by way of investment support in DAs. He asks that RIGs should be allowed the same tax treatment as RDGs. The Secretary of State for Scotland has supported that view in his letter of 29 January.

3. This note describes how RDGs are treated for tax purposes and recommends that you should not accede to Mr Clark's request. Treasury Officials (IAE Group) have seen this note and agree with the recommendation]

Origin and tax treatment of RDGs

4. RDGs were introduced in 1972 to provide help towards capital expenditure on new plant and machinery and buildings used in manufacturing and certain other industries in the assisted areas. Latterly, the rate of grant for capital projects in development areas has normally been 15% of the value of the project or £3000 for each new job created.

5. The scheme has provided automatic grants open to companies of any size and without any prior assessment of the benefits likely to result from the project supported.

6. RDGs are treated specially for capital allowance purposes. Generally, where capital expenditure is partly met by any subsidy, grant or contribution from public funds the taxpayer can only claim capital allowances on his expenditure net of subsidy. But, uniquely, an RDG does not reduce entitlement to capital allowances. That situation arises from the decision taken in 1972 that a system of lower rates of grants and larger tax allowances would ensure that maximum benefit went to more profitable firms.

Regional Selective Assistance (RSA)

7. Unlike RDGs, other financial support provided by DTI for investment, both nationwide and in the assisted areas, is normally given on a selective basis at varying rates and does not enjoy special tax treatment. These grants are negotiated on the basis of the minimum amount necessary for the project to go ahead as proposed. Selective grants of this kind are either treated as trading receipts or, if made towards capital expenditure, reduce a taxpayer's entitlement to capital allowances to the amount of expenditure he actually incurs. Where available, fixed rate investment grants under the European Regional Development Fund Business Improvement Services scheme and the DTI funded equivalent in Cornwall similarly do not enjoy special tax treatment

8. For the purpose of the new discretionary RIGs, projects will be assessed against criteria of viability and commercial benefit. For RSA grants, the criteria are viability, need, the creation or safeguarding of jobs and benefit to the regional and national economy.

9. Grants under the new schemes are intended to be mutually exclusive with RSA so that there will be no question of a firm being able to benefit under both schemes. Nevertheless, DTI tell us that a firm which is able to satisfy both sets of qualifying criteria will be able to choose between RIG and RSA. For example, since RSA has no fixed upper limit on either the amount or rate of grant which may be given, a firm may be able to attract substantially greater grant under RSA than under RIG.

10. Because of the selective nature of the new grants special tax treatment could in theory lead to inequality of treatment as between businesses, possibly businesses in competition with each other.

Cost

11. On the basis of the £37m provision quoted by Mr Clarke for the new scheme in England for 1990/91, the cost of allowing special tax status would be £2m in 1991/92, rising eventually to about £13m pa in 20 years. The inclusion of provisions for Scotland and Wales would make very little difference to the costs.

Conclusion

12. The rate of RIG (15%) is the same as the rate of RDG currently prevailing and DTI see it as a successor to RDGs for the smallest firms. On that basis, there is a prima facie case for treating the two forms of grant alike for tax purposes. If you decide to allow special tax treatment you could justify the necessary legislation on those grounds.

13. Moreover, the cost would be small, £2m, in 1991/92 rising eventually to about £13m pa, compared with the long term cost of the present treatment of RDGs (if they were being preserved) of around £50m pa.

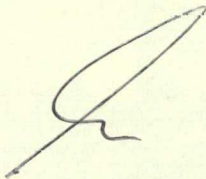
14. But the discretionary nature of RIGs is the distinguishing feature. It is one thing to give special tax treatment for RDGs which any firm carrying on qualifying activities could expect to receive and quite another when to do so could lead to situations where firms qualifying for RIGs get full capital allowances while others, possibly operating in the same field of activity but receiving some other form of discretionary industrial assistance, do not. A special regime for RIGs would mean singling out for favourable tax treatment this particular form of grant from all the other schemes of assistance for industry. It would be difficult to justify this distinction.

15. Mr Clarke attaches considerable importance to special tax status for the new grants in presentation of the changes in

regional policy. Clearly there is force in that view. But he has not provided any evidence that the additional cost to the Exchequer of introducing an exemption for the new grants would be justified in terms of regional policy benefits. And in the longer term it could prove troublesome as inequities between taxpayers begin to appear.

16. Subject to any wider political considerations our advice would be to preserve an even playing field by treating RIG on the same lines as other selective contributions towards capital expenditure. In other words the taxpayer should only get capital allowances on that part of the cost of assets which he meets from his own resources. The present tax treatment of the RDGs (which are now to disappear) is clearly anomalous and the new approach to regional development assistance would be the logical occasion to bring the tax treatment of all development subsidies into line.

17. Mr Clarke would like to be in a position to say what the tax treatment of the new grant will be when Committee Stage for the Bill terminating RDG begins on 9 February. We assume you will wish to tell him your decision before then but, if you decide to concede special tax status, it would be a matter for your consideration whether you would want it to be announced by Mr Clarke or left until the Budget. We will supply a draft reply when we have your decision, although you may prefer to speak to Mr Clarke in advance.



M A KEITH

CONFIDENTIAL

PPS - pl.



FROM: MISS S J FEEST
DATE: 3 February 1988

PS/CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Burgner
Mr Culpin
Mr Waller
Miss Sinclair
Mr N R Williams
Mr A M White
Mr Riley
Mr Cropper
Mr Call
Mr Jenkins (OPC)
Mr Painter
Mr McGivern
Mr Deacon
Mr Pearson
Mr Keith
Mr Elmer
PS/IR

Hayes ✓

Ch. Agree with FST (i.e. in opposition to official advice, behind, that RIGs should be allowed same tax treatment as RDGs)?

If so, to be announced by Mr Clarke, or wait until the Budget? You will presumably want to inform Mr Clarke of your decision in any case; I shall arrange for a draft.

2/3/2

CAPITAL ALLOWANCES: NEW SCHEME OF GRANTS UNDER DTI ENTERPRISE INITIATIVE: CHANCELLOR OF DUCHY'S LETTER OF 26 JANUARY

The Financial Secretary has held a brief meeting on this subject and supports the Chancellor of the Duchy's views (his letter of 26 January 1988) ie that RIGs should be allowed the same tax treatment as RDGs.

The Financial Secretary recommends that this decision is reviewed after 3 or 4 years.

Susan Feest

SUSAN FEEST
Assistant Private Secretary

CONFIDENTIAL

FROM: P J CROPPER
DATE: 8 February 1988

CHANCELLOR



cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Tyrie
Mr Call

(X) CAPITAL ALLOWANCES: NEW SCHEME OF GRANTS UNDER DTI ENTERPRISE
INITIATIVE: CHANCELLOR OF DUCHY'S LETTER OF 26 JANUARY

(X) There seems to me a very strong case for level playing field
treatment of the new Regional Investment Grants, for tax
purposes. As Mr Keith's note of 2 February says:

"It is one thing to give special tax treatment for RDGs
which any firm carrying on qualifying activities could
expect to receive and quite another when to do so could
lead to situations where firms qualifying for RIGs get
full capital allowances while others, possibly operating
in the same field of activity but receiving some other
form of discretionary industrial assistance, do not.
A special regime for RIGs would mean singling out for
favourable tax treatment this particular form of grant
from all the other schemes of assistance for industry.
It would be difficult to justify this distinction."

Discretionary awards should not carry automatic tax relief.
Neither Mr Beighton nor I can think of any comparable case
in other parts of the tax system.

2. It may be argued that RIGs are simply a lineal descendant
of RDGs and that they should get similar tax treatment. In
one crucial respect they are not lineal descendants - the
RDGs were available to anybody who met certain criteria,
whereas RIGs are to be handed out at the whim of officials.

3. Given that tax relief on RDGs was already an anomaly in the tax system, it seems to me that the opportunity should be seized for not continuing it on RIGs. This would have the additional advantage of firing a shot across the bows of this insidious trend towards discretionary intervention.



P J CROPPER

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0538
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Papers please (or are they in with Cl?)
WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-270 3000 (Switchboard)
01-270 (Direct Line)
0538
From The Secretary of State for Wales

The Rt Hon Peter Walker MBE MP

REC.	09 FEB 1988
ACTION	FST
NOTES TO	

8 February 1988

CONFIDENTIAL

As usual

Ch
Also note by
Make Call below
if this is

Kenneth Clark wrote to you on 26 January about the tax treatment which should be accorded to the new Regional Investment Grant which was announced on 12 January. I have now seen Malcolm Rifkind's reply.

The new grant will be seen by the small firms at whom it is aimed as the only direct replacement for RDG following our decision to terminate that form of assistance. It is a direct contribution at a very modest level towards the capital investment of firms but its value to some potential applicants will be significantly diminished unless it is given comparable tax treatment with RDG.

It is important that we derive maximum benefit from our presentation of the new package and, particularly, the new grant schemes. A decision to tax the RIG grant will be seized upon by opponents of the new arrangements in the way that the different tax treatment, under RSA and RDG is already stimulating adverse comment and I, therefore, endorse Kenneth's proposal.

I am copying this letter to Kenneth Clark and Malcolm Rifkind.

Nigel Lawson

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
11 Downing Street
LONDON SW1

CONFIDENTIAL

FROM: MARK CALL

DATE: 9 FEBRUARY 1988

CHANCELLOR

cc Chief Secretary
 Financial Secretary
 Paymaster General
 Economic Secretary
 Mr Cropper
 Mr Tyrie

Ch
Mark gave the f
me after Poyes
- he hadn't got it
must be he thought
you might like to see
anyway

CAPITAL ALLOWANCES FOR RIG

I have seen the Revenue submission on this, Mr Cropper's contribution and the Financial Secretary's conclusion. I myself agree with the Revenue recommendation, though I think they miss some of the arguments.

2. Firstly, since RDG is to be abolished and replaced by a new grant on a different basis, there is no reason a priori why RIG should automatically inherit the tax status of RDG.

3. Secondly, why should companies expect to get both a contribution to their capital expenditure and a tax shield of profits in the form of capital allowance on money they haven't spent?

4. There is, thirdly, the Cropper argument about the level playing field. I wouldn't push this too far since, while it certainly makes sense to my mind to give the same tax treatment to RIG as to RSA on the grounds of tidy minded consistency, the playing field is hardly level with a system of discretionary grants. That is the whole point of making them discretionary.

5. So if the logic points to not granting the allowance what about the politics. DTI will no doubt argue that this is the crucial element which will allow smooth presentational reception for the new system. Given that we are talking about £2 m rising to £13 m after 20 years, compared to spending of hundreds of million £ on RDG I'm not sure that cuts much ice.

6. Just to record for posterity a unique conjunction, the three special advisers are in agreement on this (I'm sure a bad omen).

7. If my pessimism is well founded could I argue for a fallback? If capital allowance for RIG is allowed could we make it clear to the DTI that this is a short term (2, 3 year maximum) sweetener, and that either it will be withdrawn (difficult) or that a reduction in PES will be sought to offset the tax advantage?

Mc

MARK CALL

CONFIDENTIAL



FROM: CHIEF SECRETARY

DATE: 10 February 1988

CHANCELLOR

cc: Financial Secretary
Paymaster General
Economic Secretary
Mr Cropper
Mr Call
Mr Tyrie

CAPITAL ALLOWANCES FOR RIG

I have seen the Revenue's advice and the subsequent recommendations of the Financial Secretary. I have also seen Peter Cropper's and Mark Call's notes.

2 I think this is finely balanced as a piece of political judgement. I doubt that our future PES ambitions weigh heavily either way.

3 I tend to agree with Peter's line although the Department of Trade and Industry will object and Lord Young/Ken Clarke may well ask us to reconsider. I don't think we should do so:-

(a) We have just agreed to abolish RDGs and I see no reason at all why RIGs (as a small business surrogate for these) should inherit their favourable tax status. Anomalies should not be entailed to the second generation.

(b) The level playing field point does appeal to me and RIGs and RSA (as alternatives in some instances) should have the same tax treatment. Although other inconsistencies exist that is no reason for adding to them.

4 There are other reasons too but these will suffice. I would not give RIGs favourable tax treatment.

JOHN MAJOR

Handwritten notes in red ink:
I think we agreed
oh
@ James
These should be favourable tax treatment for RIGs.
The
Mr Clarke
for v. Cropper
presumably
doughs.
good pts
have
Brent
in this
document
with RIG
or use
Mr.

CONFIDENTIAL



FROM: J M G TAYLOR
DATE: 12 February 1988

67 15/2
H/2

PS/CHIEF SECRETARY

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Cropper
Mr Call
Mr Tyrie

CAPITAL ALLOWANCES FOR RIGS

The Chancellor has seen the Chief Secretary's minute of 10 February.

2. He has commented that, as agreed at Prayers, there should not be favourable tax treatment for RIGs. The reply to Mr Clarke will, however, need to be very forcefully and persuasively drafted. A number of good points have emerged in the exchanges of minutes on this subject which should be used.

3. I should be grateful if Mr Heywood could arrange for a draft reply to be prepared.

A handwritten signature in dark ink, appearing to be 'J M G Taylor'.

J M G TAYLOR

Ch. The Revenue tell me that RIGs would not be
the first example of a tax relief going to a
discretionary grant (there is some obscure
precedent in N. Ireland). So I have ~~not put~~ ^{added}
in an extra sentence. N. Ireland ^{is} ~~not~~ ^{of} ~~the~~ ^{type}
25 2/2



Inland Revenue

Policy Division
Somerset House

FROM: G A A ELMER

DATE: 16 FEBRUARY 1988

- 1. FINANCIAL SECRETARY
- 2. CHANCELLOR OF THE EXCHEQUER

Content. A.H. 17/2

As I understand it, there is no particular for

Ch/ Content to write to drafted?

17/2

CAPITAL ALLOWANCES FOR RIGS

The draft reply for the Chancellor to send to Mr Clarke requested in Mr Taylor's minute of 12 February is annexed to this note together with drafts of covering letters to be sent to Mr Rifkind and Mr Walker.

IN

G A A ELMER

tax relief depends on a decision. If so, this is an important part, wh.

- c: PS/Chief Secretary
- PS/Financial Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Mr Anson
- Mr Monck
- Mr Scholar
- Mr Burgner
- Mr Culpin
- Mr Waller
- Miss Sinclair
- Mr N R Williams
- Mr A M White
- Mr Riley
- Mr Cropper
- Mr Call
- Mr Tyrie

- Mr Painter
- Mr McGivern
- Mr Deacon
- Mr Pearson
- Mr Keith
- Mr Elmer
- PS/IR

See Mr Walker Mr Elmer.

file type for the org.

The Rt Hon Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry
Department of Trade and Industry
19 Victoria Street
London SW1H 0ET

Thank you for your letter of 26 January about your new scheme of grants to small independent firms in Development Areas and their treatment for tax purposes.

I appreciate the importance you attach to treating the new grants in the same way as Regional Development Grants (RDG) by excluding them from the provisions of Section 84(1) and 95(6) of the Capital Allowances Act 1968 and I note that the rate of grant has been set at the same level of 15 per cent. But it seems to me that that is where the similarity between the two forms of grant begins and ends.

The special treatment of RDGs was a departure from the general principle that a taxpayer should not get tax relief on that part of any capital outlay which is met from public funds. As you say, RDGs do not reduce the cost of assets for capital allowance purposes but the fact that a system of lower rates of grant and larger tax allowances was felt to be justified in 1972 has to be judged against the way that the RDG scheme operated.

I realise that the new grants will be specifically targeted at small firms but there is no reason why they should automatically inherit the favourable tax status of RDGs. In general, businesses ought not to expect both a contribution to their capital outlay from Exchequer sources and favourable tax treatment as well. Moreover the new grants differ from RDGs in one vital respect. RDGs were automatic for businesses

within the Development Areas provided they were carrying on qualifying activities. By contrast, the new grants are discretionary with projects being assessed against criteria of viability and commercial benefit.

There is no precedent for
It seems to me that this is a crucial distinction. The decision taken in 1972 to give special tax treatment for grants of a more or less automatic nature is one thing; but we are entering into an altogether different field when to concede special tax treatment could lead to situations where firms receiving the new grant would get full capital allowances while others, possibly operating in the same field of activity but receiving some other form of discretionary industrial assistance, do not. That is something which I think would be difficult to justify, particularly as I understand that a 15 per cent rate is not exclusive to the new regional investment grant scheme.

Moreover, there is no precedent for tax relief depending on a discretionary decision; it would be highly undesirable to set one.
I am sorry that I cannot be more receptive to your proposal but, in my view, the time has come with the ending of RDGs, to return to the principle that capital allowances should only be given for expenditure which the taxpayer actually meets out of his resources. The general thrust of policy since 1984 has been to create a more neutral system of business taxation and it would scarcely be consistent with this to perpetuate the RDG anomaly.

I am copying this letter to Malcolm Rifkind and Peter Walker.

NIGEL LAWSON

CONFIDENTIAL

DRAFT

The Rt Hon Malcolm Rifkind QC MP
Secretary of State for Scotland
Scottish Office
Whitehall
London SW1A 2AU

Thank you for your letter of 29 January in which you express support for the suggestion made by Kenneth Clarke in his letter of 26 January that the tax treatment of the new Regional Investment Grants should be the same as that for Regional Development Grants.

As you will see from the enclosed copy of my reply to Kenneth Clarke, that suggestion is not one that I have felt able to accept. The treatment of RDGs was itself an anomaly and, with the decision to abolish them, I would not wish to see that anomaly perpetuated, particularly when to do so would be likely to give rise to inequality. My view is that any business receiving RIG should not expect to receive capital allowances on that part of the cost of its investment which is met by subsidy. That view is of course consistent with the overall thrust of policy over the period since 1984 which has been to create a more neutral system of business taxation.

NIGEL LAWSON

CONFIDENTIAL

DRAFT

The Rt Hon Peter Walker MBE MP
Secretary of State for Wales
Welsh Office
Gwydyr House
Whitehall
London SW1A 2ER

Thank you for your letter of 29 January in which you express support for the suggestion made by Kenneth Clarke in his letter of 26 January that the tax treatment of the new Regional Investment Grants should be the same as that for Regional Development Grants.

As you will see from the enclosed copy of my reply to Kenneth Clarke, that suggestion is not one that I have felt able to accept. The treatment of RDGs was itself an anomaly and, with the decision to abolish them, I would not wish to see that anomaly perpetuated, particularly when to do so would be likely to give rise to inequality. My view is that any business receiving RIG should not expect to receive capital allowances on that part of the cost of its investment which is met by subsidy. That view is of course consistent with the overall thrust of policy over the period since 1984 which has been to create a more neutral system of business taxation.

NIGEL LAWSON

cc: PS/Chief Secretary
 PS/Financial Secretary
 PS/Paymaster General
 PS/Economic Secretary
 Sir P Middleton
 Mr Anson
 Mr Monck
 Mr Scholar
 Mr Burgner
 Mr Culpin
 Mr Waller
 Miss Sinclair



pmp

Treasury Chambers, Parliament Street, SW11
 01-270 3000

19 February 1988

The Rt Hon Kenneth Clarke QC MP
 Chancellor of the Duchy of Lancaster and
 Minister of Trade and Industry
 Department of Trade and Industry
 1 Victoria Street
 London SW1H 0ET

Mr N R Williams
 Mr A M White
 Mr Riley
 Mr Cropper
 Mr Call
 Mr Tyrie

Mr Painter IR
 Mr McGivern IR
 Mr Deacon IR
 Mr Pearson IR
 Mr Keith IR
 Mr Elmer IR
 PS/IR

Ken Clarke

Thank you for your letter of 26 January about your new scheme of grants to small independent firms in Development Areas and their treatment for tax purposes.

I appreciate the importance you attach to treating the new grants in the same way as Regional Development Grants (RDG) by excluding them from the provisions of Section 84(1) and 95(6) of the Capital Allowances Act 1968, and I note that the rate of grant has been set at the same level of 15 per cent. But it seems to me that that is where the similarity between the two forms of grant begins and ends.

The special treatment of RDGs was a departure from the general principle that a taxpayer should not get tax relief on that part of any capital outlay which is met from public funds. As you say, RDGs do not reduce the cost of assets for capital allowance purposes, but the fact that a system of lower rates of grant and larger tax allowances was felt to be justified in 1972 has to be judged against the way that the RDG scheme operated.

I realise that the new grants will be specifically targeted at small firms but there is no reason why they should automatically inherit the favourable tax status of RDGs. In general, businesses ought not to expect both a contribution to their capital outlay from Exchequer sources and favourable tax treatment as well. Moreover, the new grants differ from RDGs in one vital respect. RDGs were automatic for businesses within the Development Areas provided they were carrying on qualifying activities. By contrast, the new grants are discretionary with projects being assessed against criteria of viability and commercial benefit.



It seems to me that this is a crucial distinction. The decision taken in 1972 to give special tax treatment for grants of a more or less automatic nature is one thing; but we are entering into an altogether different field when to concede special tax treatment could lead to situations where firms receiving the new grant would get full capital allowances while others, possibly operating in the same field of activity but receiving some other form of discretionary industrial assistance, do not. That is something which I think would be difficult to justify, particularly as I understand that a 15 per cent rate is not exclusive to the new regional investment grant scheme.

I am sorry that I cannot be more receptive to your proposal but, in my view, the time has come with the ending of RDGs, to return to the principle that capital allowances should only be given for expenditure which the taxpayer actually meets out of his resources. The general thrust of policy since 1984 has been to create a more neutral system of business taxation and it would scarcely be consistent with this to perpetuate the RDG anomaly.

I am copying this letter to Malcom Rifkind and Peter Walker.

A handwritten signature in dark ink, appearing to read 'Nigel Lawson', written in a cursive style.

NIGEL LAWSON

CLARKE
10/3



the department for Enterprise

CONFIDENTIAL

The Rt. Hon. Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

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

CH/EXCHEQUER	
REC.	10 MAR 1988 ✓ 10/3
ACTION	FST
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Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5147
Our ref
Your ref
Date 10 March 1988

Ch: I do not find Mr Clarke's counter-arguments
at all persuasive.
10/3

Dear Chancellor,

Thank you for your letter of 19 February about the tax treatment of the new regional grants for small firms which will be available in Development Areas from 1 April.

I was extremely disappointed by your response. Malcolm Rifkind and Peter Walker have both emphasised the importance which they attach to exempting the new grants from taxation. This reflects the fact that we are going through a sensitive period in the presentation of regional policy. Any decisions taken in relation to the new scheme which can be perceived merely as minor cost-cutting exercises need careful justification. I do not think that the arguments put forward in your letter will serve well in defence.

You refer to the overall policy aim of creating a neutral system of business taxation. However you will not necessarily reflect that aim in deciding to tax the new grants. The main instrument of regional assistance following the termination of Regional Development Grants will be the Regional Selective Assistance (RSA) scheme operated under Section 7 of the Industrial Development Act 1982. RSA is negotiable and offers are made in terms of the minimum necessary for projects to proceed. Tax treatment is therefore irrelevant since the fact that the grant is taxable can be taken into account in setting the level of an

And, presumably, the reverse would apply, so why is Mr Clarke worried?

EC3AKM

offer. As you are aware the new grants will not be negotiable. Applicants will be offered a flat 15% grant of eligible project costs up to a maximum of £15,000.

You emphasise the "discretionary" nature of the new grants. This should not be over-stated. The scheme will not be automatic like RDG but neither is it as selective as RSA. The new scheme will not include the full range of criteria which applies to RSA grants. Viability will be appraised but on the basis of a simple business plan.

Your letter also refers to other grants available at a 15 per cent rate for investment projects. Such grants are available in Penzance, St Ives and Thanet Travel to Work Areas under Business Improvement Services (BIS). Funds available for Penzance and St Ives are almost totally committed and need not concern us. BIS in Thanet is a very small scheme amounting to £0.5m over 3 years. Much of this will go on other services within the BIS package rather than investment grants. Again I think it need not concern us. The important issue is to provide special tax status for the new grants which are targeted at areas of greatest need. The area coverage and the funding are very much larger. I should remind you that we intend to extend the availability of the new grants to areas qualifying under the European Regional Development Fund's Community Programmes for declining steel and shipbuilding areas (RESIDER and RENAVAL) when these areas have been designated. We have not announced this as yet.

In view of the additional arguments I have outlined, I would ask you to reconsider your decision. The small amount you propose to save is simply not worth the political controversy.

I am copying this letter to Malcolm Rifkind and Peter Walker.

Yours sincerely,

Alastair Morgan

pp

KENNETH CLARKE

*(Approved by the Chancellor of the Duchy & signed
in his absence)*

EC3AKM

Y SWYDDFA GYMREIG

GWYDYR HOUSE

WHITEHALL LONDON SW1A 2ER

Tel. 01-270 3000 (Switsfwrdd)
01-270 0538 (Linell Union)

Oddi wrth Ysgrifennydd Gwladol Cymru



WELSH OFFICE

GWYDYR HOUSE

WHITEHALL LONDON SW1A 2ER

Tel. 01-270 3000 (Switchboard)
01-270 0538 (Direct Line)

From The Secretary of State for Wales

The Rt Hon Peter Walker MBE MP

15 March 1988

Thank you for copying to me your letter of 19 February to Kenneth Clarke on the tax treatment of the new regional enterprise grants. Kenneth has since replied to you asking you to reconsider the decision not to give the new grants favourable tax treatment.

I have to say that I am in full agreement with the case deployed in Kenneth's letter. Presentation will be a very important feature of the new grant arrangements and opponents will make much of the limitations of the new grants, which will be represented as an inadequate substitute for the abandoned RDG scheme for small firms, unless they carry the same tax status.

I am putting considerable effort into the presentation of the recast schemes of regional assistance and the benefits which can be gained from the combined operation of all the various instruments available in Wales. To date the new arrangements have had a favourable reception but critics have been quick to compare the proposed schemes with those which they replace and will make much of the adverse tax treatment which you propose and our immediate decision to restrict firms to a single application for support. Much of this criticism is avoidable and, for the sake of the very small amount of money involved, I agree with Kenneth that the new grants should be treated for tax purposes in the same way as RDG.

... I am copying this letter to Kenneth Clarke and Malcolm Rifkind.

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer

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SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Handwritten initials

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Square
LONDON
SW1P 3AG

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16 March 1988

Handwritten notes in red ink:
[unclear]
(a copy of [unclear] letter)

Dear Nigel,

flipped, behind

I have just seen Kenneth Clarke's letter to you of 10 March in which he expresses his disappointment at your decision not to accord to the new regional investment grant the same tax treatment as that currently enjoyed by Regional Development Grants.

I share his sentiments and would urge you to reconsider your decision both in the light of the arguments he advances and because of the need not to detract from what have been effectively presented changes in regional policy.

I am copying this letter to Kenneth Clarke and Peter Walker.

*Yours ever,
Malcolm Rifkind*

MALCOLM RIFKIND

CONFIDENTIAL



FROM: G A A ELMER

DATE: 25 MARCH 1988

1. MR KEITH *25/3/88*
2. FINANCIAL SECRETARY
3. CHANCELLOR OF THE EXCHEQUER

The FST continues to disagree with the line we are taking on this. He thinks it would be better to "net" RIG.

q.n. 28/3

Cropper

CAPITAL ALLOWANCES FOR RIGs

1. As expected, the Chancellor of the Duchy, supported by Mr Rifkind and Mr Walker, has asked that the decision not to accord to the new Regional Investment Grants (RIGs) the same treatment as that currently enjoyed by Regional Development Grants should be reconsidered.


2. That decision was made in the light of minutes from the Chief Secretary (10 February) Mr Call (9 February) and Mr Cropper (8 February) arising out of Mr Keith's note of 2 February.

-
- cc: PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Burgner
Mr Culpin
Mr Waller
Miss Sinclair
Mr N R Williams
Mr A M White
Mr Riley
Mr Cropper
Mr Call
Mr Tyrie
- Mr Painter
Mr McGivern
Mr Deacon
Mr Pearson
Mr Keith
Mr Elmer
PS/IR

3. Mr Clarke and Mr Walker both emphasise the presentational value of favourable tax treatment for the new grants. Mr Clarke also makes the point that, unlike Regional Selective Assistance, the amount of a RIG is not negotiable and that the tax treatment of a RSA grant can be taken into account in setting the level of grant.

4. These are not new points and the fact remains that both types of grant are discretionary so that not every business can be certain of receiving a grant while others will be able to choose between RSA and RIG. There is no reason why RIGs should automatically inherit the tax status of RDGs.

5. A draft reply is attached. It has been prepared on the assumption that the Chancellor will not wish to vary his original decision.


G A A ELMER

DRAFT

Pre type for Mr. S. J.

Rt Hon Kenneth Clarke QC MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON SW1H 0ET

Thank you for your letter of 10 March replying to mine of 19 February about the tax treatment of the new Regional Investment Grants for small firms.

Disappointing as my response to your request for special tax treatment for the new grant has been, I must emphasise that in making the decision I took fully into account both presentational considerations and variations in the ground rules as between Regional Selective Assistance and the new grants.

Having looked at the matter again, I remain convinced that it would be wrong to treat the new grants differently from other forms of discretionary assistance. It is not a matter of achieving small Exchequer savings. The essential point is that businesses should not expect to get both a contribution to their capital expenditure and a shelter for their profits (albeit a small one) in the form of capital allowances on money which they have not provided. The disappearance of RDGs provides the opportunity to reinstate that principle and it is not one that I think we should miss.

I am copying this letter to Malcolm Rifkind and Peter Walker.

NIGEL LAWSON

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Burgner
Mr Culpin

CONFIDENTIAL



Mr Waller
Miss Sinclair
Mr N R Williams
Mr A M White
Mr Riley
Mr Cropper
Mr Call
Mr Tyrie

A large, stylized handwritten signature in black ink, possibly reading 'PMP'.

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

29 March 1988

Rt Hon Kenneth Clarke QC, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
London SW1H 0ET

A handwritten signature in black ink, appearing to be 'Ken Clarke'.

Thank you for your letter of 10 March replying to mine of 19 February about the tax treatment of the new Regional Investment Grants for small firms.

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I am copying this letter to Malcolm Rifkind and Peter Walker.

A handwritten signature in black ink, appearing to be 'Nigel Lawson'.

NIGEL LAWSON