PO-CH/NL/0487
PART A

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PART A

PO CH/NL/0487
PART A

1989 BUDGET SUBSIDIES
MORTGAGES AND LOANS.

THIS FOLDER HAS BEEN
REGISTERED ON THE
REGISTRY SYSTEM

SUBSIDIES 487

MORTGAGES
+ LOANS

14

1/23

FROM: C J RILEY
DATE: 17 ~~DECEMBER~~ NOVEMBER 1988

CHANCELLOR

Many thanks. Interesting, but depressing reading. The only sort of CGT option, which we need to be considering alongside IHT. A small mtg first, as indicated in response to Mr Scholar's IHT submission.

Ch. IR ppr (Cayley 16/11) behind. We shall need to have a mtg. on this.
17/11

see my note

cc Financial Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Lawton
Mrs Chaplin
Mr Tyrie

Inland Revenue
Mr Battishill
Mr Isaac
Mr Painter
Mr Pitts
Mr Calder
Mr Cayley
Mr Weeden

THE TAXATION OF OWNER-OCCUPIED HOUSING

You have received a paper from Michael Cayley on Starter 250 - CGT Main Residence Exemption. We - FP and ETS - thought it might be helpful to provide a paper setting this proposal in a somewhat wider context, and considering it in relation to other measures which might in principle be taken to improve the present tax treatment of owner-occupation. I am sorry that it has turned out to be a rather long paper.

2. The first part of the paper (paragraphs 7-40) sets out the basic economic analysis, and assesses the impact of the replacement of domestic rates by the Community Charge in 1990. Our conclusion is that this marks a significant increase in the fiscal privilege available for owner-occupation, with effects on house prices which we estimate at over 10% - rather larger than set out in the 1986 DOE Green Paper, but rather less than some other analysts have suggested. The question is: does the Government wish to acquiesce in this increase in fiscal privilege and higher house prices - ie does this tie in with the Government's policy of encouraging home ownership - or should some action be taken to redress the situation if possible?

3. The next section of the paper (paragraphs 41-51) considers some general principles which might underlie any attempt at reform, distinguishing in particular between the impact on saving and

investment, and the implications for the way the housing market functions and hence for labour mobility. In some cases these objectives may conflict. Finally, the paper goes through some of the more obvious measures of reform.

4. Significant action to limit mortgage interest relief is ruled out (paragrphs 53-6). This being so, a move to tax imputed rent on owner-occupied houses (as proposed by Professor Muellbauer), combined with a reduction in the basic rate and an increase in allowances, has a number of attractions in principle. But the paper concludes that:

- it would be extremely difficult, in terms of both politics and administration, to do this at any time;

- it is now impossible to introduce such a charge when rates are abolished in 1990, the natural time to do so.

Although this option remains very attractive in economic terms, we cannot recommend that you should consider it any further.

5. Next we come to CGT, the subject of Michael Cayley's paper (paragraphs 75-93). The Revenue conclude that a CGT charge should involve a high threshold, no roll-over, significant exemptions, a half rate, and no ring-fencing. The trouble is that this would be likely to entail:

- a minimal effect on housing generally;

- adverse effects on housing costs and labour mobility at the top end of the market, and hence in the South East in particular;

- a lot of political hassle with no presumption of any clear economic benefit.

6. Our paper therefore sets out a rather different option. It argues that a worthwhile CGT charge would involve a relatively low threshold and a minimal annual exemption, with roll-over to prevent adverse consequences for the operation of the housing market and hence labour mobility. This would require a CGT charge on houses on

death and gifts, and probably ring-fencing. A CGT charge on houses on death would be a natural consequence of the need to provide roll-over, and could therefore be confined to housing. It would be necessary to consider the implications for IHT.

7. If you wish to take action to offset any of the effects of abolishing the rates, we believe that a CGT scheme of this kind would be worthwhile. Whether it is worth the hassle is a matter of political judgement.

8. The paper also considers various other options which would impact on housing - extending VAT, changing stamp duty, and taxing consumer credit (paragraphs 94-102). But none seem worth pursuing further.

CJR

C J RILEY

but have to have exemption from IHT — means not an overall IHT/CGT regime

THE TAXATION OF OWNER-OCCUPIED HOUSING

Introduction

The period since 1982 has seen house prices rising significantly faster than incomes and the general price level, and a widening of regional house price differentials. Although there are some signs that house price inflation may be starting to fall back, and regional differentials have shown signs of narrowing, behaviour in the housing market is still a cause for concern. There are worries in some quarters that rapid house price inflation might exacerbate general inflationary tendencies, and that wide regional differentials may be inhibiting labour mobility and thus damaging the supply side of the economy.

2. To some extent these phenomena undoubtedly reflect the rapid growth of mortgage lending, in part a consequence of financial deregulation and increased competition between banks and building societies. But the relatively favourable tax treatment of owner-occupied housing may well also have played an important role; with a less favourable tax treatment there would have been less scope for banks and building societies to increase the supply of mortgage credit.

3. A more deep-seated worry is that the favourable tax treatment leads to a serious distortion of the pattern of saving and investment, with adverse effects on industrial investment and the supply side. Although cuts in income tax rates in recent years have reduced the extent of tax privilege, the replacement of domestic rates by the Community Charge in 1990 will increase it.

4. It therefore seems sensible in current circumstances to take a further look at the tax treatment of owner-occupied housing. There has been a good deal of outside comment and analysis - eg by Professor Muellbauer - and some quite radical suggestions for changing the tax treatment have been made. Although there is always a tendency to try to solve yesterday's problem, it seems unlikely that this one will go

away in the immediate future. The purpose of this paper is therefore to:

- explore the implications of the present tax treatment of owner-occupied housing, and the prospect when domestic rates are abolished;

- consider the various possible objectives which might underlie any reform in this area;

- consider specific options for reform against a background of Government pledges already given and brief assessments of the administrative implications.

A more detailed discussion of the tax position under present policies, and the economic implications, is contained in an annex which is available on request.
attached

5. Housing is, of course, an extremely sensitive and difficult area for policy makers. Many might subscribe to the view that the tax treatment is at present, or is about to become, unsatisfactory while accepting that there are severe constraints on what can be done about it in practice. The first part of this paper, up to paragraph 36, sets out the position in principle as we currently see it. The second part discusses what could perhaps be done to tackle the problem, if Ministers wished, consistent with pledges which the Government has made, and provides a brief assessment of the practicalities.

6. The main conclusions are as follows:

- owner-occupied housing benefits from a considerable degree of tax privilege which, notwithstanding housing policy objectives, has adverse effects on the allocation of savings and investment and may well damage labour mobility;

- the degree of privilege is set to increase substantially when domestic rates are replaced by the Community Charge;

- unless housing policy objectives have also shifted, indicating a desire to give further encouragement to owner-occupation, there is a strong case in principle for action at least to offset the impact of abolishing the rates;

- with restriction of MIR ruled out, there are strong economic arguments for extending income tax (or VAT) to imputed rent. This would permit a significant reduction in the basic rate. But it would be politically very difficult, and a considerable administrative burden would be placed on the Revenue. We have almost certainly now missed the opportunity to make such a change in 1990, the natural time to do so.

- if taxing imputed rent is also ruled out, extending CGT to housing has much to commend it. But if there are to be significant economic gains it would be important to have a relatively low threshold, provide for roll-over relief with a charge on gifts and death, and allow minimal exemptions. This suggests a rather different scheme from that proposed by Michael Cayley in a separate paper, and would be administratively much more burdensome.

<u>The present tax position</u>

7. There are a number of dimensions to the tax treatment of owner-occupied housing, including its relationship to the taxation of:

- other forms of saving;
- other forms of consumption;
- other forms of housing.

But whichever baseline is chosen, it is clear that owner-occupation benefits from a significant degree of fiscal privilege.

8. It is helpful initially to examine this fiscal privilege in relation to the present income tax treatment in which investment is made out of taxed income, borrowing is non-deductible, and the returns

to investment are also taxed. The present sources of privilege for owner-occupation are as follows:

- imputed income/rent is free of income tax. It used to be taxed under Schedule A, the tax base being the notional rental value as assessed for local authority rates. But with maintenance expenditure deductible and failure to revalue after 1935-6, the yield had declined significantly in real terms by 1963 when the Schedule was abolished.

- capital gains tax is not levied on the main residence. This exemption has been in force since the introduction of CGT in 1965. Second homes are liable for CGT, as are lettings.

- mortgage interest relief. Under Schedule A, mortgage interest was deducted from income in assessing tax liability; interest payments generally were regarded quite correctly as an offset in calculating net income. But when Schedule A was abolished in 1963 interest relief was retained; in the case of MIR, the interest offset was allowed even though the relevant gross income was no longer taxable. Since 1974 there has been a limit on the size of loan eligible for relief; at £30,000 it is now worth in real terms about one third of its value in 1974.

[illegible] all interest relieved @ one time

9. Local authority rates can be regarded as an offset to the tax privileges described above. They are a charge on occupiers irrespective of tenure, and so affect all forms of housing. They are akin to a tax on rent, imputed or otherwise, although the relationship with house prices or rents is obscured by local variations and the infrequency of revaluations.* Furthermore domestic rates are to be replaced by the Community Charge in 1990; this will further increase the tax privilege for owner-occupied housing, giving windfall gains to existing owner-occupiers. It will also increase the privilege for owner-occupation relative to renting, because rates payable by landlords are tax deductible.**

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* If anything, the burden of rates tends to rise less than proportionately with house prices.

** Rates paid directly by tenants are, of course, not deductible.

10. Rates can also be considered as an indirect tax on housing consumption, and hence an alternative to VAT. Exemption of all housing services from VAT is a further source of fiscal privilege.

11. Putting numbers on the tax privileges of owner-occupation is not straightforward. While we have reasonably firm figures for mortgage interest relief and domestic rates, foregone CGT (especially), income tax on imputed rent and VAT can only be estimated imprecisely. Our best estimates for 1987-88 are given in the table below.*

Table 1: Estimated value of tax privileges for owner-occupiers in 1987-88

Tax foregone	£ billion	% of housing stock* Gross	Net
Imputed rent	8	1.2	1.6
CGT**	4	0.6	0.8
Mortgage interest relief	5	0.8	1.0
VAT	4	0.6	0.8
Total	21	3.2	4.3
Domestic rates	7	1.1	1.4
Total net of rates	14	2.2	2.9

* The gross value of the owner-occupied housing stock in 1987 is put at £650 billion. Net of outstanding mortgages it is around £490 billion.

** Assumes net imputed rent is 5% of the housing stock, a somewhat higher percentage than assumed by Muellbauer, for example, but lower than the figure derived by the 1987 Cassell Group on private renting.

*** The figure for CGT (which assumes no roll-over) reflects rapid house price inflation in recent years, and is probably higher than its longer run trend level.

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* Note that the corresponding figures for 1988-89 would be slightly different, reflecting inter alia the rise in house prices and mortgage rates, the fall in income tax rates and the reform of CGT.

12. While domestic rates remain, the net total of tax privileges is tentatively put at around £14 billion, equivalent to nearly 2¼% of the gross housing stock or nearly 3% of the net stock. Ignoring rates - as one would from 1990 on the introduction of the Community Charge - privilege is put at £21 billion, equivalent to about 3¼% of the gross housing stock and about 4¼% of the net stock. Abolition of rates will thus raise the tax privilege for owner-occupation by about a half.

13. The tax privilege for owner occupied housing relative to <u>other forms of saving</u> is best illustrated by tax wedges - the difference between pre- and post-tax rates of return. These are based on stylised assumptions about inflation and rates of return, and in the case of housing depend on the size of mortgage and whether or not rates are included. A selection of figures is given in Table 2 below.

<u>Table 2: Illustrative tax wedges for owner-occupied housing (%)*</u>

Mortgage as percent of price	With rates 25%	With rates 40%	Without rates 25%	Without rates 40%
25%	0.3	- 0.2	- 1.1	- 1.5
50%	- 1.3	- 2.6	- 3.3	- 4.6
90%	- 19.3	- 31.4	- 29.3	- 41.4

Other savings media	25%	40%
deposits	1.9	3.3
gilts**	2.3	3.6
pensions***	- 0.4	- 0.8

* Assumptions: nominal gross return = 10%
nominal interest rate = 9%
mortgage = £30,000 or less
stamp duty ignored.
rates are assumed = 1% of capital value

** Conventionals

*** Average wedge for a pension built up over 40 years, with a 25% lump sum. For a pension built up over 20 years the figures are -0.9 and -1.7.

14. These figures illustrate how the tax subsidy for housing (a negative wedge) rises as the percentage mortgage increases. They show

that while domestic rates remain, the average outstanding mortgage of a little under 25% implies a tax wedge of about zero. But when rates are abolished, a significant tax subsidy emerges; the degree of tax privilege relative to income tax treatment increases markedly.

15. With an average 25% mortgage, housing is at present less privileged than most pensions, though this will cease to be the case when rates go; tax relief on pension contributions and non-taxation of the lump sum will then typically be worth less than MIR and the non-taxation of imputed rent and capital gains. But both are greatly favoured in relation to interest-earnings assets such as bank/building society deposits and gilts, which face significantly positive tax wedges.

16. It is important to remember that insofar as borrowing is used to finance personal investment in assets other than housing, this increases the relevant tax wedges - ie decreases the post-tax return on the equity stake. This is because interest on non-mortgage borrowing is not deductible, and is a departure from a pure income tax system - as with the old schedule A - in which tax is levied on income net of interest. From this perspective, the appropriate measure of tax privilege for housing should include tax foregone on imputed rent and CGT but <u>not</u> MIR. As already argued, interest relief is quite defensible in principle when imputed, as well as actual, income is taxed.

17. By comparison with <u>other forms of consumption</u>, housing benefits from both the absence of indirect taxes on the services provided and the availability of MIR. When rates go this will mean that housing is more favoured than <u>average</u> consumers' expenditure on non-durables and especially, because these are often financed by borrowing, on durables.

18. Prior to the extension of BES in this year's Budget, owner-occupied housing received noticeably more favourable tax treatment than <u>private renting</u>. Private rents are liable to income tax or CT, after netting off rates, expenditure on repairs and maintenance, and interest. Houses for rent are liable to CGT. The extension of BES

has redressed the balance somewhat by levelling tax privilege up, but the intention is that this should be only a temporary measure.

19. Before moving on to consider the economic effects of the tax privileges for owner-occupation, we should briefly note two other relevant features of the tax system. First, transactions in houses are liable to stamp duty above a threshold of £30000. The rate was reduced from 2% to 1% in 1984, but was left unchanged in 1986 when the rate on shares was cut to ½%. The effect of stamp duty on the overall return to housing is, however, small; owner occupiers move on average once every seven years, so the effect on the annual rate of return is a little over 0.1%. The revenue yield from all residential property in 1988-89 is put at about £1.2 billion.

20. In common with other benefits in kind, mortgage subsidies escape NICs. At present relatively few mortgages are subsidised (260,000 in 1987), and the implications for the housing market are probably relatively slight. However the fear is that mortgage subsidies will spread, in which case the implications may become more profound. But because this is part of a wider problem about the treatment of benefits in kind, rather than specifically a housing problem, the mortgage subsidy issue is not discussed further in this paper.

Economic implications of the present tax treatment

21. The favourable tax treatment for owner-occupied houses can be expected to have significant effects throughout the economy. For present purposes, we confine ourselves to three main areas: real house prices and the housing stock, saving and investment, and labour mobility.

(a) Real house prices and the housing stock

22. Unless houses are in perfectly elastic supply, favourable tax treatment means that real house prices are likely to be higher than they otherwise would be. Tax breaks raise the demand for housing, and to the extent that supply is not forthcoming this will add to prices. Insofar as real house prices are increased and this does not feed fully into higher land prices, house building becomes more profitable

and the stock of houses becomes correspondingly higher. The scale of the effects depends crucially on the responsiveness of demand and supply in the housing market to changes in prices; they also depend on the supply of land and how this is affected by the planning process.

23. Our estimates of the long term effects of ending the tax privileges are summarised in Table 3 below. Ranges are presented because of the considerable uncertainties involved, though this is not to imply that effects outside the ranges are ruled out. Note we have assumed that rates are properly perceived as a tax on housing, affecting the demand for housing as any other tax on housing would.

Table 3: Estimated effects on real house prices and the housing stock (per cent)

	Real house prices	Owner-occupied housing stock
Imputed rent*	8-13	4- 9
CGT**	2- 3	1- 2
Mortgage interest relief	4- 7	2- 5
VAT	6- 9	3- 6
Total	20-32	10-22
Domestic rates	10-17	5-12
Total net of rates	10-15	5-10

* Makes an allowance for effect of independent taxation

** Assumes roll-over until death and no separate threshold

24. It would be unwise to treat these figures as other than an indication of orders of magnitude. The assumption that rates are just like any other tax on housing, for example, is certainly debateable. But taken at face value, they suggest that the present tax privileges for owner-occupied housing account for 10-15% of the real house price, and 5-10% of the owner-occupied stock. Of course it does not follow that their removal would be desirable; income tax treatment without interest deductibility, plus VAT, is not necessarily the appropriate objective.

25. However once again the abolition of domestic rates is of considerable significance. Taken at face value, our calculations suggest that this about doubles the size of the tax privilege, perhaps adding 10-17% to real house prices and 5-12% to the housing stock. Our central estimate of the price effects (around 13%) is somewhat less than those produced by Peter Spencer and Gordon Hughes (20%) but higher than that in the DOE Green Paper (5%).*

26. It might appear counter-intuitive that replacement of one tax on households (rates) by another of broadly equal size on average (Community Charge) should have much effect on house prices. The essential point is that while the income effect on an average household is close to zero, there will be a substitution effect which encourages additional housing expenditure. Individual households can reduce their liability to rates, other things (like location) being equal, by moving to a smaller or cheaper house. But they cannot reduce their liability to the Community Charge by this means, so the switch in local taxation will give a boost to the demand for housing, and hence house prices.

27. Two further points are worth noting about the effect of abolishing rates. First, all the calculations referred to above are based on relatively simple models of the housing market rather than direct empirical evidence on the effects of rates. It could be that rates are not perceived fully as a tax on housing, although this assumption is used in all the available studies - including the DOE's. Econometric work does not typically distinguish rates from other determinants of house prices, and for example it is difficult to assess the extent to which the increasing burden of rates in recent years has offset the impact of financial and other factors tending to boost house prices.

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* Our reservations about the methodology in these studies are discussed in the annex. DOE assume a rather high supply elasticity for houses, and in our view understate the share of rates in total housing costs; both of these assumptions depress the estimated effect on prices.

28. The second point is that we don't know to what extent the impact of abolishing domestic rates is already being felt. To the extent that the longer term effects on prices are already perceived by those potentially involved in housing transactions, prices may already have been bid up somewhat. But once again this is very difficult to disentangle from other influences. There is perhaps a presumption that the housing market typically reacts relatively sluggishly to changing circumstances, unlike financial markets; but it can react quite quickly in some circumstances.

29. In any event, and despite the uncertainty surrounding our estimates, Ministers have to decide whether the implications of abolishing rates for the housing market and house prices are compatible with the Government's housing policies and the efficient allocation of resources.

(b) Saving and investment

30. The effect of tax on the pattern of personal saving and asset holding may well be substantial, although we have little good empirical evidence in this area. However one can draw some tentative conclusions from examination of personal sector portfolio shares. It is important to remember that the share of housing, shown in Table 4 below, reflects not only the tax treatment of housing, but also the tax treatment of other forms of saving. Furthermore, fluctuations in portfolio shares reflect macroeconomic and other factors as well, including inflation, real interest rates, and institutional change in financial markets.

Table 4: Share of housing in personal sector portfolios (%)

	1957	1962	1967	1971	1976	1979	1983	1987	1988*
Gross	24.3	27.4	33.3	35.4	51.1	54.8	48.0	48.1	49.5
Net**	19.3	23.0	29.0	31.2	45.4	50.3	41.8	41.0	42.6

Memo item: value of housing stock as a percent of personal disposable income

	1957	1962	1967	1971	1976	1979	1983	1987	1988*
	71	92	110	121	126	159	157	213	242

* Industry Act Forecast
** Net of loans for house purchase

31. The share of housing rose considerably in the 1950s and 1960s on both the gross and net definitions. Among other things this may have reflected a process of adjustment to the increasingly favourable tax treatment, but it may also have reflected the role of housing as an inflation hedge during a period when the latter was rising and becoming more variable. Note however that the scale of tax privilege enjoyed by housing <u>increases</u> as inflation increases, because higher nominal interest rates imply higher mortgage interest relief in real terms. Low or negative real interest rates limited this effect somewhat in the 1970s, though of course directly boosting the housing market at the same time.

32. Between the mid to late 1970s and 1987, the share of housing stabilised or even fell, despite the rapid growth in mortgage credit in recent years. To some extent this probably reflected factors other than tax: the move to lower and more stable inflation, booming stock markets, high real interest rates and the growth of institutional savings. And the value of the housing stock has continued to rise relative to personal disposable income. But the scale of tax privilege has also probably been falling in the 1980s: as already noted, lower inflation has this effect; and domestic rates have been rising as a share of the housing stock while the real value of the mortgage interest relief ceiling has been declining (despite the nominal increase in 1983). However as one might expect, figures for

Minimal

1988 based on the forecast in the Autumn Statement show some recovery in the share of housing as a consequence of the recent boom in prices.

33. These figures do not allow us to assess the extent to which the share of housing is distorted upwards by the tax system. However the centre of the ranges in table 3 imply that the value of owner-occupied housing is 20% higher than it would be in the absence of fiscal privileges, which is equivalent to around 10% on the portfolio share.*

34. It is even more difficult to assess the implications of the distortion to saving behaviour for the pattern of investment and, more generally, for economic performance. However it has been argued that the present tax regime encourages investment in housing at the expense of more productive investment in industry or overseas, so reducing GNP; the tax wedge on industrial investment is positive on average, while on housing it is - or soon will be - negative. While there may well be something in this argument, which depends on the proposition that housing investment is less productive than industrial investment, we are not in a position to produce quantitative estimates.

(c) **Labour mobility**

35. Much has been made of the adverse impact of widening regional house price differentials on labour mobility. Muellbauer, in particular, has done a good deal of empirical work on this. However while we may concede that this effect is an important one, it is much more difficult to determine the extent to which the problem is a reflection of the present tax treatment of housing. In considering the latter we should distinguish regional and structural effects.

36. Just as the tax privilege for housing boosts real house prices, so it is likely also to increase the absolute size of regional house price differentials. Imputed rent and capital gains are likely to be higher in absolute size in areas where house prices are higher; the average mortgage, and hence the value of mortgage interest relief, is also higher in such areas. But this does not mean that the regional

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* Assumes house prices 12½% higher in real terms and the housing stock 1517½% higher.

dispersion of total housing costs - net of tax payments - is likely to be greater. For this to be the case it would be necessary for the differences in tax privilege to be fully reflected in price differentials, but this seems rather unlikely.

37. The effects of tax on housing tenure are probably rather more important, though complex. The data we have (from the 1981 Census) suggests that owner occupiers are more mobile between districts than those in public rented housing, but markedly less mobile than those in the private rented sector.* Of course this may reflect a variety of different factors, including age and socio-economic status, but the inherent characteristics of the different forms of housing tenure is probably important. Changes in the pattern of housing tenure may reflect factors other than tax, but there is a clear presumption that tax is also relevant.

38. It seems probable from the data that shifts in housing tenure since the war have, until the beginning of the 1980s, contributed to a reduction in overall labour mobility. The growth of owner occupation over this period was more than matched by a decline in the private rented sector, with public housing also growing in importance. However since the early 1980s, the decline in private renting has slowed in absolute terms - the share of the market is now very small - and continuing increases in owner occupation have been largely at the expense of public housing. The net effect on labour mobility has probably been slight in recent years; the declining trend has been arrested.

39. The right-to-buy policy has thus probably benefited labour mobility, by switching families out of public housing into owner-occupation. But it seems likely that the favourable tax treatment of owner-occupation *per se* has an adverse effect on mobility: the latest mobility figures suggest that this is so as long as 35% of any boost to owner-occupation is at the expense of the private rented sector. This is not to imply that the longer term decline in private renting has been caused solely or primarily by tax considerations.

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* Within the private rented sector, furnished accommodation provides the greatest degree of mobility.

40. In addition to these changes in the pattern of tenure, the tax system also affects mobility within the owner-occupied sector by altering transactions costs. In particular, the cost of moving house is reduced by the CGT exemption, although probably not by much on average given the annual exemption and assuming other costs would be deductible; but costs are increased by the continuance of stamp duty.

The options for reform: objectives

41. The previous discussion suggests two main conclusions:

(i) Owner-occupation currently benefits from a considerable degree of tax privilege relative to other forms of housing and saving. These privileges are set to increase further with the abolition of domestic rates, after which there will be a clear tax subsidy for all mortgaged housing. Unless there has been a corresponding shift in the objectives of housing policy, or in the strength with which they are to be pursued, there is a clear case in principle for altering the tax regime so as to offset the increase in privilege and so prevent further distortions of the housing, saving and investment markets.

(ii) The favourable tax treatment of owner-occupation if anything has adverse effects on labour mobility, because an important counterpart is likely to be a smaller private rented sector. This conclusion probably remains valid despite deregulation and the extension of BES (temporarily) to private renting. The adverse impact on labour mobility and the supply side is likely to increase with the abolition of rates, suggesting a need for offsetting measures.

42. These conclusions are not new. They have prompted various commentators to suggest ways of improving the situation. It would clearly be preferable in economic terms to alleviate the structural problems in the housing, saving and investment markets by levelling the scale of tax privilege down rather than bringing the tax privileges of the rented sector up to that currently enjoyed by owner-occupiers. Deregulation of the private rental sector is a step in the right direction, designed to improve supply. Extension of BES to private renting in the Budget was clearly a second best - and temporary - solution, intended to give a kick start to the rental market.

43. Some would argue that the tax treatment of owner-occupation is unduly favourable even with the present system of rates. But it is not necessary to hold this view in order to justify reform.

Replacement of rates by the Community Charge suggests a case for action; the reform of local government finance has been prompted primarily by considerations other than the state of the housing market.

44. There may also be macroeconomic arguments for reforming the taxation of housing, but these are not considered in detail here. The macroeconomic concerns may well prove transitory; interest rates are arguably the appropriate weapon for dealing with them, though reform of housing taxation may perhaps permit interest rates to be lower than they otherwise would be by restraining credit demand.

45. In thinking about possible reforms it is clearly important to distinguish the two main objectives:

- the need to reduce the distortions of saving and investment patterns, because they adversely affect economic performance;

- the need to improve the functioning of the labour market, and hence the supply side.

Main objective presumably is to avoid house/bubbles

In certain cases, notably stamp duty and CGT, these different objectives may conflict.

46. Reducing the tax privileges of owner-occupation could in principle be achieved in various ways, including:

- further restrictions on mortgage interest relief;
- re-introduction of a tax on imputed rent;
- levying VAT on housing services;
- extension of CGT to main residences;
- increasing stamp duty.

47. A desire to improve labour mobility through the functioning of the housing market suggests a need to boost the private rented sector. Partly this may be achieved by restricting the provision of public housing, but it would also be aided by a reduction in the privileges of owner-occupation. However the way in which these privileges are

scaled down is of considerable importance. Options in the previous paragraph which would run counter to the mobility objective are:

- increasing stamp duty - if anything the reverse is indicated;
- extending CGT to main residences, except on gifts and death.

48. Strictly speaking, the way in which any reform of the taxation of owner-occupied houses should proceed depends on:

- the desired relationship with the taxation of other forms of consumption, saving and housing;

- the extent to which taxation of these is likely to be reformed;

- the different ways in which tax privileges are given in particular instances.

Parity of treatment with private renting, for example, would require taxation of imputed rent and capital gains while retaining MIR; parity with annual pension payments would require, in addition, investment in housing equity to be deductible; while parity with other forms of consumption would require abolition of MIR and imposition of VAT on housing services.

49. Retaining mortgage interest relief but taxing imputed rent and capital gains at income tax rates would generally mean a positive tax wedge; extending VAT to housing would have much the same effect. Abolition of mortgage interest relief would imply a zero tax wedge following the abolition of rates. Any of these changes would be exceedingly difficult politically; anything which went beyond offsetting the broad effect of abolishing the rates would be regarded as a significant shift in present policies.

50. How much weight should be given to the labour market objective is a matter of judgement. Labour market behaviour remains a constraint on the success of the UK economy, and action to increase labour mobility is likely to be helpful in this respect - though companies may not necessarily wish to see faster labour turnover and reductions in employee loyalty. The minimum objective should be to avoid

reducing tax privileges for owner-occupation in a way which reduces mobility; but reducing taxes on housing which impede mobility would not obviously be attractive, taken in isolation.

51. Other aspects of housing policy obviously have to be kept firmly in mind. The desire to help people buy their own homes, including first time buyers, is an important aspect of Government policy. The Government has pledged itself to maintain the present system of mortgage interest relief. The trade-off between housing policy objectives and the desirability of changing the tax treatment of owner-occupation on economic grounds cannot be avoided. But it may be that in the longer term, as real incomes rise and owner-occupation comes within reach for all, the need for fiscal encouragement will diminish.

The options for reform: specific measures

52. We consider in turn a number of specific options for reform in the light of the objectives discussed in the previous section.

(i) Restrict or abolish mortgage interest relief

53. Action in this area would contribute to both main objectives. Complete abolition would produce a zero tax wedge for owner-occupation, equivalent to expenditure tax treatment. It would currently save around £5 billion in revenue, and might in the longer term, taken by itself, reduce real house prices by 4-9%.

54. But the Government has pledged to leave the present system of mortgage interest relief intact. Abolition is not an option, however desirable it might be in principle. Restriction to first time buyers is also ruled out; it would in any case lead to serious locking-in effects, and thus adversely affect mobility, unless restricted to a fairly short period.

55. Restriction to the basic rate is an option which it might be possible to present as consistent with the Government's pledges as long as it was part of a general restriction of reliefs for savings to the basic rate. However a decision was taken in July not to introduce

a general restriction of this type, largely because of difficulties with pensions. Furthermore such a move would have little impact on the housing market as a whole, because only about 8% of total relief is above the basic rate.

56. The only practical option is thus to freeze the ceiling for MIR, allowing it to wither on the vine. As already noted, the ceiling has fallen in real terms by about 2/3rds since 1974; continuing inflation would progressively reduce its real value if the nominal ceiling could be held. At 5% inflation, the real value halves in little over 14 years.

(ii) A tax on imputed rent

57. It is difficult in principle to justify the continuation of mortgage interest relief in the absence of a tax on income from housing. This is what gives rise to the tax subsidy in the present system, at least after domestic rates are abolished. We now effectively provide an offset for expenses against a tax which we don't collect.

58. So if MIR is to be retained, which it is, a tax on imputed rent to replace domestic rates is worth another serious look. Our figures suggest that taxing imputed rent at income tax rates would more or less compensate for the abolition of rates. This would leave the tax wedge on owner-occupation broadly as it is now - ie on average close to zero.

59. Taxing imputed rent at income tax rates would permit a substantial reduction in the basic rate while maintaining an unchanged yield from income tax. We estimate that the basic rate could in principle come down by as much as 3p.* This would have major benefits throughout the economy, improving work incentives, reducing the value of tax reliefs, and generally reducing distortions - a prize well worth grasping. But in practice there would be considerable pressure

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* Based on the assumption that net imputed rent is 5% of the value of the housing stock, and making a rough allowance for the impact of independent taxation.

to choose relatively low estimates of imputed rent, permitting a reduction in the basic rate of rather less than 3p.**

60. If income tax were to be extended to imputed rent, it would make sense on both economic and equity grounds to abolish the ceiling for MIR. This would limit the extent to which the basic rate could be brought down, but only rather slightly - probably by under ½p on a revenue neutral basis assuming interest rates come down from present very high levels.

61. If a proposal along these lines were to be implemented, the Government would inevitably have to answer the charge that it was simply re-introducing rates. This would be difficult. One would have to argue that rates were abolished primarily because it was desirable to change the system of local government finance, not because it was desirable to reduce the tax burden on housing. Indeed the fact that rates are to be abolished makes it all the more important to make an offsetting increase on the tax on housing so as to prevent a further increase in fiscal privilege for owner-occupiers and further upward pressure on house prices.

62. It would undoubtedly be argued that imputed rent does not confer taxable capacity, in the sense of cash resources. Three points should be noted about this argument:

- if tax rates are reduced at the same time and allowances increased, the impact on cash flow should be small for most people;
- owner-occupiers who own a good deal of the equity of their houses, for example the elderly, are in a position to realise some of it by suitable mortgage/annuity arrangements;
- owner-occupiers do not have to pay rent.

But again, this would be an extremely contentious issue which would undoubtedly cause great political problems.

** It could be argued, here and elsewhere, that a reduction in tax privileges for housing should be used to finance tax reductions for other less privileged forms of saving. Otherwise, the overall incentive to save would be reduced.

63. Whatever the arguments in principle, the demise of Schedule A in 1963 does not engender confidence that a tax on imputed rent would be either workable in practice or politically acceptable. Major differences from the old system would be necessary, as Professor Muellbauer - a keen proponent of this option - recognises. At a minimum it would be necessary to link the tax more closely to current property values, avoid the administrative problems associated with deductibility of maintenance/improvement expenditure, and avoid some of the worst distributional consequences.

64. It if were to be workable, any scheme would probably have to be fairly rough and ready. But this may be no bad thing. It might involve the following features:

(a) The tax base might be related to capital values by applying a fixed rate of return - say up to 5%. There would inevitably be an element of arbitrariness about the rate of return, but it would be possible to err on the low side, and there would be much pressure to do so.

(b) A rough and ready allowance could be made for average maintenance expenditure, estimated at perhaps 1% of the housing stock per annum. This could take the form of a reduced rate of tax or, more straightforwardly, a lower assumed rate of return. Major improvements would not attract tax relief, but would be reflected in capital gains and a (probably untaxed) addition to imputed rent.

(c) Property values could be based on either purchase prices or periodic valuations. Between transactions or revaluations, values could be uprated using local house price indices; uprating factors might be issued by the Government annually. This approach would avoid the problems caused by infrequent upratings under Schedule A.

(d) The tax could be collected through the PAYE system for most taxpayers. Owner-occupiers taxed under PAYE would all receive codes incorporating the (estimated) imputed rent on their houses. Others would have to be assessed individually.

65. But though such a scheme might be workable, it would in practice place a very heavy administrative burden on the Inland Revenue. The burden would arise in the context of both valuation and collection.

66. Initial valuations would be required for all owner-occupiers before the tax could be collected. But given the present burden on the Valuation Office, most notably in connection with the national non-domestic rate, and the severe problem of staff shortages which it faces, a full scale valuation exercise for domestic property could not be contemplated in the near future. At best it would be necessary to spread the process over a long period, starting around 1990. At worst, a further drain on VO resources would make such an exercise completely impossible.

67. The only practical alternative would be to adopt a system of self assessment, subject to random audit. This would inevitably involve an element of arbitrariness, and powers would be needed for the audit and the imposition of suitable penalties in the case of fraudulent assessments. It would thus undoubtedly be very contentious. Furthermore even this alternative would put additional pressure on the Valuation Office indirectly, because the private sector demand for qualified valuers would be increased.

68. Collection of the tax, even through the PAYE system, would require a major increase in taxpayer contact with the Revenue. At present the Revenue has dealings only with a small minority of taxpayers - about 4¼ million employees. With the composite rate system and MIRAS, basic rate taxpayers generally need have no dealings at all. But a tax on imputed rent would require all owner occupiers (about 14 million) and, under independent taxation, their wives, to be coded each year. And in many cases, imputed income to be coded in would exceed available personal allowances; tax liability would in some cases exceed available cash income.

69. The Revenue have not examined in detail the staffing implications of taxing imputed rent. But in broad terms it seems probable that the extra staff required would run into several thousands, even in the long term when the initial valuation has been completed. The change envisaged is more complex - and would be more contentious - than independent taxation, which is estimated to require 2100 additional staff.

70. One reason why the Revenue believe that the staffing consequences would probably be quite severe is that extending income tax in this way would generate a large and continuing volume of correspondence and casework. If Schedule A is anything to go by, much of this would probably focus on the valuation of individual properties, including the effects of maintenance (or lack of it) and improvement expenditure. But in any event, such a move would be deeply unpopular, with many complaints about unfair treatment. The experience with Schedule A suggests that most people find it difficult to understand what imputed rent is, never mind why they should be taxed on it. It would be regarded by many as akin to a wealth tax rather than income tax.*

71. The distributional consequences could be considerable. Revenue neutrality, if that were the aim, would mean losses for owner-occupiers and gains for taxpayers living in rented accommodation. Rich people in small houses would gain relative to poor people in large houses, though introduction at the same time as rates are abolished, if that were possible, would significantly reduce the net impact at the time. In any event, distributional considerations suggest that such an extension would cause least difficulty politically - although still probably a great deal - if it could be introduced at the same time as a net reduction in income tax.

72. While it may be difficult to offset the distributional impact of variations in house price/income ratios, the broader distributional consequences could be offset by suitable manipulation of personal

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* When reform of domestic rates was under active consideration in 1985, schemes based on capital values were eventually ruled out for essentially this reason.

allowances/thresholds and the basic and higher rates. For example, one would presumably want to raise personal allowances and thresholds sufficiently to ensure no increase in the number of taxpayers at either the basic or higher rate as a result of this proposal - ie by the average imputed rent enjoyed by those around the present tax thresholds. But because the correlation between household income and the value of housing is only rough, there would inevitably be many individual losers (as well as gainers) unless the total tax take were reduced. The political problem of little old ladies in large family houses, for example, would once again emerge with a vengeance.

73. Taxing imputed rent would thus involve major political and administrative problems whenever it was done, though it would technically be feasible. As regards <u>timing</u>, there would be a good case for going ahead in 1990, at the same time as domestic rates are abolished. This would help mitigate the distributional consequences, as one property-based tax would be replacing another. But in order to get the tax off the ground in 1990, it would be necessary for the Revenue to receive all the property valuations by the end of 1989 - little more than a year from now, and only 9 months from Budget day. Even with a system of self assessment this seems quite impractical; a 1990 start can effectively be ruled out.

74. <u>To sum up</u>, taxing imputed rent would pose great difficulties, though we should note that it is part of the income tax base in 11 out of 24 OECD countries. Whatever the economic arguments in favour, and they are strong ones, it would require immense political courage to reintroduce it in the UK; and it would be very costly in terms of resources. We have almost certainly missed the boat for 1990, the natural occasion for introducing it.

<u>(c) CGT on main residences</u>

75. Ending the CGT exemption on main residences would be another way of bringing the return to owner-occupation into tax. However the economic implications of ending the exemption would depend crucially on how it was done. Restricting the tax privilege for owner-occupation by extending CGT meets one of the main objectives for reform, but runs the risk of compromising the mobility objective.

76. In designing a scheme for ending the exemption it would be necessary to consider a number of key issues:

- whether to allow roll-over relief, and in what circumstances;
- whether to allow a separate annual exemption or threshold;
- what rate to charge.

We consider these in turn; Michael Cayley's paper provides a much more extended treatment.

Given gifts treatment?

77. If the CGT charge is to bite to any significant degree, roll-over relief must clearly be restricted. However, labour mobility could be badly affected if there were no roll-over at all. The most satisfactory approach from an economic point of view would be to allow roll-over to the extent that sale proceeds are re-invested in housing, but not otherwise. CGT should be payable on gifts and on death; otherwise the charge could clearly be avoided indefinitely. The revenue effects would take a good deal of time to build up, as also probably would any impact on house prices. But damaging effects on mobility would be avoided.

78. It would be desirable in principle to take into account changes in mortgages or other secured loans when assessing the CGT charge when houses are bought and sold. This would provide a disincentive to remortgaging property for consumer spending by triggering a tax charge whenever this occurred. Unless this approach were adopted there would be a danger of individuals deferring or avoiding CGT by borrowing against their accrued gains. However it would not be without a number of practical difficulties, and the Revenue doubt that it would be a viable option.

79. It might be objected that a complete absence of roll-over relief would actually encourage mobility. Owner-occupiers could avoid the CGT charge by moving sufficiently frequently to ensure that the taxable gain is less than the CGT threshold. But this argument seems a little far fetched. People would have to move on average at least once every five years to avoid a CGT charge; they would incur additional transactions costs as a result, which would need to be set

against the CGT liability thereby avoided; those with more expensive houses would have to move more often; and when house prices were rising rapidly, as in recent years, even more rapid moves would be required.

80. Roll-over relief would not significantly alter the staff consequences; providing relief as suggested above would be only marginally more staff intensive than not doing so. The main determinant of staff costs would be the basic scope of the charge, and hence the threshold and annual exemption to which we now turn.

81. Whether or not there is a high threshold or a separate annual exemption for housing determines whether the CGT charge actually bites on the bulk of the housing stock. If the intention is that it should bite, it would not be desirable to build these features into the system.

82. A separate annual exemption could be justified on three grounds:

(i) Maintenance/improvement expenditure. An exemption would effectively make a rough and ready allowance for this. But there is no reason why such expenditure should be offset against CGT liability if imputed rent remains exempt. If imputed rent is taxed, of course, the argument for a separate CGT exemption is stronger.

(ii) Roll-over. An exemption might be considered a substitute for roll-over relief. But in practice it would be a poor substitute. As argued above, roll-over relief would ideally be available only when sale proceeds are reinvested in housing, but an annual exemption would be equivalent to an element of roll-over for all forms of disposal - including gifts and death - enabling the tax to be avoided completely.

(iii) Staff and compliance costs. A high threshold and a separate annual exemption would significantly reduce compliance costs and the costs to the Revenue of administering the tax. As already noted, Revenue involvement would not be much affected by the proposed roll-over arrangements.

83. In practice the third reason is by far the most telling. Michael Cayley's paper suggests that a threshold of £110,000 - the figure considered in the summer - and special annual exemption of £5,000 might mean that, out of some 1.2 million owner-occupier moves a year, less than 200,000 a year might be above the threshold in the first two years, and that only a minority of these might involve chargeable gains (the remainder producing capital losses). The Revenue would have to establish the gains and losses on all disposals over the threshold. Their staff need would run into hundreds. Without a threshold or special exemption, thousands of extra staff would be required. Thus there is a clear trade-off between administrative costs and the impact of the CGT charge on the housing market.

84. As Mervyn King has recently argued (in his paper for the Tax Consultative Committee), CGT on housing should ideally be considered in conjunction with IHT. A low threshold for housing CGT on death would point to an increase in the IHT threshold, or removal of houses from IHT, or perhaps even complete abolition of IHT. The aim would presumably be to confine any double taxation of houses on death to a very small minority of the largest estates.

85. Any decision about the rate would depend to some extent on whether imputed rent were being brought into tax. If it were not, there would seem little reason to have a special CGT rate for housing. If imputed rent were being taxed at income tax rates, there would be a case for a lower rate of CGT to allow for maintenance/improvement expenditure.

86. The base date for the CGT charge would presumably have to be 1989 (or whenever the tax was introduced) in order to avoid retrospection. In principle this would require the domestic housing stock to be valued in 1989 in order to provide a basis for future CGT charges, so posing much the same problems as with taxing imputed rent. But in practice, while they would be considerable, the difficulties would be significantly less serious in the case of a CGT charge.

87. A full scale valuation exercise in 1989 could not be contemplated, for the reasons already discussed. But this would

matter less for CGT since under 15% of houses are typically traded in one year, whereas 100% would be subject to an imputed rent tax. It would be possible to consider an alternative, more arbitrary, approach to 1989 valuations rather than using 1989 open market values as the base. This could be done broadly as follows:

(i) when a house comes onto the market the total gain would be computed, using information from the Land Registry if the owner does not have a record of the purchase price.

(ii) the total gain would be apportioned to pre- and post-1989 periods using some arbitrary rule - eg time apportionment or interpolation using an appropriate (probably national) house price index.

(iii) once a house has been traded, and a price established, the Revenue would have acquired a base for calculating future gains.

88. This sort of approach, discussed in more detail in Michael Cayley's paper, would involve an element of rough justice and might be quite complicated (eg if interpolation were the chosen method). But it could be made to work if necessary.

89. The <u>economic effects</u> - on house prices and the size of the owner-occupied sector - would clearly depend on all these decisions. With a low threshold and no special annual exemption, prices might ultimately be lower by somewhere in the region of 3%; the revenue yield might be of the order of £3 billion in the long run. But with roll-over relief, and so tax collected mainly on death and trading down, the build up of these effects would be very slow indeed; the full effect might take 40-50 years to come through. The justification would have to be in terms of the structural effect on the housing market in the longer term, not the short term impact.

90. The economic effects in the longer term would also depend on the prospect for growth in real house prices. The figures above assume a continuation of the post-war trend of about 2% per annum, which may or may not be appropriate. There are demographic reasons for thinking

that the underlying growth in real house prices might be rather less than this in the 1990s, though probably still positive; net household formation is projected to decline, with the number of new entrants falling and an increasing number of dissolutions of elderly households. But against this, supply side improvements can be expected to lead to faster growth of real personal incomes, which will have the reverse effect on real house prices. The figures for prices and revenue effects in the previous paragraph may not in practice be very far out.

91. Two final points. First, CGT is a relatively complex tax to administer and understand. The arguments for extending it to housing would be weak if the other tax privileges available for owner-occupation were not so great. If extending income tax to imputed rent were a serious runner, one would not want to press the case for a CGT extension as well. But if taxing imputed rent is not on, the case for extending CGT is that much stronger - provided it is designed in such a way that the charge does actually bite.

92. However the distributional impact of extending CGT would probably be bearable; it would certainly be much less worrying than for a tax on imputed rent. Whereas the latter might produce significant losses unless it was introduced in 1990 <u>and</u> was accompanied by a general reduction in income tax, CGT with roll-over would have little immediate effect. The main losses would fall on those in receipt of gifts or inheritances, who would in general have sufficient resources to bear them.

93. <u>To sum up</u>, the scheme put forward in Michael Cayley's paper is one possible way of offsetting the impending increase in tax privilege for owner-occupiers without incurring excessive administrative costs or causing acute distributional difficulties. But the inevitable counterpart to these advantages is that it would bite on a very small section of the housing market and would thus do very little to offset the increase in tax privilege. Insofar as it did bite - at the top end of the market - the absence of roll-over would have adverse consequences on mobility. Housing costs would be raised in the South East, for example, relative to other regions. It is thus highly debateable whether the economic effects would be sufficiently

favourable to outweigh the inevitable political costs. The scheme suggested in this paper, in contrast, would undoubtedly cause more aggravation than the Cayley scheme, and would only make sense with a CGT charge for housing on gifts and death. But there is a much greater presumption that it would produce economic benefits.

(iv) VAT on housing consumption

94. Extending VAT to consumption of housing services would have similar advantages to extending income tax to imputed rent, and would pose similar - if anything greater - problems. It would raise much less revenue, and thus permit a much smaller reduction in the basic rate. The statisticians might well argue that it should raise the RPI. Administration would probably be at least as difficult; quite how Customs would go about collecting it is unclear, and if the Revenue had to do so it would be marginally more complex than a tax levied at income tax rates. If taxing imputed rent is not on, then levying VAT is even less so.

(v) Stamp Duty

95. Stamp duty on housing has two broad effects:

- it offsets some of the tax privileges of owner-occupation;
- it increases transactions costs, inhibiting mobility.

It is thus not immediately clear what if any change is indicated, given the objectives for reform set out earlier.

96. In practice much would depend on whether any other action was being taken. For example if CGT were extended to housing without roll-over, the case for reducing or abolishing stamp duty would be that much stronger. The adverse effects of CGT on mobility would be offset, but so would the impact on tax privilege; whether the net effect would be an improvement on the present situation is doubtful.

97. The case for reducing or abolishing stamp duty would be weak if neither CGT nor income tax were being extended to housing. Although the immediate impact on mobility would be favourable, it would be

difficult to justify yet further reducing the tax on housing. But an increase in stamp duty would be the least helpful way of reducing tax privilege.

(vi) Consumer Credit Tax

98. A consumer credit tax has been considered regularly in recent years. The present conjuncture is one in which fiscal action to restrain credit and increase saving would be more than usually welcome, and it could be designed in such a way that mortgage credit is affected in the same way as other forms of personal credit.

99. It was concluded when this subject was last discussed that the tax should be levied on interest payments. In the context of housing it would thus be an offset to mortgage interest relief; it would be justified as an across-the-board measure designed to get at all forms of credit without singling out mortgages. Such a tax would reduce the tax privilege of owner-occupation in absolute terms, but not relative to other forms of saving financed by borrowing. In practice this probably means that both housing and consumer durables would become less privileged relative to other forms of saving which are less likely to be financed by borrowing.

100. It is helpful to think of the tax treatment of consumer credit in a slightly wider context. Many countries at present make interest on consumer credit deductible for income tax purposes, just as we do for mortgage interest. This produces a neutral outcome, in the sense that borrowing is not unduly favoured or disfavoured, as long as the services/income from the goods/assets purchased are taxed as income. But since this is typically not the case with durables and current consumption - though in many of these countries imputed rent on housing is taxed - the net result is a tax subsidy. This is analogous to our problem with MIR.

101. Because of the presumption that this type of tax treatment inflates borrowing and depresses personal saving, it is a matter of concern in many of the countries concerned. Denmark, for example, has introduced a 20% consumer credit tax - not applied to housing - to provide an offset to interest deductibility. Although clumsy, this

solution has a certain logic in the Danish context because it brings the tax treatment of housing and consumer durables more closely into line. But a consumer credit tax would be less logical in the UK context; superimposed on our tax system, such a tax would provide a positive disincentive to expenditure on durables and do nothing to redress the balance with housing.

102. The main practical stumbling block in the way of a consumer credit tax in the past has been the difficulty of devising a scheme which would be effective for individuals while exempting unincorporated businesses. This could in principle be looked at again; while foolproof anti-avoidance devices may be difficult if not impossible to devise, this does not rule out a reasonably satisfactory scheme. But the arguments in principle for the imposition of such a tax are arguably not sufficiently powerful to warrant a further look.

Conclusions

103. The taxation of housing is a minefield for policymakers. There are strong economic arguments for reforms which increase the tax burden on owner-occupiers, but immense political difficulties. The Government is hemmed in by election pledges; with the best will in the world, freedom of action is limited.

104. But whatever one's views about the present (ie 1988) tax treatment of owner-occupiers, the replacement of domestic rates by the Community Charge is a significant shift. This alone suggests a need for action <u>unless</u> the Government's housing policy indicates a need for more favourable tax treatment for owner-occupiers than they currently enjoy. In the absence of such action, distortions in the saving and investment markets will increase. Quite independently, problems of labour mobility and the interaction with the housing market suggest a need to increase the size of the private rented sector relative to owner-occupation.

105. Significant restriction of <u>mortgage interest relief</u> is ruled out by Government pledges, although continuing inflation will progressively reduce its importance in real terms. The economic case for extending income tax to <u>imputed rent</u> is a strong one; and it

might permit a substantial reduction in the basic rate, with all the benefits which that would confer in terms of incentives and reduced distortions. But the political and practical difficulties would be enormous; it is almost certainly too late for introduction in 1990, the natural opportunity. Much the same arguments apply with extending VAT to housing consumption.

106. Extending impending CGT to owner-occupied housing would be another way of offsetting the increase in tax privilege, and one which has not been ruled out by Government pledges. But the scheme favoured by the Revenue would not obviously be the best way of proceeding on this. Because CGT bears particularly heavily on transactions, care would be needed to ensure that labour mobility was not damaged; this indicates that roll-over would be desirable. And if there is to be a significant impact on the scale of tax privilege, the threshold would need to be low and exemptions minimal. The trouble is that this would mean a substantial administrative burden on the Revenue; the Revenue option avoids much of this extra burden, but also much if not all of the economic advantages.

107. A broadly based consumer credit tax would do nothing to redress the balance of advantage between borrowing for housing and other purposes. But it would reduce the fiscal privilege enjoyed by both housing and consumer durables, while perhaps having macroeconomic and monetary advantages in current circumstances. However this has been examined many times in the past and there is no reason to think it is a more promising option now.

ETS Division
17 November 1988

Ch
None of the objections seem insuperable to me. Could do either mortgages alone, or cars as well.
AA

COPY NO 1 OF 22

FROM: S J FLANAGAN
DATE: 19 January 1989

1. MR CULPIN
2. CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Gilhooly
Mr Matthews
Mr McIntyre
Mr Macpherson
Mrs Chaplin
Mr Tryie

Sir A Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Lewis - IR

Is this worth further work?

If so, should the presumption be that we concentrate on mortgages or on NICs on benefits more generally?*

* Quick views of Mins. & advisers, pl.
19/1

NICS ON SUBSIDISED MORTGAGES AND OTHER BENEFITS-IN-KIND

You asked at the Overview Meeting on 16 January for a note on the prospects for imposing NICs on benefits-in-kind, and particularly on subsidised mortgages. This is very much a quick and dirty first look, and if you are interested in taking this further we would need to look at the issues in more detail.

2. The main taxable benefits-in-kind are company cars (received by 1.4 million people to a value of about £2 billion a year), free petrol for private use (received by 800 thousand people, value £440 million a year) and private medical insurance (also received by about 800 thousand people, annual value £280 million).

3. Our rough estimate is that there were about 260,000 subsidised mortgages extant in January 1988, providing an annual benefit of about £340 million.

FLANAGAN → CHEX 19/1

4. There would be obvious problems in applying NICs to private health insurance in the present climate. The same probably applies to similar, but less major, benefits such as child care provision. The rest of the taxable benefits, other than cars, petrol and mortgages, are relatively small, but each brings its own administrative problems. The cumulative effect is daunting, and has been a major stumbling-block during previous considerations of NICing benefits.

5. The case is less clearcut for company cars. Arguably, priority should be given to getting the income tax treatment right. But that may prove to be a drawn-out process. And whereas the extra income tax would be paid by employees, the NIC burden would be borne mainly by employers - exclusively so, if you were only to apply employers' NICs and not employees. Free petrol is also ambiguous. There is a case for keeping the tax/NIC treatment in line with company cars, but it is not overwhelming. So these options can more easily remain open.

6. Clearly, applying NICs to subsidised mortgages is likely to require major changes to the NIC system. This note concentrates on subsidised mortgages because, as you said, they are the most obvious target in present circumstances, and because the background is less familiar than that to company cars. But if you decide subsidised mortgages are worth pursuing, you will eventually also have to decide whether to include one of the other major options as well, or whether you could defend applying NICs to subsidised mortgages alone.

7. Prior to the 1988 Budget, we looked at various options to increase the taxation of subsidised mortgages. These come to nothing, largely because it transpired that subsidised mortgages did not have any tax advantages, due to the interaction with MIR discussed in the annex. But there is no question about the NIC advantage of receiving a subsidised mortgage rather than its equivalent in cash.

8. In January 1988 we estimated that applying employee and employer NICs would bring in £37 million in employer NICs, £22 million in employee NICs and £8 million in income tax. The calculation involved behavioural effects, which inter alia produce the income tax yield from people who cash out, so applying employer NICs alone was expected to yield only about £30 million. A higher employer NIC liability implies a lower CT liability, so the net yield was estimated at perhaps £20 million.

9. Since January 1988, of course, interest rates have changed considerably, and yields would be highly sensitive to such changes. An increase in base rates is likely to bring about a proportionately larger yeild from NICs on subsidised mortgages.

10. Applying employee NICs might have unfortunate distributional effects as they'd only hit people earning less than the UEL. It would also create a problem about whether or not the extra contributions would count towards benefits. Applying only employer NICs would avoid this - benefits in no way depend on employer contributions. This would greatly simplify the administrative angles too. But there may be problems in this approach. Earnings are current defined the same way for both employers' and employees' NICs. So although there is a distinction - because employees' NICs have a UEL where employers' don't - this could be seen as a new departure and an erosion of the contributory principle.

Administrative Considerations

11. A number of administrative hurdles would have to be overcome if employer NICs were to be charged on subsidised mortgages. The main problems are:

(a) P11D forms, on which expenses are declared to the Revenue, are not aggregated at the company level;

(b) although P11Ds contain details of the size of the loan and the interest rate charged, they do not contain any calculation of the benefit derived;

(c) NICs are charged on a weekly basis. P11Ds are submitted once a year.

12. A rough and ready solution might be to require firms to calculate the aggregate mortgage subsidy to employees and applying a flat 10.45 per cent rate to give the NIC liability. The aggregate mortgage subsidy would be the average subsidised debt outstanding multiplied by the difference between the average "official" rate and the average rate charged to employees. The official rate is currently used to work out tax liability on subsidised loans. It is broadly 1½ per cent above the base rate.

13. If such an approach proved unacceptable to some employers, they could be given the option of working out their NIC liability on an employee by employee basis. Either way, it would be hard to monitor.

14. Since employers' NICs do not give entitlement to benefits and involve no UEL, there is no reason why NICs paid on subsidised mortgages should be paid weekly. For example, they could be paid twice a year like Class 4, or even once a year at the end of the tax year. If this was inconsistent with the statutory basis of Class 1, a new class could be created - presumably Class 5. An annual payment would also fit in more neatly with the car scale system used for applying income tax to company cars. A new class, though, might be seen as a new tax.

15. Whatever approach was adopted, compliance costs for employers would undoubtedly increase. Generally speaking we don't like to do this, and we would risk separating the ways the tax and NICs bases are calculated. However, companies would have the option of pulling out of subsidised mortgages and increasing their employees' pay in lieu. Indeed, this might be one of the main objects of the exercise.

Presentation

16. If you were to go ahead with a NIC charge on subsidised mortgages alone, you would need to consider how to present such a move. There is the obvious argument from equity, but that applies to other benefits-in-kind as well. A case might be built upon:

- removing a buffer from the effects of interest rate increases;

- removing distortions in the housing market - particularly between regions;

- making a favourite "locking-in" device less attractive, so improving labour mobility.

But none of these is particularly strong, and we would need to think about them further. There is no real parallel with gilts, which were a straightforward avoidance device.

17. Some of the issues surrounding subsidised mortgages are discussed in more detail in the attached annex.

Next Steps

18. If you decide you do want to pursue this option, it would almost certainly not be possible to apply NICs instantly, particularly if a new NIC class was needed. Employers would need some time to get their mechanisms in place, and there would be some lead time for DSS and the Revenue as well. We don't know for sure, but the earliest date might be October, or even April 1990.

19. If you are still attracted once we have looked at options in more detail, we would need to involve nominated DSS officials at some stage. It would ~~seem~~ sensible for you to have a word with Mr Moore before we do that, but we are not there yet.

Steven Flanagan

S J FLANAGAN

ANNEX A

NICS ON SUBSIDISED MORTGAGES: BACKGROUND

Tax Treatment

1. Generally speaking, employees receiving cheap or interest-free loans from employers pay IT on the benefit they get. The benefit is the difference between the interest they actually pay and the interest they would pay at the "official rate" (broadly 1½ per cent above Base Rate - but the official rate is only changed when the Base Rate moves by more than ½ per cent). There is only charge to tax if the employee if is receiving more than £8,500 in total salary and benefits and then only if he receives more than £200 per annum benefit from cheap loans.

2. Mortgages are treated rather differently. Below the MIR limit, IT is <u>not</u> paid on the benefit from a cheap mortgage, as the MIR foregone is equivalent to the IT liability that would otherwise arisen. In other words, the system is tax-neutral between an employee getting £1,000 a year benefit from a cheap mortgage and one getting £1,000 a year in higher salary and spending it on mortgage interest.

3. On mortgages of over £30,000 tax is paid on the benefit of the amount exceeding the MIR threshold only. So again, the system should be neutral in terms of income tax between those benefiting from a subsidised mortgage and those benefiting from an equivalent payment of some other kind.

Extent

4. In 1985-86, 56,000 people were taxed on a total £55 million benefit from subsidised loans. This is, of course, not the total number of people benefiting from such loans. This figure include those being taxed on the benefit derived from the element of a subsidised mortgage above £30,000, but in 1985-86 there were

probably very few of these. To be caught by P11D, employees have to be earning over £8,500 a year. Also, there is a statutory de minimis rule, and the Revenue ignore cases where the benefit of a subsidised loan is under £200 a year. If we assume that the interest rate on these loans is, like that on subsidised mortgages, about 5 per cent below the "official rate", that means loans of up to £4,000 are not being caught.

5. By January 1988, there were estimated to be about 260,000 subsidised mortgages extant - about 3.3 per cent of the total, probably concentrated in the South East. The average subsidised mortgage was around £24,000, with a total outstanding debt of £6¼ billion. About 50,000 people had mortgages of over £30,000. The average interest rate was 5 per cent, compared to a market rate of around 10.5 per cent. The total net value to employees of these subsidies was estimated to be about £340 million.

6. Presumably new mortgages taken out since January 1988 have been larger on average but they probably don't push the figures for total outstanding mortgages into a different league.

Housing and Labour Market Effects

7. Subsidised mortgages account for only 3.3 per cent of the total number of mortgages. So the global effect of subsidised mortgages on the housing market is unlikely to be significant. In the case of particular localities, however, subsidised mortgages may have a greater effect in pushing up house prices: for example is in the South East generally, or in specific cases such as the move of Barclays Bank's headquarters to Coventry.

8. However, the alternative to offering a subsidised mortgage is probably to offer a higher salary. That, in turn, would allow the employee to afford a larger mortgage at a non-subsidised rate than would otherwise be the case. That would muffle the effect of introducing NICs. The total impact of such salary increases on overall earnings growth is not likely to be significant.

9. Over the past few months, there has been a significant slowdown in house price inflation. Even so, subsidised mortgages probably keep prices somewhat higher than they would otherwise be, and may help maintain distortions between regions. To the extent that introducing NICs would erode such differentials, it should have a slight effect of increasing labour mobility. But one reaction might be for employers not to offer new subsidised loans, while avoiding the hassle of renegotiating outstanding ones. That would be expected to have a locking-in effect on employees already in receipt of loans - especially mortgages.

10. If subsidised loans become less popular, that should also remove a buffer to the effects of interest rate rises.

Coverage

11. Applying NICs to subsidised loans is likely to be complicated and burdensome for both employers and the relevant Departments. When options for increasing the taxation of subsidised mortgages were considered prior to the 1988 Budget, the Revenue therefore suggested that new measures might only be applied to new mortgages, rather than to existing ones, to ease the transition.

12. Against this, such a measure would increase the likelihood of locking-in, take a very long time to bite, and bring in very little revenue for many years. It would also create a double standard operating in favour of existing home-owners, to the detriment of new buyers.

chex.md/jmt/46 BUDGET SECRET

FROM: J M G TAYLOR
DATE: 20 January 1989
COPY NO: 23 /23.

PS/CHIEF SECRETARY

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Gilhooly
Mr Flanagan
Mr Matthews
Mr Culpin
Mr McIntyre
Mr Macpherson
Mrs Chaplin
Mr Tyrie

Sir A Battishill IR
Mr Isaac IR
Mr Painter IR
Mr Lewis IR

NICS ON SUBSIDISED MORTGAGES AND OTHER BENEFITS-IN-KIND

The Chancellor has seen Mr Flanagan's note of 19 January. He would be grateful for urgent views from Ministers and Advisers on the points raised.

JT

J M G TAYLOR

JMGT → PS/CST 20/1

chex.pj/drafts/20.1.1

BUDGET SECRET

COPY NO 1 OF 22

FROM: MRS JUDITH CHAPLIN
January 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Anson
Sir Terence Burns
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Matthews
Mr McIntyre
Mr Macpherson
Mr Flanagan
Mr Tyrie

Sir A Battishill)
Mr Isaac) IR
Mr Painter)
Mr Lewis)

CHAPLIN → CHEX 20/1

NICS ON SUBSIDISED MORTGAGES AND OTHER BENEFITS IN KIND

It is irrefutable logic that if you are trying to arrive at a system in which the choice between more pay or a perk is neutral, NICs should be imposed on both employers' and employees' benefits-in-kind. Indeed, I know that the IOD has annually expected you to do so.

2. However I think it would be difficult to defend imposing them on subsidised mortgages whilst leaving the rest, substantially bigger, benefits-in-kind NICs free. Because of the impact on the incomes of those earning in upper teens and early twenty thousands, linked to the likely increase in car scales, and without the benefit of a basic rate cut, it would be difficult to impose NICs on car benefits this year. Imposing them on private health insurance is presumably ruled out this year, and imposing them on work place nurseries (unless it was part of a total imposition) would seem to be deliberately provocative. It therefore looks as though imposing them on subsidised mortgages cannot be part of a total package.

3. It could be defended by arguing that you are trying to stop a growing practice by making the choice neutral and encouraging the employer to increase pay rather than subsidise a mortgage. And it does not lock in the employee to that job.

4. Even so, I do not think it the right year to do it. It is very difficult for young people to get into the housing market at all, and particularly difficult for people to move from the North to the South at the moment. Both of these things we are encouraging them to do, and I think it would look odd to take away a facility which may help them at the present time. My preference would be to do it when it is part of a total package of NICs on benefits in kind. But if not that, at least to leave it until some of the heat has gone out of the housing market.

5. There is also an interesting read across to the pension changes. If you have a contributory pension you pay NICs on your total remuneration (as does your employer) and then your pension contributions are deducted. If you have a non-contributory pension, funded or unfunded, even though your employer knows the notional sum by which your salary is reduced (eg 8% according to the Scott report for the civil service), because that sum does not reach the pension fund via you, neither you nor your employer pay NICs on that amount. It is the equivalent of a NIC perk.

6. The subsidised mortgage is somewhat analogous with the pension changes proposed. All get tax relief up to a certain cap (£30,000 for houses) and then the tax benefit ends. But the NIC perk for houses goes from the first pound of benefit upwards, and for the pension until you are above the upper earnings limit when you would not be paying NICs anyway. (So it does not affect the unprivileged fund because the limit is above the UEL.) The employer is paying part of what you would otherwise pay, and thus avoiding NICs. The comment on this could be 'so what'. Perhaps because I have not been here long, I still like coherence!

JC

JUDITH CHAPLIN

cst.rj/docs/20.1.3

Copy No 1 of 18

BUDGET SECRET

FROM: A G TYRIE

DATE: 20 January 1989

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Flanagan
Mr Macpherson
Mrs Chaplin
Mr Call

Mr Battishill
Mr Isaac

Ch/ see also Judith's note, behind. He would [illegible]
20/1

TYRIE → CHEX 20/1

NICS ON SUBSIDISED MORTGAGES ETC

Things look much the same as they did last year on this.

2. The lost employer NIC yield on health (around £30 million), petrol (around £45 million) and mortgages (£20 to £30 million, depending on interest rates) are all dwarfed by the big NIC loss on cars (£200 million plus). But we have looked at cars exhaustively, and decided that a 20% increase in car scales is all we can do this year (we could of course reduce the 20% increase and impose NICs).

3. It would look perverse to do something on health with the Review going in the other direction. We didn't like the look of most of the others (canteens, private education, travelling etc) when we last looked at them. So in my view, for this year, mortgages are probably the only realistic target. Pretty small beer.

4. I really don't think that we can impose a NIC charge on existing mortgagors, particularly this year. It has a whiff of retrospection. Would employers absorb it or would they try and pass it on? If any of it were passed on there would be squeals of anguish at current mortgage rates. So I think we can act

only on new mortgages. Initially that would mean virtually no yield at all.

5. Mr Flanagan's note suggests that the most administratively simple way to collect a charge might be to create a new class of NICs. If we are going to do that I see a case for making the charge 20%, not 10%. 20% has distinct attractions:

- we would kill off low interest mortgages once and for all. Below the UEL the total NIC advantage is 19.45%. A 20% charge would force clearing banks etc to cash out their subsidised mortgages. Perhaps about 150,000-200,000 subsidized mortgages are below the UEL. For the fat cats in the city, above the UEL, (who appear to collect a big benefit but in reality don't) there would be a 10% surcharge for the provision of interest free mortgages. So they would go too.

- A class of NICs would have been created which could subsequently be imposed on other benefits-in-kind when the time is right (for example, on cars at the beginning of the next Parliament).

6. The argument for a 10% charge is, I suppose, that it might be administratively possible to handle it through existing NIC structure (we need more advice on this). It might also be just enough to make the additional administrative hassle of running these schemes not worth it to employers. They might phase their schemes out even though (below the UEL) a 9% NIC advantage remained. 10% should be enough to kill off 'fat-cat' mortgage subsidies in the City.

Against doing anything:

- The best time to do this would have been last year (with tax cuts and lower mortgage rates).

- Anything on new mortgages alone would take a while to take effect. It might also lock some people in.

- Anything we do is likely to involve a lot more Revenue staff. I gather that, last year, the Revenue gave an estimate of 1,500 more staff if we imposed NICs on all benefits.

7. Michael Scholar raised the idea in the overview of disallowing subsidized mortgages for corporation tax. At 35% this would be heavy overkill, but it might be worth a look.

pp RJ.

A G TYRIE

cst.ps/5jm20.1/mins

BUDGET SECRET

0029 25/1

FROM: CHIEF SECRETARY
DATE: 20 January 1989

CHANCELLOR

cc: Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Gilhooly
Mr Matthews
Mr McIntyre
Mr Culpin
Mr S J Flanagan
Mr Macpherson
Mrs Chaplin
Mr Tyrie

Sir A Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Lewis

Thanks — [I await more from others]

Ch, see also notes from Judith + Andrew, behind.
JT 29/1

CST → CHEX 20/1

NICS ON BENEFITS IN KIND

You asked this morning whether we should continue to examine charging NICs on benefits in kind.

2. My instinct says yes, a detailed re-examination reluctantly leads me to say no.

3. The principal argument in favour, to my mind, is that it would act as a deterrent against the spread of benefits in kind. Charging NICs on employers is more attractive than on employees since we then capture payments above the UEL. Frankly, I do not favour extending NICs to employees' benefits in kind for all the reasons we discussed comprehensively last year.

4. The problem is timing and coverage. On timing we would be extending employer NICs to health insurance premiums in the same Budget as we offered tax relief on such premiums for retired people. Odd juxtaposition. But it is hard to see how we could justify removing the employer NICs break for some benefits but not others.

5. My conclusion, therefore, is that we should delay until we are in a position to carry out a consistent across the board reform.

JOHN MAJOR
(Approved by the Chief Secretary and signed in his absence)

Robert 02.23.1.89

BUDGET SECRET

FINANCIAL SECRETARY TO THE TREASURY

COPY NO: 1 OF 21

FROM: FINANCIAL SECRETARY
DATE: 23 January 1989

FST → CH/EX 23/1

CHANCELLOR

cc Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Matthews
Mr MacIntyre
Mr MacPherson
Mr Flanagan
Mrs Chaplin
Mr Tyrie

Sir A Battishill)
Mr Isaac)
Mr Painter) IR
Mr Lewis)

NICs ON BENEFITS-IN-KIND

You asked for my views.

On the specific point about subsidised mortgages, it would look odd to single out one benefit-in-kind, particularly when (as we discovered last year when I raised this) there is in fact no net tax benefit to the employee.

On the more general issue, I think putting NICs on benefits-in-kind would be a complicated and far-reaching change to do at this stage even if we wanted to. Moreover, we would not in any event want to charge them on employees' benefits-in-kind because of the unfortumate distributional consequences we discussed last year. And putting them on employers' contributions only is far from simple. The contrast with our decisions on health insurance premiums would also be tricky presentationally.

All in all, my advice would be to leave this area alone for this year.

R.C.M.J.

pp NORMAN LAMONT

est.ld/lilley/23 Jan/CHX

BUDGET SECRET

COPY NO. 1 OF 20 COPIES

ECONOMIC SECRETARY TO THE TREASURY

EST → CHEX 23/1

FROM: ECONOMIC SECRETARY
DATE: 23 January 1989

CHANCELLOR

cc: PS/Financial Secretary
PS/Paymaster General
PS/Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Gilhooly
Mr Matthews
Mr McIntyre
Mr Culpin
Mr S Flanagan
Mr Macpherson
Mrs Chaplin
Mr Tyrie

Mr A Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Lewis - IR

NICS ON SUBSIDISED MORTGAGES

2. Despite the negative tone of Messrs Flanagan, Chaplin and Tyrie I believe the NICs on mortgages proposal is well worth pursuing.

3. To be precise I would favour: imposing on employers at least the 10% charge on all loans to employees (not just mortgages), both existing loans and new ones. I am quite attracted to Andrew Tyrie's proposal of imposing a special 20% rate.

4. The main reason for doing so is, and should be presented as, primarily an extension of our monetary policy. We have raised interest rates to curb personal borrowing (and encourage saving). This measure does not bite directly on those fortunate enough to have subsidised loans from their employers. The least we can do is

to reduce the fiscal incentive on employers to extend more such loans and, ideally, encourage them to cash out existing loans.

5. In that context the argument 'why not apply it to all benefits in kind' is easy enough to tackle. The response is:-

(i) monetary/anti-inflationary policy is paramount

(ii) accept that there is a case for tackling the NICs incentive on benefits in kind generally

(iii) but cars are the main benefit in kind and the priority must be to get the income tax treatment right first.

6. I see no objection to being explicit as in 4(ii) above that we may extend this NIC treatment of benefits in kind. The argument that we should not do mortgages as it will be seen as the thin end of the wedge were best dealt with by Prof Cornford. He defined the thin end of the wedge argument as the argument that we should not do a little of a good thing now for fear we might be led to do a lot of a good thing later!

7. Concern about employer compliance cost is misplaced. If employers do not like it they can cash out the benefit with desirable consequences for mobility and pay transparency.

pp **PETER LILLEY**
(approved by the Minister and signed in his absence)

BUDGET SECRET

COPY No 1 OF 22

PS/PMG
PS/CHEX
23/1

FROM: MALCOLM BUCKLER
DATE: 23 January 1989

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Mr Scholar
Mr Gilhooly
Mr Flanagan
Mr Matthews
Mr Culpin
Mr McIntyre
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Sir A Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Lewis - IR

Ch,
Apart from EST, general disposition otherwise seems to be inclined against action.
JF
25/1

Prayers

NICS ON SUBSIDISED MORTGAGES

Your minute of 20 January asked for Ministers views on the points raised in Mr Flanagan's note of 19 January. The Paymaster General has commented that if the conceptual climate only favours mortgages being charged and if the Doctrine of Unripe Time prevails, what circumstances would be required for Ripe Time? A broader conceptual climate? It is difficult to see how we shall get a more favourable time on mortgages themselves.

MALCOLM BUCKLER
Private Secretary

NIC ON SUBSIDISED MORTGAGES

cst.pas/mc/1.26.1

BUDGET SECRET

COPY NO. 1 OF 22.

FROM: MARK CALL
DATE: 26 JANUARY 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Matthews
Mr McIntyre
Mr S Flanagan
Mr Macpherson
Mrs Chaplin
Mr Tyrie

Sir A Battershill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Lewis - IR

Pro	Anti
PMG	CST
EST	FST
MC	JC
AT	~~[illegible]~~

NICS ON SUBSIDISED MORTGAGES

I have only just seen the papers on this. I do think it is worth pursuing the idea of a special class of NICs on mortgages and other loans to employees. Applying employee NICs would have undesirable distributional effects since they would only hit people earning less than the UEL, so I would confine the measure to employer NICs. Since we are primarily trying to influence employer behaviour, to offer straightforward salaries rather than benefits-in-kind, that is all right.

2. The rationale for such a measure is presentational rather than economic. There are few people with significant subsidised loans (50,000 with a mortgage over £30,000). Furthermore, since the measures would probably have to apply only to new mortgages because of retrospection, the revenue effect is small compared to other benefits-in-kind. The presentational argument would be that it is inequitable for some people, many of them high earning City types, to escape the uncomfortable but necessary effects of a tightening of the money supply through higher interest rates. Of course this argument applies equally to other fringe benefits, but I think in the public mind there is something different and fundamental about housing.

3. Although we all know what a quagmire the extension of NICs to other benefits is, action on subsidised loans might have a useful demonstration effect if companies see it as the first step in a tightening up on fringe benefits. Employers will complain about the compliance burden, but that is part of the reason that such a measure is likely to be effective. Employers would also find the coexistence of employees with subsidised mortgages alongside those without (assuming it was decided to apply NICs only to new mortgages and loans) very awkward, and this might encourage them to cash out existing subsidised loans.

MC

MARK CALL

fp.pk/rc/1989/27.1.02

COPY NO. 1 OF 3 COPIES

BUDGET SECRET

FROM: ROBERT CULPIN

DATE: 27 January 1989

CHANCELLOR

NICs ON SUBSIDISED MORTGAGES

Any comments on this specification?

2. If we are going to get anywhere, we shall have to send the Revenue an outline of this kind, with firm instructions to concentrate on helping us fill in the practical details.

ROBERT CULPIN

RC

Thanks. This specification seems fine. I would be inclined to follow option B (with £8,000 paid immediately: ~~[illegible]~~ on applying). Further questions: (i) is this (as I would hope) an extension of employers' NICs, or is it a tax on loan? (ii) what happens to self-employed & others not paying standard-rate NICs? (iii) should charge apply to new loans only, or also to existing loans. Latter seems a better idea; but need to know (a) precedents & (b) yields.

N

NICS ON SUBSIDISED MORTGAGES : A SPECIFICATION

PROPOSAL:		Employers' NICS to be charged on benefit derived from subsidised loans.
RATE:		10.45 per cent (Anything higher would be hard to justify given employee's UEL.)
LIABILITY	=	$.1045\ (r_o - r_s)\ l_s$
	where	r_o = official interest rate (set as now by Inland Revenue)
		r_s = subsidised interest rate
		l_s = subsidised loan
BASE:		All subsidised loans. (Could confine it to mortgages only, but might be difficult to ring fence.) Would need to exclude small loans, say under £500.
		All employees (though may have to confine it to employees earning

over £8500 if use P11D method of collection below)..

TIME OF COLLECTION: Once a year in arrears. (Probably in May at same time as submission of P11Ds).

METHOD OF COLLECTION: Either **METHOD A:** an annual company return to be submitted with May NIC bill, along following lines:-

(i) What was your total outstanding subsidised debt (on average) last year?

(ii) What was average gross interest rate charged?

(iii) Subtract (ii) from the official rate.

(iv) Your NIC liability is 10.45 per cent of the product of (i) and (iii).

Or **METHOD B** Through PIID. Section C (attached) would have to be amended so that information on mortgage loans of less than £30,000 was given. Questions would also have to be inserted to force employer to calculate subsidy.

Method A would bc appropriate for the likes of Nat West, while Method B might be easier for the firm with only a few subsidised loans.

Date of Implementation : 1 October 1989 or 1 April 1990

Appendix 4

Form P11D and Inland Revenue Guidance Notes

Form P11D is updated annually and the new form will be available for use in April 1988

Inland Revenue
Income Tax

For Official Use
Assessing point reference
if elsewhere

To be completed by employer

Employer's PAYE reference

Employer's name ....

Name of director/employee ....

National Insurance number of director/employee

Return of expenses payments and benefits, etc. to or for directors and "higher-paid" employees – Year Ended 5 April 1987

You are required to make a return by 6 May 1987 giving particulars of expenses payments and benefits etc. provided by reason of

- any employment as a director, within the meaning of Section 72 Finance Act 1976 (but excluding, if he does not have a material interest in the company, either employment as a "full-time working director" or employment with a charity),

or
- any employment (as a "higher-paid" employee) with emoluments **inclusive of expenses payments and benefits etc.** at the rate of £8,500 or more a year. Please also give details below of certain emoluments.

General guidance on the completion of Section D is given in Form P11D(Guide). You may also find it helpful to refer to Booklet 480 ("Notes on expenses payments and benefits for directors and certain employees") later referred to as "Notes" and the "Employer's Guide to PAYE".

Expenses and benefits covered by a dispensation (see Form P11D(Guide)) need not be shown.

A

Remuneration paid in a year other than that to which it relates

You are asked to give the following information relating to salary, fees, bonuses, commissions, etc., paid or payable after the end of the year for which earned.

(a) Payments relating to a period commencing before 6 April 1986, included in total pay on the End of Year Return for the year 1986-87
Description and period .... Amount £ ....

(b) Payments relating to the year 1986-87 which have been or will be made after 5 April 1987

i Ascertained amounts £.......... Date payment was or will be made..........

ii Estimated amounts £.......... Date payment will be made, *if known*..........

Director's PAYE tax not deducted but subsequently paid to the Collector

If in 1986/87 or any earlier tax year the person to whom this form relates was a director and

(a) in the year ended 5 April 1987 the company paid to the Collector tax which it had failed to deduct from remuneration paid to the director (irrespective of the year in which that remuneration was paid); and

(b) the director has not made good all such tax paid by the company,
please state here the amount of tax paid in 1986/87 but not made good £..........

Declaration

I declare that all particulars required are fully and truly stated according to the best of my knowledge and belief.

Signature .... Date ....

State capacity in which signed ....

P11D(1986)

B **General Information – Cars and car fuel**

1 Cars made available for private use to director/employee *See Notes, chapters 10 to 12 and appendix 1*
If more than one car made available (e.g. car changed during the year) give details of each car at (1) and (2) below.

	(1) "√" as appropriate	(2) "√" as appropriate
(a) Make and model	(1)..........	(2)..........
(b) Value when new £19,250 or less		
£19,251-£29,000		
more than £29,000		
(c) First registered on or after 6 April 1983		
before 6 April 1983		
(d) Cylinder capacity if value when new £19,250 or less	cc	cc
(e) Made available to the director/employee	from ....to	from ....to..........

Please complete the "scale charge" box at Section D *See notes, Appendix 1*

Where it is known that
(a) any of the above cars was used to the extent of less than 2,500 miles for business travel then the scale charge is to be increased by one half.
(b) two or more cars were concurrently available to the director/employee then the scale charges of all cars other than that of the car most used for business travel are to be increased by one half.

"√" as appropriate YES NO

2 Car available for private use – Car fuel "Scale charges"

(a) Was fuel for the car(s) shown above provided other than for business travel? ...
(b) If the answer to question (a) is "Yes" was the director/employee required to make good the cost of **all** fuel used for private motoring including travel between home and his normal place of work? ...
(c) If the answer to (b) is "Yes" did the director/employee actually make good the cost of **all** fuel so provided ...

If the answer to (b) or (c) is "No" then enter the appropriate car fuel "scale charge" at Section D.
See Notes, chapter 14 and appendix 2

C **Beneficial loans** *See Notes, chapter 15*

Enter details, etc., of loans made to, or arranged for, a director/employee (or any of his relatives) on which no interest is paid or on which the amount of interest paid is less than interest at the official rate

"√" as appropriate YES NO

(a) Are there any property loans the interest on which is, or would be if any interest were payable, wholly "eligible for relief"? *See Notes, chapter 15.5 and appendix 3* ...
(b) Are there any loans not within (a) above? ...
You should consult the Tax District if you have any doubt or difficulty in answering questions (a) and (b).
(c) If the answer to question (b) is "YES" does the benefit *(see Notes, chapter 15.4, 15.9 and 15.19)* exceed £200? ...
(d) If the answer to question (c) is "YES", aggregate all loans which are not wholly "eligible for relief" and state
i the amount of the loan *(see Notes, chapter 15.19)* at 5 April 1986 or at the date the loan was made if this was later ... £..........
If the loan was made on or after 6 April 1986 state here the date upon which made..........
ii the amount of the loan *(see Notes, chapter 15.19)* at 5 April 1987 or at the date the loan was discharged if this was earlier ... £..........
If the loan was discharged on or after 6 April 1986 state here the date of dishcarge..........
iii the amount of interest actually paid by the borrower for the tax year ended 5 April 1987 *If no interest was paid enter "NIL"* ... £..........
(e) Were any loans made by you waived or written off in the year ended 5 April 1987?
If so, enter the amount waived ... £..........

cst.pas/mc/2.27.1

BUDGET SECRET

COPY NO. 1 OF 9

FROM: MARK CALL
DATE: 27 JANUARY 1989

CHANCELLOR e

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mrs Chaplin
Mr Tyrie

POST-PRAYERS DISCUSSION, 27 JANUARY

1. SUBSIDIES MORTGAGES AND LOANS

Following discussion, the Chancellor asked that the option of applying NICs to subsidised loans, including mortgages, be examined further. This would be for employer NICs only, and be based on the standard 10.45% rate. Two options should be evaluated: (1) applying NICs to new mortgages and loans only, and (2) applying NICs to existing as well as new mortgages and loans. Advice was also needed on the administrative complexity of both options.

2. TAX RELIEF FOR RESIDENTIAL LANDLORDS

This had some attraction and should be looked at further as a matter of urgency. The scheme could be limited either to a certain number of rooms for a certain number of days, or to a given income per week or per month. The income limit per resident was probably the more attractive option and would most effectively stop abuse. The level of such a limit should be based on real, market rates, and could be in the order of £90 to £100 per week.

MC

MARK CALL

chex.md/aa/21 **BUDGET CONFIDENTIAL**

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

3 March 1989

P R C Gray Esq
Private Secretary to
Prime Minister
10 Downing Street
LONDON
SW1

Dear Paul,

TAX RELIEF FOR RELOCATION

The Chancellor and Prime Minister discussed the Budget proposals on relocation expenses yesterday. In the light of that discussion, the Chancellor has asked me to write to you to set out some more of the details.

There are at present two extra statutory concessions in this area: the first gives tax relief for removals expenses paid by an employer; this applies to both new recruits and to existing employees. The second gives tax relief for employers' contributions to employees' additional on-going housing costs (eg mortgage payments, rent etc) where an employee is compulsorily moved by his employer to a more expensive housing area; this concession is available only to existing employees.

The Budget proposals are that the first of these reliefs, for removals expenses, should be placed on a proper statutory footing. And that the second relief, on additional housing costs, should be abolished. The effects of the housing cost relief is to reduce the market pressures on employers to relocate to lower cost areas, and to exacerbate (rather than alleviate) existing house price differentials. Removing the concession will produce an eventual yield of around £100 million a year, though anyone who has moved (or has entered into a commitment to move) before Budget day will continue to receive the relief.

Most public sector employees, other than those in the Civil Service, do not benefit from the present relief. Teachers, firemen, policemen etc are employed by individual local authorities. The relief is therefore not available when they move from one authority to another, since they are joining a new employer. The same applies to NHS employers employed by district or regional health authorities - though in the case of regional health authority employees it is conceivable that a few employees could benefit if they were to be compulsorily transferred to a higher housing cost area within the region's borders.

We shall be considering the implications for the Civil Service with departments after the Budget. We shall need to consider, among other things, whether payments should be grossed up to reflect the changed tax treatment and whether any additions to running costs would be justified.

The relief does not, as I have mentioned, apply to new employees. So abolishing the relief will not affect the tax treatment of housing cost allowances or other inducements to people to take up employment ("Golden Hellos" etc), which will all remain taxable.

The Chancellor hopes that, in the light of these points, the Prime Minister is content for these proposals to proceed.

Yours
Alex

A C S ALLAN
Principal Private Secretary

chex.rm/aa1/58

BUDGET CONFIDENTIAL AND PERSONAL

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

3 March 1989

Paul Gray Esq
10 Downing Street
LONDON
SW1

Dear Paul,

TAX RELIEF FOR RELOCATION

The Chancellor has asked me to make one additional point relevant to the decision on removing the relief on additional housing costs. This is that the revenue yield from this measure in 1990-91 (about £30 million) would enable him to include an additional Budget proposal with an equivalent revenue cost, which would be of particular benefit to small businesses, while keeping the size of the Budget package for 1990-91 below £3½ billion. The additional proposal would be to allow unincorporated businesses to set trading losses against realised capital gains in computing CGT liabilities. At present, incorporated businesses can do this but unincorporated businesses cannot. This measure would be of particular benefit to farmers.

Yours,
Alex

A C S ALLAN
Principal Private Secretary

chex.rm/jmt/85 **BUDGET SECRET** Copy 19 of 21

FROM: J M G TAYLOR
DATE: 31 January 1989

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Gilhooly
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
Mr Bush - IR
Mr Lewis - IR
PS/IR

SUBSIDISED MORTGAGES AND LOANS

This is to confirm the Starter which the Chancellor mentioned at yesterday's overview:

- He would like the option of applying NICs to subsidised loans, including mortgages, to be examined further;

- Employer NICs only should be considered, based on the standard 10.45 per cent rate;

- Two options should be considered
  (i) Applying NICs to new mortgages and loans only, and
  (ii) Applying NICs to existing as well as new mortgages and loans;

- The administrative complexity of both options should also be considered.

2. Mr Culpin has set work in hand.

JT

J M G TAYLOR

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Please type for signature [note by Mary Hay below]

~~DRAFT~~ **LETTER FROM ALEX ALLAN TO:**

Mark Roberts: Fine (a v. few minor drafting pts). W.

Ch

OK? I am not quite sure what position on Civil Service is (para 5) & will check A.M.

AA

Noted

P R C Gray Esq
Private Secretary to
Prime Minister
10 Downing Street
LONDON
SW1

TAX RELIEF FOR RELOCATION

The Chancellor and Prime Minister discussed the Budget proposals on relocation expenses yesterday. In the light of that discussion, the Chancellor has asked me to write to you to set out some more of the details.

2. There are at present two extra statutory concessions in this area: the first gives tax relief for removals expenses paid by an employer; this applies to both new recruits and to existing employees. The second gives tax relief for employers' contributions to employees' additional on-going housing costs (eg mortgage payments, rent etc) where an employee is compulsorily moved (by his employer) to a more expensive housing area; this concession is available only to existing employees.

3. The Budget proposals are that the first of these reliefs, for removals expenses, should be placed on a

proper statutory footing. And that the second relief, on additional housing costs, should be abolished. The effects of the housing cost relief is to reduce the market pressures on employers to relocate to ~~lost~~ lower cost areas, and to exacerbate (rather than alleviate) existing house price differentials. Removing the concession will produce an eventual yield of around £100 million a year, though anyone who has moved (or has entered into a commitment to move) before Budget day will continue to receive the relief.

4. Most public sector employees, other than those in the Civil Service, do not benefit from the present relief. Teachers, firemen, policemen etc are employed by individual local authorities. The relief is therefore not available when they move from one authority to another, since they are joining a new employer. The same applies to NHS employers employed by district or regional health authorities - though in the case of regional health authority employees it is conceivable that a few employees could benefit if they were to be compulsorily transferred to a higher housing cost area within the region's borders.

5. We shall be considering the implications for the Civil Service with departments after the Budget. We

shall need to consider, among other things, whether payments should be grossed up to reflect the changed tax treatment and whether any additions to running costs would be justified.

6. The relief does not, as I have mentioned, apply to new employees. So abolishing the relief will not affect the tax treatment of housing cost allowances ~~these payments~~ or ~~of~~ other inducements to people to take up employment ("Golden Hellos" etc), which will all remain taxable.

7. The Chancellor ~~would be grateful to know whether~~ hopes that, in the light of these points, the Prime Minister is content for these proposals to proceed.

A C S ALLAN

Principal Private

Secretary

COPY NO. 4 OF 4 .

FROM: J M G TAYLOR
DATE: 30 January 1989

MR R CULPIN

NICs: ON SUBSIDISED MORTGAGES

The Chancellor was grateful for your note of 27 January.

2. He has commented that this specification seems fine. He would be inclined to favour Method B (with £8,500 P11D limit therefore applying).

3. He has some further questions. These are:

(i) Is this (as he would hope) an extension of employers' NICs, or is it a tax in lieu?

(ii) What happens to self-employed and others not paying standard rate NICs?

(iii) Should the charge apply to new loans only, or also to existing loans? The latter seems a better buy; but we need to know:

(a) precedents; and

(b) yield.

J M G TAYLOR

BUDGET SECRET

FROM: ROBERT CULPIN
DATE: 31 January 1989

CHANCELLOR

Thanks

This is to answer some of your questions.

NICs on subsidised mortgages

2. Mr Taylor of 30 January.

3. I have sent Terry Painter the specification you saw over the weekend, and asked him to help us work it up. On the points you raised:

(i) We are talking about an extension of employers' NICs, not a tax in lieu.

(ii) I assume there is no problem with the self employed, because I assume they do not have subsidised mortgages: it is difficult to subsidise yourself. I think we should charge all employers 10.45 per cent. That would keep it simple. No contracted out rebate, because NICs on mortgages would not establish rights to a guaranteed minimum pension or any other benefits. Precedents: no contracted out rebate on pay above the UEL, or on the pay of women over 60 or men over 65.

(iii) I agree we want the charge to apply to all loans. I doubt if we will find a clear precedent for this, but I don't think there are clear NIC precedents against it, either. When we extended NICs to payments in gilts and equities, there was no let-out for people already receiving these payments. They are flows, whereas mortgages are stocks; but we shall only be extending NICs to the annual flow of subsidies. Yield in the FSBR period will be small whatever we do. We can probably not make the change straight away, so 1990-91 is likely to be the first full year to which the charge applies; and we are proposing that it should be only collected once a year in arrears.

CT threshold for small companies

4. Mr Taylor of 27 January. - folder behind

5. Now that this is a serious runner, I have asked the Revenue for a full submission, for the next Overview. I should warn you that they think it would be stark staring bonkers to give fish and chip shops and so on an incentive to incorporate.

6. I don't think the slight twiddle you suggest would make much difference to the points in my note of 27 January. Subject to checking, it would make the 37½ per cent band run out at £450,000 instead of £470,000. In all probability, neither figure would be quite right, since the <u>present</u> 37½ per cent band runs up to £500,000, and a reduction would create some losers. (They would lose a bit of the benefit of the small companies' rate.) But we can sort all that out later, if you want to go ahead.

Life Assurance

7. Mr Taylor of 30 January. - folder behind

8. We now have a Revenue paper - Deacon of 30 January. There should be an FP comment today. I hope this will make it possible for the Financial Secretary to have a meeting, or meetings, this week, so that his advice is ready when you come back from Washington. You can then have a discussion after Monday's Overview.

RC

ROBERT CULPIN

FROM: J M G TAYLOR
DATE: 2 February 1989

PNP

MR CULPIN

BUDGET: QUESTIONS

The Chancellor was grateful for your note of 31 January.

JT

J M G TAYLOR

fp.ac.hay/33

BUDGET CONFIDENTIAL

FROM: MISS M HAY

DATE: 2 March 1989

PRINCIPAL PRIVATE SECRETARY

cc Mr Culpin
Mr Gilhooly

Mr Lewis - IR
Mr Wilcox - IR

RELOCATION : ADDITIONAL HOUSING COST ALLOWANCE

You asked for a note on the implications of the abolition of relief for additional housing cost allowances for public sector employees other than central Government employees.

2. The relief is available only where an allowance is paid by an employer to an employee whom he has relocated. It is not available where such an allowance is paid to a new employee. Moreover, it is only available where an employee is compulsorily transferred to a higher cost area. Moves at the employee's initiative do not qualify.

3. The vast majority of non-central Government public sector employees are employed at regional or local level (although their terms and conditions may be negotiated nationally). Such an employee moving from one relevant authority to another would not qualify for relief under the existing rules since he would be joining a new employer. Withdrawal of the ESC will not therefore affect such people.

4. Teachers, fireman, policemen and so on are employed at the local authorities level. NHS employers are generally employed by District Health Authorities although some are employed by the Regional Authorities. (After 1991, hospitals "opting out" will become employers in their own right.)

5 The Revenue have confirmed the general position in regard to local and health authorities. But have not been able to explore the intricacies of all the possible cases - for instance, an NHS employee employed at Regional level transferred to a higher cost area within the Region. The number of employees potentially affected by removal of the ESC must be very small.

pp. **MARY HAY**

BUDGET CONFIDENTIAL

CH/EXCHEQUER
REC. 6 MAR 1989
ACTION
COPIES TO

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

6 March 1989

pup

Dear Alex,

TAX RELIEF FOR RELOCATION

Thank you for your letter of 3 March setting out more of the details on these proposals. As I mentioned to you when we spoke early this morning, the Prime Minister continues to have major reservations about the proposal to remove the concession giving tax relief from employers' contributions to employees' additional ongoing housing costs where an employee is compulsorily moved by his employer to a more expensive area. You told me later this morning that the Chancellor had now decided to drop the idea for this year's Budget.

Yours,

Paul

PAUL GRAY

Alex Allan, Esq.,
H.M. Treasury.

BUDGET CONFIDENTIAL