PO-CH/NL/0491

Part A

PO CH/NL/0491
PART. A

PO CH/NL/0491
PART. A

1989 BUDGET:
REVISED BUDGET
PACKAGE

mp.pc/Riley/061

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BUDGET

COPY NO 1 OF 37 COPIES

FROM: C J RILEY
DATE: 9 February 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Dame Anne Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr A C S Allan
Mr Davies
Mr Gilhooly
Mr Matthews
Mr Macpherson
Miss Simpson
Mr Courtney
Mr Flanagan
Mrs Chaplin
Mr Tyrie
Mr Call

Sir Anthony Battishill)
Mr Beighton)
Mr Isaac) IR
Mr Painter)
Mr Calder)

Mr Unwin)
Mr Jefferson Smith) C&E
Mr Allen)

SECRET

B.L.O.

THE PACKAGE AND THE FISCAL ADJUSTMENT

I attach a note on this, as requested at the last Overview meeting.

SECRET

C J RILEY

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THE PACKAGE AND THE FISCAL ADJUSTMENT

The Scorecard contains estimates of the claim made by the present package on the fiscal adjustment. These are lower than the total direct effect on revenue set out in table 1, especially in 1990-91.

£ billion	1989-90	1990-91
Direct effect on revenue	1.2	2.1
Claim on fiscal adjustment	1.0	1.3
Fiscal adjustment in the January forecast	1.5	1.5

Background and definitions

2. The direct effects aim to capture the impact of the measures on revenue for a given tax base. In some cases, where they are quantitatively significant, allowance is made for behavioural effects. But no allowance is made for second round effects, occurring for example as a consequence of changes in incomes, prices or other macroeconomic variables.

3. The claim on the fiscal adjustment takes into account our best estimate of the second round effects, as well as the direct effects, using simulation results from the Treasury model. The calculations assume that:

- the PSBR is held fixed at the values in the January forecast by means of variations in the basic rate of income tax;

- money GDP is held on the path in the January forecast by adjustments in interest rates.

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4. The January forecast allowed for a cut in income taxes in 1989-90 worth £1½ billion, also taking the form of a reduction in the basic rate. The call on the fiscal adjustment shown in the Scorecard gives our estimate of how much of that £1½ billion would have to be used up to finance the present package, assuming the post-Budget paths for the PSDR and money GDP were as in the January forecast. The figures suggest that we need to use up only about £1 billion in 1989-90 and £1¼ billion in 1990-91; the implication is that in the absence of other changes to the forecast, the PSDR would turn out somewhat higher than shown in January.

5. Differences between direct effects and the call on the fiscal adjustment are often relatively small, because they reflect only the macroeconomic impact of a switch between one form of taxation or expenditure (the Budget measures) and another (the basic rate). But they are not always small. The call on the fiscal adjustment will tend to be lower than the direct effects insofar as:

- the package has a more favourable effect on inflation that a cut in the basic rate, so allowing a more favourable split of money GDP between output and prices;

- the package shifts activity, expenditure or saving into more highly taxed areas than does a change in the basic rate.

6. In practice the first of these sources of difference tends to be more important than the second. Lower inflation tends to reduce both tax revenue and public expenditure; the precise effects depend on the source of the reduction in inflation and the extent to which cash limits are biting on public expenditure. But the consequential increase in output raises revenue, and reduces expenditure mainly through lower social security payments. The net effect is to improve the financial position of the public sector and limit the call on the fiscal adjustment.

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7. One final point on methodology which is of particular relevance to the present package. When indirect taxes are changed, we assume that money GDP is held fixed at factor cost rather than market prices. This reflects the view that the Government would usually aim to accommodate any shift in indirect taxes on the price level, rather than force an offsetting adjustment on tax-exclusive prices and hence nominal incomes. This mirrors the assumption underlying the direct effects, adopted for the first time in the ready-reckoners in the 1988 Autumn Statement, that consumers' expenditure is held fixed at factor cost.

The present package

8. The paragraphs which follow describe how the call on the fiscal adjustment differs from the direct effects on revenue for the main measures, or groups of measures, in the package as it currently stands. The figures are shown in the table below.

£ million, yield (+)/cost(-) changes from an indexed base

Measures (lines in Scorecard)	Direct Effects 1989-90	Direct Effects 1990-91	Call on fiscal adjustment 1989-90	Call on fiscal adjustment 1990-91
Freeze excise duties (1)	-1225	-1325	-1060	- 590
VAT: Non-domestic construction etc (4)	+ 315	+ 540	+ 310	+ 540
Savings package (8-10)	- 175	-1000	- 120	- 920
Other measures	- 95	- 270	- 90	- 280
Totals	-1180	-2055	- 960	-1250

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(i) **Excise duties**

9. The freezing of excise duties accounts for essentially all the difference for the package as a whole. A reduction in excise duties (relative to the revalorisation assumed in the forecast) has a more favourable effect on inflation in the short term than does the cut in the basic rate of income tax assumed in the forecast. Although we assume that the direct effect of the non-revalorisation of excise duties is accommodated in lower money GDP, the knock-on effects of the lower price level on pay settlements mean an improvement in the split of factor cost money GDP between output and prices. This improves the public finances, as already noted, and the call on the fiscal adjustment is lower than the direct revenue effect. The difference is particularly large in the second year.

(ii) **VAT on non-domestic construction etc**

10. There is almost no difference between the estimated call on the fiscal adjustment and the direct revenue effects of the proposed extension of VAT coverage. The VAT paid by the public sector feeds directly into central government revenue and has no impact on the price level. The January forecast already allows for the estimated impact on public expenditure; neither the direct revenue effect given in the Scorecard nor the call on the fiscal adjustment net off this extra expenditure.

11. The increase in VAT paid by the private sector is expected to have little immediate impact on the price level. There is no direct RPI effect; and those in the private sector paying the extra VAT will be in exempt or partly exempt categories, and they are not expected to pass the extra cost on directly.

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(iii) **The savings package**

12. The estimated call on the fiscal adjustment due to the savings package is less than the direct revenue effect. A substantial part of the net reduction in tax accrues to financial institutions, and this in itself would lead to lower spending and lower tax receipts than a cut in income tax. However we expect that announcement of the abolition of stamp duty on share dealings will give an immediate boost to share prices, raising personal sector wealth. This will raise consumer spending relative to GDP, and hence revenues from expenditure taxes. The rise in share prices will also increase stamp duty and CGT receipts over the remainder of calendar year 1989.

(iv) **Other measures**

13. The net effect of the remaining measures on both revenue and the fiscal adjustment are small.

Conclusion

14. Our estimates indicate that the call on the fiscal adjustment due to the package is smaller than the direct effect on revenue, and is not much greater in 1990-91 than in 1989-90. The main difference from the direct revenue effect arises from the freezing of the excise duties. An implication of the figures is that not all of the fiscal adjustment in the January forecast needs to be used up.

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COPY NO 1 OF 2

FROM: ROBERT CULPIN
DATE: 10 February 1989

CHANCELLOR

OPTIONS FOR A BIGGER PACKAGE

Revenue cost of present package significantly higher in 1990-91 than 1989-90. Scorecard -1200, -2050.

2. Call on fiscal adjustment more even: -950, -1250.

3. Changes to income tax implemented from April. So additional income tax options would have substantial cost in both years.

4. Changes to NICs implemented from autumn. So affect 1990-91 much more than 1989-90.

5. Changes to CT have slowest build up. 1 per cent off is -10, -400, building up to -570.

6. Following notes rough. Produced at speed.

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Option	For	Against
Bigger package	Follows logic of view that fiscal policy = balanced budget + tax reform	Raises stakes - "only one instrument"/risk of blame for inflation, current account
	And policy that should reduce tax burden	Give with left hand (tax), take with right (mortgages)
	Gets us off RDSR treadmill	
	Backs up defence of 1988 Budget: actions speak louder than words	Assuming high interest rates, looks like schizophrenia
	Fiscal, as well as monetary, stance still tight	Divorce from Prudence and Caution?
Penny off	Advertised policy	Most likely to crystallise objections above
	Courage of convictions	
	Supply side benefit	Candy floss
	Consistency	Flouts demand for Budget for poor
	Permits bigger increase in car scales	
Allowances	Said to be what people want	Sink without trace
		Complete waste of money
	Less provocative, and therefore less risky	
	Cost adjustable	

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Exem[illegible] pension	Coup de theatre	Wrong thing to do
Reduced rate band	Surprise	Impossible for 1989-90
	Reduces starting rate	Most of benefit goes to people not in band
		Either few in band or expensive
	Addresses popular concern	Complicated
		Reverses reduction in number of rates
1% off NICs	NIC rate absurdly high	Chosen to give priority to basic rate
	1% off better for most people than penny off tax, because benefit confined below UEL	No help to pensioners, because don't pay NICs (but most don't pay income tax either)
	Something for "Budget for poor" school	Slightly more expensive than penny off
	Makes subsequent NIC reform cheaper	
	Supply side benefit	
	Reduces NIF surplus	
2% off CT	Narrows CT - income tax gap, which has widened	Slightly odd priority
	Reduces effective burden on shareholding	Has some of disadvantages of "tax cuts" without populist advantages
	Raises slightly cost of debt	Tighten with left hand (interest rates & £), loosen with right (CT)

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<u>Reform NICs</u>

Expand reduced rate bands	More people benefit	More people suffer steps
Delete 5, 7, 9, substitute (say) 3, 5, 9	Reduces marginal rates Confines benefit to low paid	Tinkering Draws attention to steps but ducks problem
Introduce more bands	Reduces size of steps...	...but introduces more of them Complicated
Convert LEL into allowance; raise marginal rate to 11½% on earnings up to £200 pw; then revert to 9%	Cheapest way (£¾bn) to abolish steps without losers	More than doubles marginal rate for those in 5% band Substantially raises marginal rate for another 10 million Abolishes reduced rate bands introduced in 1985
Convert LEL into allowance, and steps into thresholds; keep 5, 7, 9 marginal rates	Abolishes steps Keeps reduced rate bands Major reform Supply side improvement Benefits low paid	Costs £5 billion
Convert LEL etc; keep 5, 7, 9; but raise UEL (Mervyn King)		King says £3 billion, we think over 4 Raises marginal rates by 9% above UEL

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Convert LEL etc; marginal rates 7, 9, 11; leave UEL		£2½ billion
Convert LEL etc; raise marginal rates to 8, 10, 12; keep 9% band at top; leave UEL	Abolishes steps Costs £1¼ bn Supply side improvement Reduces <u>average</u> rates Benefit concentrated on low paid	Raises marginal rates for lot of people by 3 percentage points Reverses '85 reduction in marginal rates Complicated Too clever by half?

Rc

ROBERT CULPIN

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FROM: ROBERT CULPIN
DATE: 24 February 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Dame Anne Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Riley
Mr Sedgwick
Mr A C S Allan
Mr Gieve
Mr Gilhooly
Mr Matthews
Mr Pickford
Mr Macpherson
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call

Sir Anthony Battishill)
Mr Beighton)
Mr Isaac)IR
Mr Painter)

Mr Unwin)
Mr Jefferson Smith)C&E

REVISED BUDGET PACKAGE

I attach a revised Scorecard table, to reflect your provisional decisions on National Insurance contributions. These are that:

- employee NICs should be 2 per cent of the lower earnings limit (£43 in 1989-90) plus 9 per cent on earnings between the lower earnings limit and the upper earnings limit (£325 in 1989-90)

- there should be no change in the upper earnings limit

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- no change in employer NICs

- and no change in NICs for the self employed.

Only line 1 has been revised.

2. The figures are slightly higher than in the Scorecard table and notes which I circulated yesterday. That is because the Government Actuary's costings were for Great Britain only. We have added in Northern Ireland, and that makes a difference of about 2 per cent.

3. If you decide to reduce NICs for the self-employed, the extra cost would probably be of the broad order of £50 million in 1989-90 and £100-150 million in 1990-91.

4. In the light of the decision to reduce NICs across the board, we are considering options for a larger increase in car scales. Every extra 5 per cent (in line 7) would yield approximately £20-25 million in 1989-90 and £25-30 million in 1990-91.

Presentation

5. With this revised package, the popular perception of the Budget is likely to be "£3 off, nothing on". That is:

- most people will have a NIC cut of £3

- with nothing on beer, cigarettes, etc.

6. There will of course be other headline-catching measures, such as the boost for unleaded petrol, the scrapping of the earnings rule, and the improvement of the age allowance. But if past experience is any guide, the who-gets-what analysis will dominate much of the popular commentary.

7. The distributional story should be fairly simple.

- The NIC reform will leave the low paid more of their own money.

- Those who want to do so will be able to add in the cash value of indexing the income tax allowances.

- The NIC gains will be cash limited to £3 a head, and will be the same for anyone earning more than £115 a week.

- They will be worth proportionately less to high earners than low earners.

- For the well heeled with company cars, there will be an offsetting increase in car scales (yet to be settled).

8. We shall, as always, want to present the package as part of the Government's continuing programme of reform; and this week's decisions give us give us a strong Mais lecture theme - an opportunity and a challenge.

9. For counter inflationary macro policy, we have:

- high interest rates/tight money

- record Budget surplus/debt repayment

- no reduction in the tax burden.

For supply side micro improvements, we have:

- NIC reform

- wider share ownership

- reform of the taxation of pensions and life assurance.

(The lists are not exhaustive.)

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10. The NIC change will be especially important in making it easier for people to work as flexibly as they like - varying their hours and so on in whatever ways suit them, without running into the unfortunate traps which exist at the steps. There is an obvious link, if you want to make it, with the ending of the pensioners' earnings rule.

11. The main problem - and this is where the challenge comes in - is likely to be the risk of conflicting signals. Briefly:

- Government gives with left hand (tax and NICs), takes with right (mortgages)

- austere monetary policy/candy floss fiscal policy

- "no risks", but give-away Budget/fuelling flames

- "prudence and caution", but mortgaging future (cost in 1990)

- basic rate "priority when prudent", but nowhere to be seen.

12. None of this looks terribly difficult; but by raising the cost of the Budget to £2¼ billion in 1989-90 and £4¾ billion in 1990-91, we shall be raising the stakes on the argument that you have collapsed economic policy into only one instrument. The waters will be helpfully muddied by the facts that the NIC reforms only take effect in the autumn - and, perhaps, that next year's Budget surplus can be described at one and the same time as <u>higher</u> than anyone envisaged until very recently, <u>the same</u> as this year excluding privatisation proceeds, and <u>lower</u> than this year in cash.

Briefing

13. I attach a first outline by EB of the main tax brief and, below that, a first list of questions by FP. These are not essential reading for the Overview, and are very much work in progress; but they may be some help to Ministers in thinking about presentation.

14. The priority is still to work up the positive presentation of the Budget in the speech. This will then carry through to the briefing; and we are working in parallel on answers to questions, where these are not obvious. I have already given you some suggestions for Budget themes with my note of 16 February.

RC

ROBERT CULPIN

SCORECARD OF 23 FEBRUARY 1989

TABLE 1: DIRECT EFFECTS OF BUDGET MEASURES

		£ million		yield (+)/cost (-)
		1989-90		1990-91
		Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
1.	Reform employee NICs	- 985	- 985	-2785
2.	Freeze excise duties	nil	-1225	-1320
3.	Reduce duty on unleaded petrol; increase on 2 star	- 30	- 30	- 75
4.	VED: coaches and lorries	+ 40	+ 40	+ 40
5.	VAT: non-domestic construction etc	+ 315	+ 315	+ 540
6.	Index IT thresholds	-1465	nil	nil
7.	Increase car scales by 20 per cent	+ 90	+ 90	+ 110
8.	CT: raise small companies thresholds	- neg	- neg	- 35
Savings				
9.	Abolish stamp duty on shares from 1/4/90	+ 10	+ 10	- 900
10.	Life assurance	- 20	- 20	+ 45
11.	Pensions, PEPs, Share Schemes, Unit Trusts	- 5	- 5	- 10
Other				
12.	Schedule E: receipts basis	- 60	- 60	- 80
13.	VAT: bad debts, registration, etc	- 105	- 105	- 270
14.	Miscellaneous starters	- 70	- 35	+ 25
15.	TOTAL	-2285	-2010	-4715

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COPY NO 1 OF 34 COPIES

FROM: ROBERT CULPIN
DATE: 24 February 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
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Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Dame Anne Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
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- "no risks", but give-away Budget/fuelling flames

- "prudence and caution", but mortgaging future (cost in 1990)

  2nd yr fiscal drag? [2nd yr tax is 2 fiscal?]

- basic rate "priority when prudent", but nowhere to be seen.

12. None of this looks terribly difficult; but by raising the cost of the Budget to £2¼ billion in 1989-90 and £4¾ billion in 1990-91, we shall be raising the stakes on the argument that you have collapsed economic policy into only one instrument. The waters will be helpfully muddied by the facts that the NIC reforms only take effect in the autumn - and, perhaps, that next year's Budget surplus can be described at one and the same time as higher than anyone envisaged until very recently, the same as this year excluding privatisation proceeds, and lower than this year in cash.

not so

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RC

ROBERT CULPIN

BUDGET

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SECRET

[illegible]

[illegible]

+25
-125
+60
-40

+20
-50
+60
+30

Cost £5?
[illegible]
cancel 12

NB [illegible]
£5000/6000

SCORECARD OF 23 FEBRUARY 1989

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5.	VAT: non-domestic construction etc	+ 315	+ 315	+ 540	
6.	Index IT thresholds	-1465	nil	nil	
7.	Increase car scales by 20 per cent	+ 90	+ 90	+ 110	-75
8.	CT: raise small companies thresholds	- neg	- neg	- 35	
Savings					
9.	Abolish stamp duty on shares from 1/4/90	+ 10	+ 10	- 900	+900
10.	Life assurance	- 20	- 20	+ 45	
11.	Pensions, PEPs, Share Schemes, Unit Trusts	- 5	- 5	- 10	
Other					
12.	Schedule E: receipts basis	- 60	- 60	- 80	Cut Sch-N?
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14.	Miscellaneous starters	- 70	- 35	+ 25	[BBs 216; but also 650]
15.	TOTAL	-2285	-2010	-4715	LTV

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A2 OVERALL STRATEGY

Factual

(i) Continues policy of tax reform. Tax reform integral part of Government's economic strategy. Increasing incentives and improving efficiency key to economic success.

(ii) Corporate tax system reformed in 1984 and personal taxes in 1988. Improved company sector performance - profitability, productivity - clearly shows benefits of reforms. 1988 Budget measures mostly not implemented until 1990.

(iii) This budget particularly concentrates on encouraging wider share ownership. Also introduces number of simplifications and deregulation measures. Help for lower paid through reform of NICs.

(iv) Set firmly within context of prudent and cautious approach. Fiscal stance will allow further large repayment of national debt.

Budget measures

(i) [Reform of structure of employees' NICs.]

(ii) Reform of taxation of pensions means individuals' free to determine own level of pension, rather than dictated by tax system.

(iii) Reformed regime for life assurance removes worst distortions of previous system while recognizing unique nature of industry. Continues general theme of applying lower tax rates to broader base.

(iv) Number of measures to encourage personal savings and wider share ownership, building on reforms introduced in previous budgets

- abolition of stamp duty on shares. Sixth major tax abolished in last six budgets;
- PEPs and approved employee share schemes limits increased;
- new tax relief to encourage development of employee share option plans;
- pensions and life assurance reforms will reduce bias towards institutional saving.

(v) Measures to encourage businesses, especially smaller businesses

- profits limit for small companies' CT rate raised to £150,000 and cut-off for marginal relief increased to £750,000
- VAT registration requirements now based on past, not expected future, turnover. Threshold also increased in line with RPI to £23,600
- unincorporated businesses to be allowed to set-off trading losses against CGT

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- comprehensive bad debt relief scheme introduced for VAT (building on cash accounting for businesses with turnover below £100,000 introduced in 1987 Budget).

[(vi) Unleaded petrol]

(vii) Budget overall presents prudent and cautious approach. Some reductions in overall level of taxation needed to offset effects of fiscal drag. So

- most IT allowances and basic rate limit increased in line with RPI
- no reduction in IT basic rate
- no increase in excise duties
[- lower paid helped through NIC reform]

But PSDR set at [£ billion] will enable further substantial repayment of debt.

Defensive

(i) Budget basically contains nothing - tax reform has run out of steam

(ii) Failure to cut taxes/ size of PSDR show that accept verdict that last year's strategy mistaken.

(iii) "Budget for rich" last year. Why not Budget for poor this?

(iv) WSO measures only underline failure of previous attempts. Why just more of the same - no reason why should work any better.

(v) 'Savings' package basically non-existent. Will do nothing to encourage 'ordinary' savings.

(vi) Why not accept logic of NIC reforms and integrate with IT.

(vii) Why no increases in excise duties? Cynical manipulation of RPI?

(viii) Why overall tax burden still rising - Government's policy to get it down abandoned?

(ix) Why more taxpayers next year?

PERSONAL TAXES [AND NICS]

Factual

(a) Income Tax

(i) Most personal allowances and basic rate limit increased in line with indexation. Age allowance extended to over 75s.

(ii) Basic rate remains unchanged at 25 per cent and higher rate at 40 per cent.

(iii) No changes in mortgage interest relief.

(iv) Car scales increased by 20 per cent. Car fuel scales unchanged.

(v) Tax relief will be available on premiums for private health insurance paid by or on behalf of over-60s. Relief available from 1990-91.

(vi) Earnings rule for pensioners, under which state pension withdrawn for every £ earned over £75 a week, abolished.

(vii) Payroll giving limit doubled to £480 a year.

(b) Capital Gains Tax

(viii) CGT annual exempt amount unchanged at £5,000 for individuals and £2,500 for most trusts.

(ix) Gifts relief restricted to certain types of gift.

(c) Inheritance tax

(x) Threshold indexed to £118,000.

[(d) NICs

(xi) Employees' NICs restructured, building on 1985 reforms. Steps abolished. Replaced by "joining fee" at £43, while other steps turned into thresholds. LEL and UEL remain as announced in November.]

Positive

(i) Budget builds on fundamental reforms of personal taxes introduced in 1988.

(ii) Allowances up over x per cent in real terms since 1978-79. Married man's allowance maintained at highest level in real terms since before war. X million taxpayers taken out of tax altogether compared to indexed 1978-79 regime.

(iii) Number of measures to increase incentives for elderly to keep off dependency culture.

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(iv) Further steps taken to bring taxation of company cars into line with true value of benefit.

(v) Reform of NICs substantial help to lower paid. Removes very high marginal 'tax' rates at limits of bands.

(vi) Increase in payroll giving limit further encouragement to charitable giving.

<u>**Defensive**</u>

(i) Progress on cutting IT burden halted. [First time for seven years no reduction in IT beyond indexing allowances.]

(ii) 20 per cent target for IT abandoned?

(iii) Why not restrict IT reliefs to basic rate?

(iv) Why no changes to MIR : increase limit/ abolish altogether?

(v) Why not more on cars, after what said last year?

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BUDGET AND SAVINGS

Factual

(i) Pensions tax regime reformed. Tax privileges for occupational pensions will be "capped" at income level of £60,000, but employers will be free to provide pensions up to any level. Also some changes to personal pension schemes, early retirement provisions of occupational pension schemes and AVCs regime.

(ii) Tax regime for life assurance also reformed

- pensions and general annuity businesses to be ring-fenced;
- relief for expenses of acquiring new life assurance business to be spread over seven years;
- rate of tax charged on income and capital gains attributable to policy holders reduced to 25 per cent;
- Life Assurance Policy Duty abolished.

(iii) Stamp Duty on shares abolished from [1 January 1990].

(iv) Annual limits on 1978 approved employee share schemes increased to £2,000 or 10 per cent of pay up to limit of £6,000. Monthly limits for 1980 SAYE scheme increased from £100 to £150.

(v) Annual limit on investment in Personal Equity Plans increased from £3,000 to £4,800 - doubling original 1986 limit. Of this, up to £2,400 (formerly £750) may be invested in unit and investment trusts. A number of other restrictions also abolished.

(vi) New tax relief introduced for employers' payments into qualifying employee share trusts (ESOPs).

Positive

(i) Major reform to encourage saving introduced last year with independent taxation. Removed great disincentive for married women to save.

(ii) Measures encourage wide range of different savings methods, but especially share ownership. Also remove bias towards institutional saving that has accumulated over past 30 years.

(iii) Pensions proposals build on Government's earlier moves to widen pensions' choice and encourage private provision. Remove anomaly that tax rules effectively limited pensions paid. Put relief for pensions on same basis as others eg MIR. Also reduce incentive to save through pension funds rather than investing directly in equities.

(iv) Life assurance proposals

- remove distortive effect on savers by limiting 'up-front' relief on initial costs that used to be available to life assurance policy holders but not to investors directly in shares;
- remove distortions that old system produced in incidence of tax as between one Life Office and another.

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Widening tax base also enables tax rates to be reduced. So existing 35 per cent and 30 per cent rates will both, from 1 April 1990, be reduced to 25 per cent.

(v) Stamp Duty abolition will remove major cost for those investing directly in equities. Will also eliminate aspect of tax system which puts British financial services sector at disadvantage compared with some of its competitors.

(vi) Reforms to PEPs will make them simpler to administer and more attractive to first time investors; should lead to considerable increase in PEP take-up and substantial widening and deepening in share ownership.

(vii) Changes to employee share schemes limits will give substantial further boost to existing share schemes.

(viii) ESOPs

Defensive

(i) Package really does nothing for personal savings

(ii) Does not stand up well to judgement against criteria laid down in Tax Reform pamphlet.

(iii) Measures encourage rich at expense of poor? Why not encourage 'direct' saving eg in bank and building society deposits?

(iv) Why not go for expenditure tax?

(v) Stamp Duty reform benefits only city fat cats/institutions. All benefit will be capitalised before reform takes effect. And why keep for houses? Illogical to tax (through Stamp Duty) and relieve (through MIR) same transaction?

(vi) How can pensions package possibly be a simplification? And how can it be radical if not preceded by a Green Paper - or have you reneged on that promise?

(vii) Why just 'tinkering' with existing schemes; should try more radical options eg on PEPs.

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BUDGET AND BUSINESS

Factual

(i) Main Corporation Tax rate maintained at 35 per cent. Small companies' rate maintained at 25 per cent.

(ii) Small companies' profits limit raised to £150,000 and limit for marginal relief raised to £750,000.

(iii) VAT changes to comply with ECJ judgment (announced 6 February). VAT will be charged on non-domestic construction (from); water and sewerage services supplied to business (from); fuel and power supplied to businesses (from); news services (but not newspapers) (from); and certain items of protective clothing.

(iv) VAT bad debt relief introduced from 1 August 1989 for all debts over 18 months old that have been written off in traders' accounts.

(v) VAT registration rules simplified so that now refer to past, rather than expected future turnover. Registration threshold raised to £23,600. VAT default surcharge limit reduced from 30 per cent to 20 per cent.

(vi) Close company apportionment rules basically abolished.

(vii) Package of modifications to Profit Related Pay regime introduced.

(viii) ITV levy.

(ix) Suspension of Control of Borrowing Order from midnight on Budget Day.

Positive

(i) CT regime unchanged. Gives stability for companies. Main CT rates among lowest in world. Benefits of 1984 reform evident from greatly improved profitability and performance of company sector.

(ii) Small companies' limits unchanged since 1983. Time now ready to change them. Will help [ ] smaller businesses.

(iii) Bad debt relief proposals will help many businesses both administratively and financially. Build on reforms of VAT introduced in 1987 (cash accounting and annual accounting for smaller businesses).

(iv) VAT registration reforms introduce major simplification. Registration threshold raised by maximum permitted by EC.

(v) Changes in close company apportionment rules remove 20 pages of tax legislation. Contribute to Government's general approach of simplfying tax system.

(vi) Changes to PRP will encourage more firms to join schemes that give workers more direct sense of identification with firms that employ them and promote greater degree of pay flexibility.

(vii) Suspension of COBO important deregulatory measure which frees markets and underlines Government's confidence in future of London as financial centre. Sweeps away last vestige of post-war apparatus for direction of capital by state.

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Defensive

(i) Tax burden on companies increasing.

(ii) VAT on sewerage and water/ fuel and power creating trouble for major privatisations.

(iii) Why have you waited for so long to allow bad debt relief?

(iv) Increases in small companies' CT limits no more than indexation that should have taken place anyway. Why not reduce rates?

(v) VAT deregulation package boon for cowboys and fiddlers.

(vi) Why impose new levy on ITV just when facing competition from cable and satellite.

(vii) PRP is a flop. Why keep tinkering with it?

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SPENDING TAXES

Factual

(i) Tax on unleaded petrol reduced by 3.3p a gallon. Tax on 2-star and 3-star leaded petrol increased by 5p a gallon. Other road fuel duties (4-star leaded and DERV) unchanged.

(ii) No changes in alcoholic drinks or tobacco products duties.

(iii) VED for cars unchanged. Number of rates reduced from over 70 to 5. VED on buses and coaches and certain heavy rigid lorries increased to cover road track costs.

(iv) VAT rate unchanged. Coverage changed in line with ECJ judgment (see above).

(v) Number of VAT measures to help charities.

(vi) Car Tax abolished for vehicles purchased for leasing to disabled.

Positive

(i) Reduced duty on unleaded petrol adds to 10p gallon differential introduced over last two Budgets. UK now highest differential in EC except for Denmark. Considerable environmental benefits from motorists switching to unleaded fuel.

(ii) VED structure simplified and rationalised. Also further step towards making all classes of vehicles cover their road track costs.

(iii) Number of further VAT reliefs introduced for charities.

Defensive

(i) What possible justification, given health risks, for not increasing alcohol and tobacco duties at least in line with inflation? What happened to "presumption" of indexation?

(ii) What has happened to idea of shifting from direct to indirect tax?

(iii) Why pick on poorer motorists driving older cars by increasing price of 2-star petrol.

(iv) Why increase VED on buses? They (a) reduce congestion and (b) burn diesel, so less polluting.

(v) Pledges on further extension of VAT base?

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[illegible]: QUESTIONS: GENERAL

1. Missed opportunity. PSBR in 1989-90 may be smaller than 1988-89 outturn, but a lot bigger than you thought right for 1988-89 in your 1988 Budget. If tax cuts in 1988 did not harm economy, if monetary policy looking after inflation,

- why so cautious now?

- shows second thoughts about 1988 strategy?

Substantial package [incl stamp duty]
1990-91 gain 1989-90

2. What <u>is</u> aim for PSDR? Last year you announced a balanced budget aim.

- have you changed your stance on balanced Budgets? NO

- are you aiming to get the National Debt down? In the medium [illegible]

- are you implicitly accepting that privatisation proceeds, land sales, etc are family silver and should not be in the arithmetic when you decide the fiscal stance? NO - taken a/c

3. In last two years, Government has said a lot about people standing on their own two feet, not relying on State. Now that personal savings rates have collapsed, we are told it doesn't matter because companies and the State are saving more and making up the difference. Are you being consistent?

4. Budget does nothing much overall to encourage personal savings. It gives away £[2½] billions in NICs, which will go straight into consumption. Won't this simply encourage inflation and trade deficits, and thus higher interest rates?

Monetary policy [illegible] [illegible]

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5. Why doesn't Budget do something to discourage excessive pay increases?

6. Why doesn't Budget do something for the regions? Isn't it a Budget for the South-East?

7. Is there any justification for freezing excise duties, other than fiscal fine tuning of the RPI? If inflation's out of control, why not reduce VAT instead - would have benefited everyone, not just drinkers and smokers.

8. Last year you had a budget for high earners. But now you're giving them £3 more a week. Why?

9. Last year the "number one priority" was to get basic rate down to 20 per cent. Why have you given up on this?

NB. Qn: on whole staffing.

10. What does the Budget do

- for the tax burden overall as proportion of GDP?
- for the tax burden of family on average earnings, half average earnings, etc?
- for the balance between direct and indirect taxation?
- for widening the tax base?

II: QUESTIONS - SAVINGS (GENERAL)

1. Whatever happened to the "Budget for Savings"?

2. Whatever happened to the "level playing field"?

3. Why does this piecemeal collection of measures include measures which increase the emphasis on institutional savings?

4. What thread, if any, runs through the thinking?

5. Why no reform of taxation of owner-occupied housing? Root of 1988 credit boom; and will be favoured further once domestic rates are abolished?

6. Why no bold, imaginative move, eg turning PEPs into general ration of tax-privileged savings?

7. Why didn't you restrict reliefs to the basic rate?

8. Why no help for small man? Life Assurance, pensions attacked; nothing for "real" savings such as Post Office, Bank and Building Society deposits?

9. If you want to encourage share ownership, why not give relief for brokers' fees?

10. Why no front-end relief for PEPs? Why not Barclayshare?

III: QUESTIONS - BUDGET TAX MEASURES

(Except Life Assurance (See Section IV); and Pensions (see Section V).

INCOME TAX

(a) Basic Rate

- What happened to the "number one priority" of getting rate down to 20 per cent?

- Income tax cuts a sign of a successful economy - is that why there aren't any this year?

(b) (if basic rate limit not raised by as much as basic rate allowance)

- where is the consistency in reducing higher rates to single 40% rate, and then making greater and greater proportion of middle managers pay it?

(c) Car benefit scales

- everyone resigned to large increase, so why not grasp nettle and get this out of way for good?

- which is long-term objective - make everyone pay tax on full value? What about "tools of the trade"?

- if principle is that there are to be few or no net losers, why don't you apply elsewhere in the tax system? What's so special about company cars?

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(d) Schedule E receipts basis

- move to putting tax system on a current year basis. Will you apply this elsewhere, eg to self-employed?

(c) Higher rate

- Have last year's higher rate changes paid for themselves?

EXCISE DUTIES

(A) Alcohol and tobacco

- what is Government's best estimate of number of deaths which will result from failure to index duties?

- shifts tax burden away from indirect taxes. Consistency with broad aims?

- why not tax drinks according to alcoholic strength?

(b) Leaded/unleaded

- how will you stop oil companies pocketing some of the differential favouring unleaded?

- why are you giving oil companies an incentive to do something that they are doing anyway?

- if you've really serious about lead, why weren't you tougher on company cars? - Less use of them would have cut lead, and also reduced congestion in cities.

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(e) VED

- you've frozen VED on cars and petrol duties (except 2 and 3 star). You've hammered buses. And you've not hammered company cars. Why this bias against public transport? - means more cars on road, more congestion, more road accidents, more pollution; and higher fares.

- why not abolish VED, raise fuel duties? - would cure evasion overnight.

- why no help for UK commercial operators, who pay highest motoring taxes in EC?

VALUE ADDED TAX

(a) ECJ judgement on non-domestic construction, etc.

- just proves EC can force us to change our zero rates. What's next - VAT on food and children's shoes?

- changes will damage inner city development? Why not a longer transition period?

- new rules far too complicated, will lead to mistakes and administrative burdens?

- delay on fuel and power just another sop to privatisation?

- VAT on water, fuel and power creates problems for privatisation of water, electricity industries?

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(b) VAT pledge

- will you pledge now that there will be no more extensions to the VAT base? If not, what's next - newspapers?

(c) Deregulation package

- a boon for cowboys and fiddlers? (Compare pursuit of social security fraud).

STAMP DUTY ON SHARES

- why not abolish stamp duty now?

- reckless to announce a year ahead. Given trackrecord on forecasting, how do you know this will be prudent come 1 April 1990?

- surely, won't do much for wider share ownership? just a boost to city firms and large existing shareholders?

CORPORATION TAX

- high interest rates damaging companies. Overall tax burden on UK companies too high by international standards. Why no cuts in CT rates?

- what is your long-term aim for main CT rate, which is well out of line with basic rate income tax?

- basically all you've done for small companies is make up for the indexing which should have been done in your past Budgets. Why not a substantial real increase and indexed for the future?

- pre-trading changes just a dodge to help Euro Tunnel. I thought you said that project wouldn't be given special tax help?

NATIONAL INSURANCE CONTRIBUTIONS

- just an expensive way of putting right mistakes of 1985?

- still leaves cliffface at LEL. What's the point of spending £[2½] billion and not solving that?

- can you explain the logic of the different contribution rates for employers and employees?

- changes, coming on top of previous ones, not consistent with contributory principle. Why not face up to that, and abandon the contributory fiction?

- these changes don't and won't eliminate existing surplus on NIF, nor stop it growing. How can you justify that? Is the answer that the contributory principle is dead and NICs are just being used as a tax on employment?

- Another £3 a week for the well off. Why didn't you raise the UEL? Why not raise it to the basic rate limit?

- why have you done nothing for the self-employed?

- why have you done nothing for employers?

- compliance cost for employers?

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PENSIONERS' EARNING LIMIT

- unemployment still about 2 million. Why encourage old to block jobs needed by the young? Budget for the South-East?

- wouldn't it be better to spend the money on poor pensioners? What's happened to targeting?

PRIVATE MEDICAL INSURANCE

- Just a subsidy to private sector. When will you extend this relief to whole population?

- Why relieve insurance rather than hospital fees?

CHARITABLE GIVING

- Why no reliefs for one-off gifts?

- Why not extend payroll giving to self-employed?

ESOPS

- May please a few enthusiasts, but what evidence of any <u>real</u> demand for this from companies?

- Do you really expect companies to try to implement ESOPs with such a complex set of bureaucratic rules?

- Don't you agree that if you really want to boost ESOPs this half-hearted set of measures won't do it?

EMPLOYEE SHARE SCHEMES

- If you are doing this, why do you need ESOPs as well?

PROFIT RELATED PAY

- You announced one panic measure before the Budget. Now more. How big a flop is PRP?

- Is there any evidence that PRP has saved a single job, or increased any employee's identification with his employer?

- If PRP's any good, why are so many companies giving it up once they've tried it?

PEPS

- Thought this Government was against institutionalised savings ? Why have a big boost to unit trusts?

- Raising the limit just means fat cats reorder their portfolios to pick up the tax relief. Isn't limit already high enough for ordinary people you say you've trying to attract?

RELOCATION EXPENSES

- Doesn't this just hamper labour mobility?

- Why tax this - isn't it part of getting the job, not remuneration?

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UNIT TRUSTS

- If tax harmonisation is irrelevant to 1992, why are you panicking over unit trusts?

- Why have unit trusts suddenly become the Government's preferred savings medium? Why give them this advantage as well as preferential PEPs treatment?

DEEP DISCOUNTED BONDS

- Why are you abolishing COBO? Does variable/non variable distinction make any sense? Some variable bonds have capital component - why tax that as income? Does index linked bonds let-out really solve this?

CLOSE COMPANIES

- Why such vindictive action (penal rate) on close companies? Is aim to kill them off? What about close property companies?

CAPITAL GAINS TAX

- If capital gains to be taxed at income tax rates, why not integrate them fully?

- Why can't CGT losses be charged against income? - You've conceded that unincorporated business can offset income losses against capital gains, so why not the reverse?

- Why didn't you permit wider CGT rollover relief? - CGT inhibits reinvestment.

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- Why didn't you extend retirement relief to landlords?

- Abolishing gifts relief is contrary to policy of encouraging lifetime giving?

INHERITANCE TAX

- Why not abolish IHT completely? The wealthy and well-advised don't pay this voluntary tax.

- 40 per cent starting rate far too high for modest estates - why not align with basic rate of income tax?

- Why not 100% business relief?

- How does IHT burden compare in real terms with CTT in 1975?

- Why not increase threshold in line with house prices?

ITV LEVY

- Why make this change when ITV companies being exposed to satellite/cable competition? Isn't it fighting yesterday's tax battles?

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IV: QUESTIONS - LIFE ASSURANCE

1. In past Budgets you've had a go at Lloyd's; at general insurers' trading, reserves etc; now you are having a go at Life Assurance, and threatening more in 1990.

- why this assault on the insurance industry?

2. Burden of Budget measures comes on top of £700m cost of FSA (£200m on red tape, £500m on new commissions).

- why impose all these burdens at the same time?

3. Doesn't the package discriminate against companies distributing through independents?

4. Is taxation of accrued gains for pensions business first step towards taxing accrued gains of Life Funds?

5. What is planned for 1990? What consultation? Will changes be retrospective to 1 January 1990?

6. You clearly put options A and B in the consultative document as a smokescreen. Meant no meaningful consultation on what you really intended to do. Will you consult <u>properly</u> on the 1990 changes?

7. Is option A dead? Is option B?

8. Industry want Revenue to be much quicker in refunding taxes deducted at source on exempt pension business. Will the Revenue cooperate?

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9. What will this do to commissions and premium levels?

10. What will this do to cost of endowment mortgages?

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V: QUESTIONS - PENSION REFORMS

1. Why didn't you issue a Green Paper before doing this?

2. Second attack on lump sum in two years. When's the next step?

3. What's the point of changes which affect so few, don't really bite until next century?

4. Why didn't you go further to promote personal pensions, downgrade occupational schemes?

5. Do you plan to issue a Green Paper on pensions? If not, do you pledge no further changes?

6. Why did you index the limit? Why indexed to prices, not earnings?

7. If it's right to freeze MIR, why is it wrong to freeze the new pensions limit? (and vice versa).

8. How will public services deal with these changes?

9. Why do those in Final Salary schemes only get affected when they change jobs, whereas those in Personal Pensions get affected immediately?

10. Compounds mistakes of 1987. Changes will affect labour mobility more and more as time goes by? What happened to "freeing up the labour market"?

VI: WHY DIDN'T YOU

- Abolish Inheritance Tax? - which is voluntary for the well-off and well-advised?

- Limit reliefs to basic rates?

- Raise mortgage interest relief?

- Index mortgage interest relief limit? (you're indexing the new pensions limit)

- Abolish mortgage interest relief?

- Limit mortgage interest relief to the basic rate of tax?

- Abolish stamp duty on house sales?

- Increase stamp duty on house sales?

- Introduce a lower rate of income tax at the bottom end?

- Abolish Car Tax when you could afford to?

- Do more to encourage investment?

- Do something effective on savings? eg tax free savings ration?

- Do something for war widows?

- Do more than you have for the elderly? [There has been a very heavy postbag on help for the old.]

- Give tax relief for creches at work? For child care for working parents more generally?

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- face up to sovereign immunity problem, and deal with Kuwaiti abuses?

- stand up to the Greek shipowners on residence? What makes them, other foreigners so special?

- do more in this Budget instead of stacking up so much for the 1990 Budget?

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FROM: M J NEILSON
DATE: 24 February 1989

1. MR SCHOLAR

2. CHANCELLOR

Ch. Points for decision summarised in para 31.

27/2

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Wicks
Mr Monck
Mr Culpin
Mr Odling-Smee
Mr Peretz
Mr Ilett
Mr Pirie
Miss O'Mara
Mr Kroll
Mr Sharples

This submission is the outcome of a good deal of work here, and of extensive discussions with the Bank. For myself I would not speak to the Stock Exchange before Budget day.

MCS 24/2

BUDGET CAPITAL MARKETS PACKAGE

This submission rounds up the outstanding issues on the various capital market deregulatory measures in this year's budget.

2. The following changes have already been agreed

- The abolition of the bond and equity queues

- rationalisation of the tax treatment of corporate and other bonds (starters 262 and 453)

- Deregulation of the sterling commercial paper regime

3. Following extended consultation with the Bank we now propose:

- Creating a unified regime for sterling issues up to 5 years, by bringing the short-term corporate bond regime into line with that for sterling commercial paper.

4. This submission also deals with:

- The future of the Bank's lead management guidelines

- Whether we should give the Stock Exchange advance warning of the abolition of the queue, in case they wish to set up an alternative voluntary arrangement.

Commercial Paper and Corporate Bonds

5. The definition of deposit taking in the Banking Act would normally catch issues of short-term debt instruments. Banking Act Exemption regulations have therefore been put in place to allow companies to issue sterling commercial paper (up to 1 year) and short-term corporate bonds (1-5 years), subject to a number of conditions. Issues of sterling commercial paper may, at present, only be made by companies listed on the UK stock exchange with net assets of at least £50 million, and the paper must have a minimum denomination of at least £500,000. The requirements for corporate bonds are similar, except that the minimum denomination is £100,000, and a prospectus has to accompany each issue.

6. In the Autumn you decided that the sterling commercial paper regime should be substantially relaxed. The main changes are to allow other types of issuer; private companies, companies listed on non-UK stock exchanges, sovereign and parastatal bodies. The minimum net asset requirement is to be reduced to £25 million.

7. The Bank have spent some time considering what consequential changes should be made to the corporate bond regime. They have concluded, and we agree with them, that the two regimes should be brought into line. This would involve establishing a single minimum denomination of £100,000, and removal of the prospectus requirement for corporate bond issues. The changes already agreed on commercial paper would apply also to corporate bonds.

8. We agree with the Bank that the minimum denomination should be £100,000 rather than £500,000. The threshold for "wholesale" money market transactions under Section 43 of the Financial

Services Act is £100,000. Standardising our definition of wholesale at this lower level may also help in negotiations on the EC withholding tax, since it gives more credibility to the argument that an exemption threshold should be introduced at that level or thereabouts.

9. The prospectus requirement for corporate bonds exists for investor protection reasons. But the purpose of the minimum denomination is to ensure that this is a professional market, whose participants can look after themselves. The conditions the Bank will be imposing on private companies and non-UK listed companies are designed to ensure that adequate disclosure takes place, without requiring a prospectus for each issue. We understand that DTI, who also impose requirements in this area (see below under timing) will not be imposing a prospectus requirement, and it is they who have prime responsibility for investor protection. Removing the prospectus requirements, and relying on ongoing disclosure requirements, will make it quicker and cheaper for companies to make such issues.

Timing

10. These changes can be announced in the Budget but it will not be possible to introduce them immediately - the Bank still have some work to do on the disclosure requirements that need to be imposed on private companies and non-UK listed companies. If this were the only constraint, we would expect to be able to implement the changes by July at the latest. But the position is complicated by the fact that issues of commercial paper and corporate bonds are also regulated under DTI legislation; currently the Companies Act, but this is to be replaced by regulations under Part V of the Financial Services Act.

11. This causes timing problems. The Companies Act imposes a prospectus requirement on corporate bond issues, which can only be lifted by primary legislation. It will be possible to lift the prospectus requirement in the regulations under Part V of the Financial Services Act, and DTI have indicated that they would be

willing to do this. The problem is that DTI do not intend implementing part V until the end of this year at the earliest. Thus, even if we make the appropriate Banking Act exemption regulations, prospectuses will still be needed for issues of over 1 year.

12. Against this background, there are two basic options:

- Press DTI to implement Part V earlier, and introduce all the changes at the same time.

- Announce all the changes in the Budget, implement the changes on commercial paper immediately, and those on Corporate Bonds when Part V comes into effect.

13. We think it is worth trying to persuade Lord Young to accelerate the timetable for Part V, but DTI lawyers are hard pressed, and a reasonable time will be needed for consultation (the regulations under Part V establish a whole new regulatory regime for unlisted issues of securities). So it is unlikely that the timetable can be accelerated enough for it to be reasonable for you to delay making changes to the Banking Act exemptions.

14. The Bank at an earlier stage argued for announcing only the Commercial Paper changes, in case a fuller announcement caused issuers to anticipate the other changes. But we see little force in this argument - an issuer anticipating the introduction of Part V will simply be breaking the law. Our strong view with which the Bank are content is that you should announce all the changes in the Budget - they form a coherent deregulatory package, of which the main feature is the integration of the two regimes. We could lay the relevant Banking Act exemption regulations as soon as they are ready, but make clear that issues will still be subject to the Companies Act requirements including the need to issue a prospectus. This will put some useful pressure on the DTI to put part V of the Financial Services Act in place soon.

Lead Management Guidelines

15. In view of the abolition of COBO we need to consider what changes, if any, to the Bank's lead management guidelines should be made. There are two questions; whether we can retain the guidelines, and whether we wish to do so.

The Current Guidelines

16. The main elements of the current guidelines are:

- All capital market issues in sterling should be managed and organised in the UK, by a UK-based firm with the capacity in the UK to act as an issuing house.

- Foreign-owned firms with such a capacity may lead manage such issues in the UK if there are reciprocal opportunities in their domestic capital markets for equivalent UK-owned firms. (This is a relatively restricted reciprocity test, in that the Bank will look only at the opportunities for lead management in the home country, rather than at wider questions of access).

17. As the Bank's market notice explains, the lead management guidelines are there to, "promote the orderly development of the sterling capital market". But recently our main interest has been in the use of the reciprocity requirement as a bargaining tool with Japan.

Can we retain the Guidelines?

18. Our legal advice is that the guidelines are based exclusively on the Bank's customary authority, and thus, strictly speaking, the abolition of COBO should not affect them. The Bank argued, before the decision on COBO was taken, that its abolition would undermine their customary authority. But you made clear in your letter to the Governor of 12 September 1988 that you saw no reason why this should be so.

19. We had thought that the Bank now shared this view, but Mr George has now told Mr Scholar that, after considerable reflection within the Bank, they consider themselves unable to continue operating the reciprocity test - though not the other aspects of the guidelines - without some form of statutory backing. Their argument is that if they were challenged in court on reciprocity they would not succeed; and that if someone challenged them effectively in Parliament - as Lord Bruce-Gardyne nearly did in the BZW/Nomura and Daiwa case - the weakness of their position would be evident.

20. This has caused us to consider the matter again with our legal advisors. The conclusion is that we could not, as the Bank propose, rely on COBO or on anything based on it to reinforce the Bank's customary authority: a reciprocity test is well outside the vires of the underlying legislation.

21. If you do wish to retain the guidelines, it will therefore be necessary to secure the Bank's agreement to continue their current practice. But before doing this you will wish to consider whether the guidelines are still needed.

Should the Guidelines be retained?

22. There are two arguments in favour of retaining the guidelines; to ensure that the sterling market remains in London, and to use the reciprocity test as a bargaining tool with the Japanese.

23. Although we share the Bank's desire to see the sterling market remain in London their proposed method of ensuring this is rather at odds with our deregulatory approach to financial markets and is in any event ultimately outside the UK's control. Removing the guidelines might, in the short-term, cause some sterling business to move outside London, but it is not clear why we should wish to impose this sort of artificial restriction in this area alone. The basic strength of the London market means that the overwhelming majority of sterling business will continue to be

done here. London has, after all, managed to attract a large proportion of Euro-market business purely because we have fewer restrictions than other countries.

24. The bank may well find information more difficult to recollect without the guidelines, but this is scarcely a reason for retaining such restrictions, and the same argument applies to the abolition of COBO itself.

25. That leaves the reciprocity argument. This is a tricky question. The Japanese clearly care about their exclusion from lead management. And they might see the lifting of this restriction as a sign of weakness. On the other hand, our shopping list for access to Japanese financial markets is much reduced. Mr Wicks is reviewing our strategy in financial relations with Japan. It is difficult to make sensible judgements about the value of the lead management card until we have reached a view on general strategy.

26. That said, the abandonment of discriminatory regulations against foreign-owned firms, and against firms wishing to make sterling issues outside London, would provide a useful argument in community debates about EMU and reciprocity. It is indeed just possible that retaining the guidelines will draw attention to them in a way that leads others in the Community to question their compatibility with EC obligations, though in fact few are in the position to throw stones. We could point to it as an example of the kind of practical steps we are pressing all member states to take to bring about the integration of financial markets; and it would marginally strengthen our position in arguing against the reciprocity provisions in the Banking and Investment Services Directive.

Assessment

27. Our feeling is that the lead management guidelines have probably outlived their usefulness. Their main current value is in negotiations with Japan, and we have doubts whether this is strong enough to justify maintaining the guidelines. But it would not make sense to take a decision on this until completion of the review of our general strategy with Japan.

28. Against this background, and given the Bank's reluctance to maintain the guidelines on their current basis (but, we suspect, their desire to maintain the guidelines on some basis!) we would suggest the following way forward:

- You should write to the Governor saying that we are reviewing the utility of the lead management guidelines, but that you do not wish to reach a conclusion until you have completed a review of our general strategy on financial relations with Japan.

- That you would therefore like to maintain the current guidelines pending completion of this review.

- That, though you appreciate the Bank's desire to give the guidelines some form of statutory backing, our legal advice is that it would be ultra vires to use COBO for this purpose.

29. What this approach would mean in practice is that the Bank's market notice announcing the changes would simply say that the Bank's lead management guidelines are unchanged.

Abolition of COBO and the Stock Exchange

30. You have decided that the Bank should cease to operate the queue immediately the Budget announcement is made. It is possible that the private sector may wish to introduce voluntary arrangements to avoid issues clashing. The Stock Exchange would be the natural body to take on this role. They would only be able to give a considered reaction on Budget day if we forewarned them. This would mean that the Exchange would be able to announce any voluntary arrangement immediately. They would also be able to forewarn us of any problems with immediate abolition that we have not so far identified.

typg.u1/ln/fim2/1.24.2.ew

Conclusion

31. Do you agree with the following recommendations:

- That you should announce a unified regime for sterling issues up to 5 years in the Budget.

- That appropriate Banking Act exemption regulations should be laid as soon as possible thereafter.

- That you should write to Lord Young outlining the capital markets package for the Budget, and asking him to accelerate the timetable for implementing Part V of the Financial Services Act.

- That you should write to the Governor asking him to retain the Bank's lead management guideline, pending the review of our strategy on financial relations with Japan.

  See note

- Should we confidentially forewarn the Quotations department at the Stock Exchange that you have decided to abolish the queue?

  No

Very many thanks. A useful package. [illegible] in margin above. The penultimate, I need to return to flavour of my last missive (some time ago) on assurance - virtually all of the Bank's customers in this area, anything in this area, they can count on my full support. (This is consistent with pts suggested in para 28.) We also need to give urgent consideration to how much of this appears in the Budget speech. I shd be grateful if Mr Scholar wd like me to have a draft passage * ASAP.

Nicholas Barker
for M J NEILSON

* We shd be [illegible] the ~~[illegible]~~ [illegible] [illegible] COBO [illegible] whether [illegible] its demise.

chex.rm/jmt1/65 BUDGET CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 24 February 1989

MR NEILSON

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Wicks
Mr Monck
Mr Culpin
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Ilett
Mr Pirie
Miss O'Mara
Mr Kroll
Mr Sharples

BUDGET CAPITAL MARKETS PACKAGE

The Chancellor was very grateful indeed for your note of 24 February. He thinks it is a most useful package.

2. On the points for decision:

- he agrees that he should announce a unified regime for sterling issues up to five years in the Budget;

- he agreed that appropriate Banking Act exemption regulations should be laid as soon as possible thereafter;

- he agrees that he should write to Lord Young outlining the capital markets package for the Budget, and asking him to accelerate the timetable for implementing Part V of the Financial Services Act.

3. On the suggestion that he should write to the Governor asking him to retain the Bank's lead management guideline, the Chancellor has commented that he needs to retain the flavour of his last note - viz an assurance that if the Bank use their customary authority in this area, they can count on his full support (this is in addition to the points suggested in your paragraph 28).

4. We also need to give urgent consideration to how much of this should appear in the Budget speech, and he would be grateful if Mr Scholar could let him have a draft passage as soon as possible. This should be enlivened by the historical origins of COBO, and rhetorical flourishes about its demise.

Anthony Sight

PP J M G TAYLOR

FROM: J M G TAYLOR

DATE: 27 February 1989

MR NEILSON

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Wicks
Mr Monck
Mr Scholar
Mr Culpin
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Ilett
Mr Pirie
Miss O'Mara
Mr Kroll
Mr Sharples

BUDGET CAPITAL MARKETS PACKAGE

Further to my earlier note, the Chancellor would prefer not to forewarn the Stock Exchange about the decision to abolish the queue.

J M G TAYLOR

fim2.cr/Neilson/m.043

BUDGET CONFIDENTIAL

FROM: M J NEILSON
DATE: 1 March 1989

1. MR SCHOLAR
2. CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Wicks
Mr Monck
Mr Culpin
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Ilett
Mr Pirie
Miss O'Mara
Mr Kroll
Mr Sharples

It would be helpful if the letter to Lord Young could go off as soon as possible.

MCS 2/3

Ch/ Content to write as proposed?

JS 2/3

OK

BUDGET CAPITAL MARKETS PACKAGE

As agreed, I attach a draft letter for you to send to Lord Young outlining the Budget capital markets package, and asking him to accelerate the timetable for implementing part V of the Financial Services Act.

2. In fact the latest intelligence from DTI on the timetable for part V is worse than we had thought - implementation by Spring 1990 at the earliest. We have therefore included in the draft the alternative proposal that DTI should achieve the same effect by amending the existing Companies Act regime in this year's Companies Bill. (The Companies Act regime is eventually to be replaced by regulations under Part V of the Financial Services Act). This could come into effect on Royal Assent, which, we understand, is unlikely to be before the Autumn.

M J NEILSON

fim2.cr/Neilson/dl.23

BUDGET CONFIDENTIAL

DRAFT LETTER TO

Pse type final

Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry

BUDGET CAPITAL MARKETS PACKAGE

When we met ~~yesterday~~ on Wednesday I mentioned that I would be announcing a major capital markets deregulatory package in my Budget statement. This letter sets out the measures which I will be announcing.

The corner stone of the package is the effective abolition of the Control of Borrowing Order 1958 ("COBO"). This is the last remaining vestige of the panoply of post-war controls on borrowing. Its main function in recent years has been to underpin the Bank's new issues queue for bonds and equities, which I judge an outdated and unjustifiable state intrusion in the markets. But it also exercises control over local authority borrowing, a control which I wish to retain until new measures are put in place in the Local Government and Housing bill. This means that I shall be issuing a general consent under COBO, effectively abolishing all parts of COBO other than that affecting local authorities. When the new controls on local authorities are in place I will revoke COBO itself, and its parent legislation, the Borrowing (Controls and Guarantees) Act 1946, will be repealed.

I also intend making major changes to the regulatory regime for sterling issues of under 5 years. At present there are two separate Banking Act regimes, one for sterling commercial paper (of less than 1 year maturity) and one for short term corporate bonds (1 to 5 years maturity). I propose unifying the two regimes and extending substantially the categories of institutions that can issue sterling paper.

The main changes required to unify the regime will be to establish a common minimum denomination of £100,000, and to remove the requirement that corporate bond issues should be accompanied by a prospectus. At the moment, the Companies Act imposes a requirement on companies to issue a prospectus if they issue paper with a maturity of more than one year. However, the Companies Act regime is to be replaced in due course by regulations under part (V) of the Financial Services Act. I understand that your current intention is that the regulations should lift the prospectus requirement from issues made to professional investors, and that you are likely to accept that a minimum denomination of £100,000 effectively directs issues towards such investors.

I would like to unify the two regimes as soon as possible, I hope you can support this objective. First, however, it will be necessary either to table a very short amendment to this year's Companies Bill to alter the existing regime, or to lay regulations under part (V) of the Financial Services Act to replace the existing regime. It would be desirable to implement the Budget proposal before the Summer Recess. If you are not able to lay the Financial Services Act regulations by that time I hope you can agree to amend the Companies Bill.

In the meantime I intend implementing the other changes affecting the sterling commercial paper regime by extending the categories of issuer and reducing the minimum denomination to £100,000. I shall be laying regulations under the Banking Act to achieve this as soon as possible after the Budget.

Tax changes

One result of the effective abolition of COBO is that foreign sovereigns and parastatals will be able to issue deep discount bonds in the UK for the first time. I shall therefore be taking this opportunity to rationalise the regime for taxing deep discount bond issues. I intend to extend the 1984 regime for non-variable deep discount issues to apply to all eligible borrowers, and to introduce a new regime for variable deep discount bonds. This will simplify the tax treatment of these instruments and create a level playing field between different borrowers.

I suggest that our officials meet as soon as possible to discuss these issues, so that we can make clear, at Budget time, which legislative route will be used. Following that meeting, I would be grateful for your views by 8 March on how best to achieve rapid unification of the commercial paper and corporate bond regimes.

N LAWSON

fp.pk/macpherson/1.3.01

COPY 1 of 13

BUDGET SECRET

FROM: N I MACPHERSON
DATE: 1 March 1989

1. MR GILHOOLY 1/3

2. CHANCELLOR

cc: Chief Secretary
Financial Secretary
Sir Peter Middleton
Mr Scholar
Mr Culpin
Mr McIntyre
Mrs Chaplin
Mr Tyrie

PS/IR

MEETING WITH MR MOORE ON BUDGET MEASURES

You are meeting Mr Moore tomorrow to tell him about your decisions on NICs and Pensions. Details are set out below.

NICS

All measures to be introduced from beginning of October:

Class 1 employees:	NICs will be payable at 2 per cent on earnings up to the LEL (£43 a week in 1989-90) and 9 per cent on earnings above LEL, up to the UEL (£325 a week in 1989-90).
Class 2 self employed:	Reduce Class 2 rate from £4.25 a week to £2.95 a week.
Class 3 voluntary:	Reduce Class 3 rate from £4.15 a week to £2.85 a week.

		1989-90	1990-91
Cost:	Class 1 employees	-1000 ~~- 985~~	-2890 ~~-2785~~
(£ million)	Class 2	~~- 35~~	~~- 145~~
	Class 3	- neg	- 5
		~~-1020~~ -1000	~~-2935~~ -2895

Pensions

- New regime for occupational schemes:

  employers will be able to set up "top up" schemes for their employees, with no limits on benefits, but without special tax reliefs;

  a limit will be placed on pensions paid from tax approved schemes, based on earnings of £60,000 a year. This is consistent with a privileged pension of up to £40,000 a year or maximum tax free lump sum of up to £90,000. The limit will be indexed to prices;

  the rules for tax approved pensions, particularly affecting those who take early retirement, will be simplified and improved. (Not introducing new facility for early retirement and so not inconsistent with DSS plans for retirement age).

  these changes will apply to schemes set up on or after Budget day and to new members joining existing schemes on or after that date.

- New simplified rules will be introduced for monitoring additional voluntary contributions. Any surplus contributions made will be returned to employees, subject to a special tax charge.

- Annual contribution limits for personal pension schemes will be increased as a percentage of earnings, subject to an overall cash limit based on the £60,000 earnings limit for occupational schemes. Also indexed.

- Propose to make it easier for individuals to manage own investments within personal pension schemes. N.B. will not affect element of personal pensions, financed by contracted out rebate where DSS rules will still apply.

Mike Macpherson

N I MACPHERSON

BUDGET SECRET

COPY NO 1 OF 18

FROM: MRS J CHAPLIN
DATE: 2nd March 1989

CHANCELLOR'S MORNING MEETING 21ST MEETING

NOTE FOR THE RECORD

Present: Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Mrs Chaplin

1. THE BUDGET PACKAGE

The Chancellor said he was concerned at the second-year cost of the current Budget package, and he would be happier with it reduced to £3½ billion. He therefore proposed that the announcement of the abolition of stamp duty should be postponed until next year. That would cause the Inland Revenue difficulties as they would have to set up temporary systems capable of collecting stamp duty after dematerialisation. As some consolation, the Schedule E receipts basis package could be reinstated. The VAT deregulatory package should also be removed and the NICs package for the self-employed, which the latest figures had shown to be extremely generous.

The Financial Secretary suggested a return to the original NICs package which increased the marginal rate, but the Chancellor said he was against increasing marginal rates.

The Chief Secretary thought that removing the self-employed from the NICs package would attract some flak, but that it was containable. The VAT deregulatory package was a good package and it was a pity to lose it. He raised the possibility of increasing duty on tobacco as the health lobby is strong, although he recognised the adverse impact on the RPI. The Chancellor said it was not only the RPI impact, but that it would look odd to raise excise duties in all areas except on alcohol. In 1987 the freezing of excise duties had not, in the event, been controversial.

The Financial Secretary suggested that it would be possible to remove the NICs package altogether. The Chancellor said this would be going back to the Dorneywood Budget, which had not been attractive.

The Paymaster General said there would need to be care taken with the presentation of leaving the self-employed out of the NICs change. The Chancellor said that John Moore was reviewing the whole area of NICs and the self-employed, although this would not be publicly announced yet.

Judith Chaplin said that the presentation of excluding the self-employed would be easier if it was clearly a NICs reform for those on lower earnings. This would be so if the UEL was raised. There would be savings, even if the increase in car scales had to be reduced somewhat. The Chief Secretary said he liked the fact that the £3 gain was through the whole income scale, as it made a more attractive Budget package.

JC

JUDITH CHAPLIN

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

Ch.

NB - a word with Ld Young in the margins, as well as with Mr Moore (briefing note for the latter enclosed).

[illegible]

1/3

chex.md/jmt/68 UNCLASSIFIED

FROM: J M G TAYLOR
DATE: 2 March 1989

MR MACPHERSON

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr McIntyre
Mr Gilhooly
Mrs Chaplin
Mr Tyrie

PS/IR

MEETING WITH MR MOORE ON BUDGET MEASURES

The Chancellor was grateful for your note of 1 March.

J M G TAYLOR

FROM: J P MCINTYRE
DATE: 2 March 1989

CHANCELLOR

Thanks. X is a great nuisance.
Are we sure it is right?
But clearly cannot
afford to do the manoeuvre
women optants @ all.

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Riley
Mr Sedgwick
Mr Culpin
Mr Gieve
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

PS/IR

BUDGET PACKAGE: UPDATED COSTINGS

X DSS have just told us that they have revised their estimate of the cost of abolishing the pensioners' <u>earnings rule</u>. They now put this at roughly £375 million in 1990-91, instead of £255 million. In 1989-90, the cost will be around £190 million, rather than £125 million.

2. The reason for the increase is that, on checking the position with their Newcastle office yesterday, DSS have discovered that the number of people who have opted to defer their pension is substantially larger than they had thought.

3. As far as NICs are concerned, there is one consequential change to the decisions you have already made. This concerned married women optants. We will be letting you have a submission on this and other, minor consequentials later today. But the likely options for this group would cost around £10-20 million in 1989-90, rising to £30-50 million in 1990-91.

4. In total, therefore, the NICs changes would cost £1030-£1040 million in 1989-90 and £3030-£3050 million in 1990-91.

Jm

J P MCINTYRE

COPY NO 1 OF 8

FROM: A G TYRIE
DATE: 2 March 1989

CHANCELLOR

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

Discuss

THE BUDGET PACKAGE

I was sorry to miss the meeting you called this morning on the Package. I was in transit at 9.00a.m., when people were notified, and didn't hear about the meeting until after it had started. (he didn't get in till 9.40)

2. I have a few points:

(i) I am not sure that the difference between £3.5 billion and £4.9 billion for year 2 would, in the event, be crucial to the markets. But there's merit in prudence.

(ii) If we judge that it is crucial, (if the current turbulence continues for a few days it might become so,) then I very much agree that stamp duty is a prime target for removal. Our decision on this has been driven by the Revenue's problems with administering a post dematerialisation regime. The other argument in favour of abolition, that we would have to do it anyway because of stock market competitiveness, is going to become crucial only in the early 1990s.

What is more, I think giving £1 billion this year to the City would take a bit of explaining. It would be surmountable but would look a little odd.

(iii) I do not think we should drop the NICs package. There was a lot of pressure for something like this (or on thresholds) among your colleagues, both backbench and ministerial. The package we have got, although expensive, is pretty attractive. A basic rate cut would sit oddly with 13 per cent interest rates. Curiously, the more expensive NIC package does not.

(iv) I agree with the Chief Secretary that we should not raise the UEL. To do that would look a bit too much like an admission that we were wrong on top rates last year.

(v) However, I am a little worried about the complete absence of anything for small businesses. With both the VAT package and self-employed NICs package removed we are left only with the increase in the small business corporation tax ceiling, which is "up market" stuff.

I think that nothing at all for the self-employed/small businesses would give backbenchers a grouse. On NICs, many of them will look back to the 1985 package which was "balanced" with the fifty per cent tax relief. The feeling is also widespread that very small businesses, unlike larger ones, have been quite badly hit by higher interest rates. So all in all, I would be tempted to keep either the class 2 cut or the VAT package, despite the cost.

p.p.

A G TYRIE

chex.ps/aa/28 BUDGET SECRET

COPY NO. 29. OF 29 .

FROM: A C S ALLAN
DATE: 3 March 1989

MR MCINTYRE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Riley
Mr Sedgwick
Mr Culpin
Mr Gieve
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

PS/IR

BUDGET PACKAGE: UPDATED COSTINGS

The Chancellor was grateful for your minute of 2 March. The increased estimate of the cost of abolishing the pensioners' earnings rule is a great nuisance. Are we sure it is right?

2. He also feels that we will not be able to afford to accept the options for married woman optants at all.

ACSA

A C S ALLAN

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

3 March 1989

Rt Hon Lord Young of Graffham
Secretary of State for Trade
and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

cc PS/Chief Secretary
PS/Financial Secretar
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Wicks
Mr Monck
Mr Scholar
Mr Culpin
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Ilett
Mr Pirie
Miss O'Mara
Mr Neilson
Mr Kroll
Mr Sharples

Dear John

BUDGET CAPITAL MARKETS PACKAGE

When we met yesterday I mentioned that I would be announcing a major capital markets deregulatory package in my Budget statement. This letter sets out the measures which I will be announcing.

The cornerstone of the package is the effective abolition of the Control of Borrowing Order 1958 ("COBO"). This is the last remaining vestige of the panoply of post-War controls on borrowing. Its main function in recent years has been to underpin the Bank's new issues queue for bonds and equities, which I judge an outdated and unjustifiable state intrusion in the markets. But it also exercises control over local authority borrowing, a control which I wish to retain until new measures are put in place in the Local Government and Housing bill. This means that I shall be issuing a general consent under COBO, effectively abolishing all parts of COBO other than that affecting local authorities. When the new controls on local authorities are in place I will revoke COBO itself, and its parent legislation, the Borrowing (Controls and Guarantees) Act 1946, will be repealed.

I also intend making major changes to the regulatory regime for sterling issues of under 5 years. At present there are two separate Banking Act regimes, one for sterling commercial paper (of less than 1 year maturity) and one for short term corporate bonds (1 to 5 years maturity). I propose unifying the two regimes and extending substantially the categories of institutions that can issue sterling paper.

The main changes required to unify the regime will be to establish a common minimum denomination of £100,000, and to remove the requirement that corporate bond issues should be accompanied by a prospectus. At the moment, the Companies Act imposes a requirement on companies to issue a prospectus if they issue paper with a maturity of more than one year. However, the Companies Act regime is to be replaced in due course by regulations under part (V) of the Financial Services Act. I understand that your current intention is that the regulations should lift the prospectus requirement from issues made to professional investors, and that you are likely to accept that a minimum denomination of £100,000 effectively directs issues towards such investors.

I would like to unify the two regimes as soon as possible, I hope you can support this objective. First, however, it will be necessary either to table a very short amendment to this year's Companies Bill to alter the existing regime, or to lay regulations under part (V) of the Financial Services Act to replace the existing regime. It would be desirable to implement the Budget proposal before the Summer Recess. If you are not able to lay the Financial Services Act regulations by that time I hope you can agree to amend the Companies Bill.

In the meantime I intend implementing the other changes affecting the sterling commercial paper regime by extending the categories of issuer and reducing the minimum denomination to £100,000. I shall be laying regulations under the Banking Act to achieve this as soon as possible after the Budget.

Tax changes

One result of the effective abolition of COBO is that foreign sovereigns and parastatals will be able to issue deep discount bonds in the UK for the first time. I shall therefore be taking this opportunity to rationalise the regime for taxing deep discount bond issues. I intend to extend the 1984 regime for non-variable deep discount issues to apply to all eligible borrowers, and to introduce a new regime for variable deep discount bonds. This will simplify the tax treatment of these instruments and create a level playing field between different borrowers.

I suggest that our officials meet as soon as possible to discuss these issues, so that we can make clear, at Budget time, which legislative route will be used. Following that meeting, I would be grateful for your views by 8 March on how best to achieve rapid unification of the commercial paper and corporate bond regimes.

Yours
Nigel

NIGEL LAWSON

COPY NO. 37 OF 37..

FROM: A C S ALLAN

DATE: 3 March 1989

Pg

PS/CHIEF SECRETARY

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Gilhooly
Mr Matthews
Mr Pickford
Mr Macpherson

Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

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

Mr Unwin - C&E
Mr Jefferson Smith - C&E
Mr P R H Allen - C&E

Mr Jenkins - Parly Counsel

BUDGET PACKAGE

The Chancellor has now taken the final decisions on the remaining points in my minute of 3 March.

(i) CGT relief against trading losses for unincorporated businesses will not be included this year;

(ii) removal of the extra statutory concession on additional housing costs on relocation will be dropped for this year; in these circumstances putting the ESC on removals expenses onto a statutory footing will also be dropped; both these starters are to be reconsidered next year;

(iii) sale of number plates is to be included;

(iv) the figuring for the ITV levy is being finalised with the Home Office.

ACSA

A C S ALLAN

chex.ps/aa/34

BUDGET SECRET
BUDGET LIST ONLY

ACSA/89/15

NOT TO BE COPIED

REF NO.
COPY NO. 36 OF 38.

FROM: A C S ALLAN
DATE: 3 March 1989

PS/CHIEF SECRETARY

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Gilhooly
Mr Matthews
Mr Pickford
Mr Macpherson

Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

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

Mr Unwin - C&E
Mr Jefferson Smith - C&E
Mr P R H Allen - C&E

Mr Jenkins - Parly Counsel

BUDGET PACKAGE

In the light of further discussions, the Chancellor has decided on the following amendments to the Budget package:

(i) stamp duty will not be abolished in this year's Budget;

(ii) the VAT deregulation package (registration rules, bad debt relief, default surcharge is to be dropped from this year's Budget;

(iii) there will be no change to Class II NICs;

(iv) the move to a receipts basis for Schedule E will be reinstated in the package.

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2. All other decisions stand and are confirmed, except on the issues below, where some doubts about their inclusion/exclusion remain or where the figuring is unclear, and where final decisions will be taken on Monday:

(i) CGT relief against trading losses for unincorporated businesses;

(ii) abolition of the relief for additional housing costs;

(iii) ITV levy;

(iv) sale of number plates.

ACSA

A C S ALLAN

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BUDGET CONFIDENTIAL

FROM: M J NEILSON
DATE: 8 March 1989

FINANCIAL SECRETARY

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Sir P Middleton
Mr Monck
Mr Scholar
Mr Peretz
Mr Odling-Smee
Mr Ilett
Miss O'Mara
Mr Pirie
Mr Kroll
Mr Sharples
Mrs Ryding

CAPITAL MARKETS PACKAGE: PRESS RELEASE

I attach a final version of the Treasury press release on the capital markets deregulation package, together with the related Inland Revenue press release on deep-discount bonds, for your approval. Also attached, for information, is the Bank's draft market notice.

2. A number of points are worth noting:

- Following the Chancellor's letter to Lord Young of 3 March, we have met with DTI officials and concluded that the best way to deal with the problem of their legislation is to make an amendment in this year's Companies Bill. This means that the unified regime can be put in place when the Companies Bill receives Royal Assent, probably in late October or early November. This will be quicker than relying on regulations under part V of the Financial Services Act. The draft press release has been amended to explain this. Are you content with this?

- The Bank have made quicker progress than expected in clearing up the loose ends, and the Treasury Solicitor has made good progress on drafting the Banking Act exemption regulations. This means that we now hope to lay the regulations on Budget day.

- On the Bank's market notice, there is still one major outstanding point - whether the reciprocity test for lead management should be retained, on which we await a response from the Governor to the Chancellor's letter. There is also some minor tidying up to do on the market notice.

Now received.

M J NEILSON

fim2.cr/Neilson/dpr.1

DRAFT PRESS RELEASE

Capital Markets Deregulation

In his Budget speech today the Chancellor announced a major new package of measures further to deregulate the sterling capital market:

- Abolition of the new issues queue for bonds and equities; from today it will no longer be necessary for issuers (other than local authorities) to obtain the Bank of England's consent to the timing of sterling issues.

- An extension of the categories of institution that can issue sterling paper of less than 5 years, to include unlisted companies, companies listed on some non-UK Stock Exchanges banks, building societies, international organisations, and foreign public sector bodies.

- The unification of the separate regulatory regimes for short-term corporate bonds of up to 5 years and sterling commercial paper.

- A simplification of the tax regime for sterling corporate bonds. In future all sterling corporate bonds, other than convertibles, will be exempt from capital gains tax.

- Extension of the tax regime for ordinary deep discount bond issues by companies to cover all other eligible borrowers, including the UK and overseas Governments, and a new tax regime for variable deep discount bonds. This will simplify the tax treatment of these instruments, and create a level playing field between different borrowers. Existing UK Government stocks will not be affected.

- Abolition of the Control of Borrowing Order 1958 and repeal of its parent legislation, the Borrowing (Control and Guarantees) Act 1946.

Taken together these changes constitute a major liberalisation of London's capital markets, giving issuers greater flexibility, giving investors wider choice, and simplifying tax treatment.

Notes for Editors

<u>The new issues queue</u>

New issues in sterling for £3 million or more currently require timing consent from the Bank of England before the issue is made. This requirement, which is imposed by the Control of Borrowing Order 1958, allows the Bank to operate the queue. The Treasury is today issuing a General Consent under COBO which removes the requirement to seek timing consent for all borrowers except local authorities.

This consent will also have the effect of removing restrictions on the issue of deep discount bonds by foreign public sector borrowers. The tax changes referred to above will provide a coherent regime for such issues.

COBO will remain in force, solely for local authorities, until new controls on their borrowing are put in place in April next year by the Local Government and Housing Bill. The Order will then be revoked, and its parent legislation, the Borrowing (Control and Guarantees) Act 1946, repealed.

<u>Commercial paper and corporate bonds</u>

At present, issues of sterling commercial paper (less than 1 year maturity) and short-term corporate bonds (1-5 years maturity), are subject to different conditions for exemption from the restrictions on deposit-taking in the Banking Act. The Chancellor proposes creating a unified regime. Before this can be achieved, changes to the Companies Act are required, since this legislation also imposes prospectus and other requirements on issues of securities of this type. The Government proposes to make these changes in this year's Companies Bill. The proposed unification of the regime is therefore intended to take place when this year's Companies bill receives Royal Assent.

It is, however, possible to make a number of changes to the sterling commercial paper regime now, and new Banking Act Exemption regulations are being tabled today. The main changes will be to extend the categories of eligible issuer, and to reduce the minimum denomination to £100,000. A further Banking Act Exemption regulation, unifying the two regimes, by extending the SCP regime to cover sterling paper of up to 5 years in maturity, will be laid to coincide with Royal Assent to the Companies the bill. Banks and building societies, which have, until now, been restricted to the issue of certificates of deposit in the under 5 years maturity range, will now be able to issue sterling commercial paper.

Details of the new arrangements are set out in a Press release and Market Notice published today by the Bank of England. Details of the tax changes on deep discount bonds and non-qualifying corporate bonds are set out in Inland Revenue Press Releases "Deep discount securities: new tax rules" and "Capital Gains: miscellaneous proposals" issued today.

HM Treasury
14 March 1989

DRAFT PRESS RELEASE

BUDGET CONFIDENTIAL

INLAND REVENUE

Press Release

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

DEEP DISCOUNTED SECURITIES : NEW TAX RULES

The Chancellor proposes in his Budget to introduce new rules (which will apply to all disposals on or after Budget day) for the tax treatment of investors in securities issued at a deep discount. These will provide a certain and consistent basis of taxation of such securities and will ensure that discounts and premiums which take the place of interest are properly taxed as income. The rules will cover the wider range of institutions which will be able to issue such securities following the abolition of the queue by a general consent under the Control of Borrowing Order 1958.

The Budget proposals cover three types of securities:-

I. NON-VARIABLE DEEP DISCOUNTED SECURITIES

1. Where securities are issued by companies with a discount of more than half a point a year, or more than 15 points overall, the discount accruing during the period of ownership by an investor is taxed under existing law as income in the year of disposal or redemption. Any difference between the acquisition cost and the disposal or redemption proceeds which is greater or less than the accrued income is normally taxed as a capital gain or loss (except in circumstances where the security is exempt from capital gains tax).

2. These existing rules are being extended to cover similar securities issued by the non-corporate sector (including Government and other public body issuers) whether in the United Kingdom or overseas.

II. VARIABLE DEEP DISCOUNTED SECURITIES

3. Where securities are issued with variable features (for example where the date of redemption can vary) it is not possible to calculate in advance the precise amount of accruing discount. For such securities, issued by either corporate or non-corporate borrowers, where it is possible for the accrued discount to exceed half a point per year or 15 points overall, the whole of the difference between acquisition cost and disposal or redemption proceeds will be taxed as income (subject to III. below). Liability to capital gains tax will not arise.

L10 312/3

GILTS

4. The proposals at I. and II. do not apply to existing issues of gilts or further tranches of existing issues. These will continue to be taxed in accordance with existing rules. Gilts issued at a deep discount on or after Budget Day (except for further tranches of existing issues) will be taxed in accordance with the new rules.

FURTHER TRANCHES OF SECURITIES OTHER THAN GILTS

5. Further tranches of other securities will normally be treated in the same way as the parent stock. Where, however, the parent stock was not issued at a deep discount the whole of an issue may sometimes be treated as deeply discounted. This will occur where the cumulative nominal value of all the tranches issued at a deep discount exceeds one half of the total nominal value of all issues under the same prospectus.

III. INDEX LINKED BONDS

6. The new rules for variable deep discounted securities will not apply to index linked bonds which meet the following conditions:-

a. The amount payable on redemption, in the case of a sterling issue, depends on movements in the United Kingdom retail price index or, in the case of a non-sterling issue, on the consumer prices index for that country.

b. The securities pay interest on the indexed principal, annually or at more frequent intervals, at not less than a reasonable commercial rate of interest for securities with similar characteristics.

c. The movement in the amount of the principal precisely follows the movement during the life of the security of the relevant index, whether up or down, and without restriction, subject to a maximum lagging of 8 months.

d. The securities are issued for a period of 5 or more years and involve no formal or informal agreement for redemption at any earlier date.

Index linked bonds not meeting these conditions will be taxed like other variable deep discount securities (see paragraph 3. above).

~~7. The new rules apply to all disposals on or after Budget Day.~~

NOTES FOR EDITORS

1. Deep discount securities are bonds issued on terms such that the amount payable on redemption is significantly higher than the amount invested. Part of the return, which on normal bonds is taken as income (and taxed as such), is taken in the form of an increased sum payable on redemption. There is therefore normally a lower rate of interest as such payable on the bonds. The existing law provides that on corporate deep discount bonds with no variable features, the discount as it accrues over the life of the bond is taxed as income when the bond is disposed of. For other bonds, the discount may, in some circumstances, be taxable as a capital gain.

before redemption

~~Post redemption~~

2. Following the abolition of the new issues queue announced by the Chancellor in his Budget, a wider range of institutions will be able to issue deep discount bonds on the sterling market. The new rules will ensure that the discount in these cases, and some others not covered by the existing legislation (including variable deep discount securities), is also taxed as income. The differences between the regimes for non-variable and variable securities arise because it is not possible to calculate what part of a gain on a variable security represents accrued discount. If the changes were not made there would be a risk that a considerable volume of bonds ~~would be issued~~ with a discount rather than a normal coupon, thus distorting the capital markets and costing the Exchequer revenue.

3. None of the changes affect the position of existing gilts.

both UK and foreign institutions would issue

CONFIDENTIAL

STERLING ISSUES

Draft Press Notice

1 In his Budget speech today, the Chancellor of the Exchequer announced that a General Consent is being issued under the Control of Borrowing Order 1958. With immediate effect, new issues in sterling, other than those by local authorities, no longer require timing consent from the Bank of England.

2 The Bank has in parallel been reviewing the present arrangements for the issue of different types of sterling instruments and has decided to make a number of changes with a view to simplifying and liberalising the overall framework for short-dated issues. Regulations are being laid today to give effect to these new arrangements, which are set out in the attached notice.

3 Most of the changes are expected to take effect on [4 April]. However, the proposal to increase the maximum maturity of sterling commercial paper from one year to five years can only be effected when Part V of the Financial Services Act 1986 is brought fully into force; until then, the maximum maturity will remain at one year.

4 The Bank has also been reviewing the short-term paper regime for deposit-taking institutions: after consultation with the market, the Bank hopes to be in a position to promulgate a new notice on [4 April].

STERLING ISSUES

Notice issued by the Bank of England, 14 March 1989

1 This notice sets out the arrangements which will apply to the issue of:

(i) Sterling commercial paper, with effect from [4 April]; and

(ii) Capital market issues in sterling, with immediate effect.

It replaces the sterling commercial paper notice of 29 April 1986 and the capital market issues notice of 27 July 1987.

The separate framework for the issue of short-term corporate bonds (notice of 19 March 1985) remains in force until Part V of the Financial Services Act 1986 is fully implemented, when it will be brought into line with the arrangements for sterling commercial paper described below. (A revised consultative notice governing certificates of deposit and other short-term paper issues by deposit-taking institutions, to replace that of 26 November 1986, will also be issued today.)

2 The main effects of these new arrangements will be:

(i) to widen the range of potential issuers of sterling commercial paper and to reduce the minimum denomination to £100,000 by amending the terms of the exemption from the Banking Act 1987;

(ii) to remove the restrictions which have to date prevented banks and building societies from issuing paper of any title other than CDs in maturities up to 5 years;

(iii) to remove the minimum maturity of 5 years currently set for sterling bond and FRN issues provided that they meet the requirements of the Companies Act 1985 or the Financial

Services Act 1986, and do not contravene the Banking Act 1987;

(iv) to abolish the requirement to obtain timing consent for new capital market issues in sterling, except for those by local authorities; and

(v) to bring the issuing requirements for short term corporate bonds into line with those for sterling commercial paper and to merge the two markets by extending the maximum permissible maturity of sterling commercial paper to 5 years when Part V of the Financial Services Act 1986 is fully implemented.

STERLING COMMERCIAL PAPER

3 Regulations revising the existing exemption from the Banking Act 1987 are being laid today. When they come into effect, sterling commercial paper will be made available to a broader group of industrial and commercial companies than hitherto. Banks, building societies, [insurance companies] and certain overseas public sector bodies will also be able to make such issues. The minimum denomination for all issues will be reduced to £100,000. All sterling commercial paper paper must be issued and payable in the United Kingdom.

<u>Banks, building societies, [insurance companies] and certain international organisations</u>

4 There is no longer any objection to issues of sterling commercial paper by institutions authorised under the Banking Act 1987, building societies incorporated under the Building Societies Act 1986, [insurance companies authorised under the Insurance Companies Act 1982], or international organisations which are exempted from the Banking Act 1987 and of which the United Kingdom is a member, provided that their issues meet the conditions set out in paragraph 6 below.

5 An order is being laid today which is expected to take effect on [4 April], enabling issues of sterling commercial paper to

be made without contravening the deposit taking provisions of the Banking Act 1987 by the following:

(a) <u>Companies</u>

Companies, both United Kingdom and overseas, which:

(i) have net assets as defined in Section 264(2) of the Companies Act 1985 of at least £25 mn [(previously £50 mn)];

<u>and</u>

(ii) have shares or debt listed on the International Stock Exchange;

<u>or</u>

(iii) have shares or debt listed on a stock exchange or on the official exchange in a country whose name appears on the "SEAQ International List" published by the International Stock Exchange (ISE), dated [ ]; and have provided in good faith to the ISE the information in English set out in the Schedule attached to the Regulations, which is equivalent to that required by the ISE for a euro-currency security debt listing*.

<u>or</u>

(iv) are unlisted, incorporated in the United Kingdom, and have provided in good faith to the ISE the information as set out in the Schedule attached to the Regulations, which is equivalent to that required by the ISE for a euro-currency security debt listing*.

---

* The ISE will levy an appropriate fee for undertaking this service.

(b) Overseas public sector bodies

Overseas national and regional governments, and overseas government-owned or government-guaranteed bodies, whose debt is listed on a stock exchange or official exchange as described under (a)(ii) or (iii) above.

(c) Other

Issuers not falling into any of these groups may issue sterling commercial paper if it is guaranteed either by a company meeting the net assets requirement under (a)(i) and falling within the category under (a)(ii) above; or by an institution authorised under the Banking Act 1987.

6 The conditions attaching to issues of sterling commercial paper will be as follows:

(a) Description

The sterling commercial paper must:

(i) if issued by an institution authorised under, or exempted from, the Banking Act 1987, carry a statement to that effect, giving the name of the issuer; or

(ii) if issued by any other institution, carry a statement that the named issuer is not authorised under, or exempted from, the Banking Act 1987; and that the paper is sterling commercial paper issued in accordance with regulations made under Section 4 of the Banking Act 1987.

If any issue of sterling commercial paper is guaranteed, it must carry a statement to that effect, giving the name of the guarantor and stating whether or not the guarantor is an institution authorised under the Banking Act 1987.

(b) Disclosure

Issuers or guarantors of sterling commercial paper which fall within paragraph 5(a) above must make a representation to the purchaser, in a statement reproduced on the securities, to the effect that the issuer or guarantor:

(i) is in compliance with the relevant listing/disclosure obligations specified in paragraph 5(a) above; and

(ii) since the information was last provided in compliance with these obligations, having made all reasonable enquiries, has not become aware of any change in its circumstances which could reasonably be regarded as significantly and adversely affecting its ability to meet its obligations on the paper as they fall due.

(c) Maturity

Sterling commercial paper must have a maturity of not less than 7 days, and not more than one year. The maximum maturity will be extended to 5 years when Part V of the Financial Services Act 1986 is fully implemented.

(d) Minimum amount

Sterling commercial paper must be issued and transferable in minimum amounts of £100,000.

(e) Monitoring

Issuers must notify the Bank of England:

(a) at the commencement or extension of any sterling commercial paper programme, of the total amount of paper they propose to issue under the programme, details of its maturity and as full as possible a description of the intended uses of the funds raised; and

(b) within one week after the end of each calendar month, of the amount of sterling commercial paper outstanding as at that end-calendar month and of the amounts of paper issued and redeemed since the previous report. In each case a distinction should be made between paper issued or guaranteed by an institution authorised under the Banking Act 1987; or issued by a building society incorporated under the Building Societies Act 1986; or [issued by an insurance company authorised under the Insurance Companies Act 1982]; and paper not so issued or guaranteed.

This information should be submitted in writing to the Bank of England, Threadneedle Street, London EC2R 8AH, addressed to the Head of the Financial Statistics Division (marked for the attention of Group 5/4).

Management of sterling commercial paper issues

7 Where an issuer engages an intermediary to manage the issue, the intermediary must be a firm with the capacity to act in that role in the UK. It must be either fully authorised under the Financial Services Act 1986 or exempted from it by virtue of Section 43 of that Act. Intermediaries not meeting these conditions are invited to discuss with the Bank the terms on which they might manage issues of sterling commercial paper in the UK.

8 Enquiries on the above paragraphs and on related matters should be addressed to the Wholesale Markets Supervision Division of the Bank (Telephones 01 601 5176 or 5178); or to the Head of the Division (01 601 4019).

CAPITAL MARKET ISSUES IN STERLING

9 The following changes are being made, with immediate effect, to the Bank's guidelines for capital market issues in sterling:

(i) A General Consent is being issued today by the Treasury under The Control of Borrowing Order 1958. New issues in sterling, except those by local authorities, will no longer require timing consent from the Bank.

(ii) There is no longer any objection to issues of sterling bonds or FRNs with a maturity of less than 5 years, provided that they observe relevant legal requirements, including the provisions of the Banking Act 1987 and Part III of the Companies Act 1985 or Part IV of the Financial Services Act 1986. Issues may carry call or put options operative at any time during their life.

(iii) There is no longer any objection to foreign public sector borrowers making issues of deep discount (including zero coupon) and index-linked stocks. The tax arrangements applying to such issues were announced by [the Inland Revenue on 14 March 1989]. It remains the position that approval will not be given for issues of this type by UK local authorities.

10 In order to promote the continued orderly development of the sterling capital market, the Bank will continue to require all capital market issues in sterling to be managed in the UK, under the lead management of a UK-based firm which has satisfied the Bank that it has the capacity in the UK to act as an issuing house.

11 These guidelines apply to all capital market issues in sterling (both debt and equities, including securities carrying a sterling option or a sterling-related element).

12 The Bank will also require to be notified of the main details of any new issue in sterling for an amount in excess of [£10] mn at the time it is made. Notification should be made to the Senior Manager (Sterling Capital Markets) in the Bank's Gilt-Edged Division (telephone numbers: 01-601 4766 and 01-601 4835), which stands ready to respond to any questions on these capital market guidelines and to give guidance on other matters which may arise in relation to capital market issues in sterling.

FOREIGN CURRENCY INSTRUMENTS

13 Instruments denominated in foreign currency and issued in the UK are not subject [to market regulation] by the Bank of England to issuing guidelines.

Issuers of such instruments must satisfy themselves that they do not contravene the Banking Act 1987 and that they meet all relevant requirements of the appropriate overseas authorities.

Bank of England
14 March 1989

dti
the department for Enterprise

BUDGET CONFIDENTIAL

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

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

CH/EXCHEQUER
REC. 8 MAR 1989
ACTION Mr ILETT
COPIES TO CST, FST, PMG, EST, Sir P. MIDDLETON, Sir T. BURNS, Mr NICKS, Mr MONCK, Mr SCHOLAR, Mr CULPIN, Mr ODLING-SMEE, Mr PERETZ, Mr PIRIE, Mr SHARPLES, Mrs CHAPLIN, Mr CALL

/8/3

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

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01-215 7877

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Fax 01-222 2629

Direct line 215 5422
Our ref PB3AQR
Your ref
Date 9 March 1989

Dear Nigel,

BUDGET CAPITAL MARKETS PACKAGE

Thank you for your letter of 3 March, following up our conversation last Thursday.

I am very pleased that you propose to do away, effectively, with the Control of Borrowing Order (COBO) and to rationalise the taxation of deep-discounted bonds.

I also welcome your proposal to unify the sterling commercial paper and short-term corporate bonds regimes. I am content with the proposition that a minimum denomination, for both, of £100,000 should be sufficient to ensure that offerings are effectively directed towards professional investors.

In practice the swiftest enabling legislation I can offer is a Companies Bill amendment extending the present one-year limit in section 195 of the Financial Services Act to five. I fear that this is highly unlikely to become law before the Summer Recess; the final stages of the Companies Bill will almost certainly not be completed until the "spillover" session in the autumn. But I see no reason why colleagues should object to the relevant provision coming into effect immediately upon Royal Assent rather than after the normal two months delay; and this would offer you a shorter route than the Financial Services Act Part V regulations. These are equivalent, in substance, to a considerable Bill and will require extensive consultation. They will not be in force until well into next year.

Our officials have now had a meeting.

Over ...

David

est.ld/james/10 Mar/Neilson

BUDGET CONFIDENTIAL

ECONOMIC SECRETARY TO THE TREASURY

FROM: S M A JAMES
DATE: 10 March 1989

MR NEILSON

cc: PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Sir P Middleton
Mr Monck
Mr Scholar
Mr Peretz
Mr Odling-Smee
Mr Ilett
Miss O'Mara
Mr Pirie
Mr Kroll
Mr Sharples
Ms Ryding

PS/IR

CAPITAL MARKETS PACKAGE : PRESS RELEASE

The Economic Secretary has seen your minute of 8 March to the Financial Secretary. The presentation of COBO has been allocated to the Economic Secretary. He has approved both the Treasury and Revenue press releases (with one small drafting amendment : 'SCP' in the Treasury press notice to be written in full). The final version of the Revenue press release differed slightly from that attached to your minute. I attach a copy (changes sidelined) for information.

S M A JAMES
PRIVATE SECRETARY

INLAND REVENUE

Press Release

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

Content

[3x] 14 March 1989

DEEP DISCOUNTED SECURITIES : NEW TAX RULES

The Chancellor proposes in his Budget to introduce new rules (which will apply to disposals on or after Budget Day) for the tax treatment of investors in securities issued at a deep discount. These will provide a certain and consistent basis of taxation of such securities and will ensure that discounts and premiums which take the place of interest are properly taxed as income. The rules will cover the wider range of institutions which will be able to issue such securities following the issue of a general consent under the Control of Borrowing Order 1958.

None of these changes, including those on indexed bonds, affect the tax treatment of existing gilts.

DETAILS

The Budget proposals cover three types of securities:-

I. NON-VARIABLE DEEP DISCOUNTED SECURITIES

1. Where securities are issued by companies with a discount of more than half a percentage point a year, or more than 15 points overall, the discount accruing during the period of ownership by an investor is taxed under existing law as income in the year of disposal or redemption. Any difference between the acquisition cost and the disposal or redemption proceeds which is greater or less than the accrued income is normally taxed as a capital gain or loss (except in circumstances where the security is exempt from capital gains tax).

2. These existing rules are being extended to cover similar securities issued by the non-corporate sector (including Government and other public body issuers) whether in the United Kingdom or overseas.

cc PS/FST
Mrs Ryding

II. VARIABLE DEEP DISCOUNTED SECURITIES

3. Where securities are issued with variable features (for example where the date of redemption can vary or the coupon is at a floating rate) it is not possible to calculate in advance the precise amount of accruing discount. For such securities, issued by either corporate or non-corporate borrowers, where it is possible for the accrued discount to exceed half a percentage point per year or 15 points overall, the whole of the difference between acquisition cost and disposal or redemption proceeds will be taxed as income (subject to III. below). Liability to capital gains tax will not arise.

GILTS

4. The proposals at I. and II. do not apply to existing issues of gilts or further tranches of existing issues. These will continue to be taxed in accordance with existing rules. Gilts issued at a deep discount on or after Budget Day (except for further tranches of pre-Budget issues) will be taxed in accordance with the new rules.

FURTHER TRANCHES OF SECURITIES

5. Further tranches of securities will normally be treated in the same way as the parent stock. Where, however, the parent stock was not issued at a deep discount the whole of an issue may sometimes be treated as deeply discounted. This will occur once the cumulative nominal value of all the tranches issued at a deep discount exceeds one half of the total nominal value of all the securities then in issue under the same prospectus. These rules will not apply to gilts where the original issue took place before 14 March 1989, but will apply in respect of tranches of gilts where the original issue took place on or after 14 March 1989.

III. INDEX LINKED BONDS

6. The new rules for variable deep discounted securities will not apply to index linked bonds which meet the following conditions:-

a. The amount payable on redemption, in the case of a sterling issue, depends on movements in the United Kingdom retail price index or, in the case of a non-sterling issue, on the consumer prices index for that country.

b. The securities pay interest on the indexed principal, annually or at more frequent intervals, at not less than a reasonable commercial rate of interest for securities with similar characteristics.

c. The movement in the amount of the principal precisely follows the movement during the life of the security of the relevant index, whether up or down, and without restriction, subject to a maximum lagging of 8 months.

d. The securities are issued for a period of 5 or more years and involve no formal or informal agreement for redemption at any earlier date other than for legitimate force majeure reasons.

Index linked bonds not meeting these conditions will be taxed like other variable deep discount securities (see paragraph 3. above).

NOTES FOR EDITORS

1. Deep discount securities are bonds issued on terms such that the amount payable on redemption is significantly higher than the amount invested. Part of the return, which on normal bonds is taken as income (and taxed as such), is taken in the form of an increased sum payable on redemption. There is therefore normally a lower rate of interest as such payable on the bonds. The existing law provides that on corporate deep discount bonds with no variable features, the discount as it accrues over the life of the bond is taxed as income when the bond is disposed of. For other bonds, the discount may, in some circumstances, be taxable as a capital gain.

2. Following the abolition of the new issues queue announced by the Chancellor in his Budget, a wider range of institutions will be able to issue deep discount bonds on the sterling market. The new rules will ensure that the discount in these cases, and some others not covered by the existing legislation (including variable deep discount securities), is also taxed as income. The differences between the regimes for non-variable and variable securities arise because it is not possible before redemption to calculate what part of a gain on a variable security represents accrued discount. If the changes were not made there would be a risk that both UK and foreign institutions would issue a considerable volume of bonds with a discount rather than a normal coupon, thus distorting the capital markets and costing the Exchequer revenue.

A2 OVERALL STRATEGY

Factual

(i) Continues policy of tax reform. Tax reform integral part of Government's economic strategy. Increasing incentives and improving efficiency key to economic success.

(ii) Corporate tax system reformed in 1984 and personal taxes in 1988. Improved company sector performance - profitability, productivity - clearly shows benefits of reforms. 1988 Budget measures mostly not implemented until 1990.

(iii) This budget particularly concentrates on encouraging wider share ownership. Also introduces number of simplifications and deregulation measures. Help for lower paid through reform of NICs.

(iv) Set firmly within context of prudent and cautious approach. Fiscal stance will allow further large repayment of national debt.

Budget measures

(i) [Reform of structure of employees' NICs.]

(ii) Reform of taxation of pensions means individuals' free to determine own level of pension, rather than dictated by tax system.

(iii) Reformed regime for life assurance removes worst distortions of previous system while recognizing unique nature of industry. Continues general theme of applying lower tax rates to broader base.

(iv) Number of measures to encourage personal savings and wider share ownership, building on reforms introduced in previous budgets

- abolition of stamp duty on shares. Sixth major tax abolished in last six budgets;
- PEPs and approved employee share schemes limits increased;
- new tax relief to encourage development of employee share option plans;
- pensions and life assurance reforms will reduce bias towards institutional saving.

(v) Measures to encourage businesses, especially smaller businesses

- profits limit for small companies' CT rate raised to £150,000 and cut-off for marginal relief increased to £750,000
- VAT registration requirements now based on past, not expected future, turnover. Threshold also increased in line with RPI to £23,600
- unincorporated businesses to be allowed to set-off trading losses against CGT

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- comprehensive bad debt relief scheme introduced for VAT (building on cash accounting for businesses with turnover below £100,000 introduced in 1987 Budget).

[(vi) Unleaded petrol]

(vii) Budget overall presents prudent and cautious approach. Some reductions in overall level of taxation needed to offset effects of fiscal drag. So

- most IT allowances and basic rate limit increased in line with RPI
- no reduction in IT basic rate
- no increase in excise duties
[- lower paid helped through NIC reform]

But PSDR set at [£ billion] will enable further substantial repayment of debt.

Defensive

(i) Budget basically contains nothing - tax reform has run out of steam

(ii) Failure to cut taxes/ size of PSDR show that accept verdict that last year's strategy mistaken.

(iii) "Budget for rich" last year. Why not Budget for poor this?

(iv) WSO measures only underline failure of previous attempts. Why just more of the same - no reason why should work any better.

(v) 'Savings' package basically non-existent. Will do nothing to encourage 'ordinary' savings.

(vi) Why not accept logic of NIC reforms and integrate with IT.

(vii) Why no increases in excise duties? Cynical manipulation of RPI?

(viii) Why overall tax burden still rising - Government's policy to get it down abandoned?

(ix) Why more taxpayers next year?

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PERSONAL TAXES [AND NICS]

Factual

(a) Income Tax

(i) Most personal allowances and basic rate limit increased in line with indexation. Age allowance extended to over 75s.

(ii) Basic rate remains unchanged at 25 per cent and higher rate at 40 per cent.

(iii) No changes in mortgage interest relief.

(iv) Car scales increased by 20 per cent. Car fuel scales unchanged.

(v) Tax relief will be available on premiums for private health insurance paid by or on behalf of over-60s. Relief available from 1990-91.

(vi) Earnings rule for pensioners, under which state pension withdrawn for every £ earned over £75 a week, abolished.

(vii) Payroll giving limit doubled to £480 a year.

(b) Capital Gains Tax

(viii) CGT annual exempt amount unchanged at £5,000 for individuals and £2,500 for most trusts.

(ix) Gifts relief restricted to certain types of gift.

(c) Inheritance tax

(x) Threshold indexed to £118,000.

[(d) NICs

(xi) Employees' NICs restructured, building on 1985 reforms. Steps abolished. Replaced by "joining fee" at £43, while other steps turned into thresholds. LEL and UEL remain as announced in November.]

Positive

(i) Budget builds on fundamental reforms of personal taxes introduced in 1988.

(ii) Allowances up over x per cent in real terms since 1978-79. Married man's allowance maintained at highest level in real terms since before war. X million taxpayers taken out of tax altogether compared to indexed 1978-79 regime.

(iii) Number of measures to increase incentives for elderly to keep off dependency culture.

(iv) Further steps taken to bring taxation of company cars into line with true value of benefit.

(v) Reform of NICs substantial help to lower paid. Removes very high marginal 'tax' rates at limits of bands.

(vi) Increase in payroll giving limit further encouragement to charitable giving.

<u>**Defensive**</u>

(i) Progress on cutting IT burden halted. [First time for seven years no reduction in IT beyond indexing allowances.]

(ii) 20 per cent target for IT abandoned?

(iii) Why not restrict IT reliefs to basic rate?

(iv) Why no changes to MIR : increase limit/ abolish altogether?

(v) Why not more on cars, after what said last year?

BUDGET AND SAVINGS

<u>Factual</u>

(i) Pensions tax regime reformed. Tax privileges for occupational pensions will be "capped" at income level of £60,000, but employers will be free to provide pensions up to any level. Also some changes to personal pension schemes, early retirement provisions of occupational pension schemes and AVCs regime.

(ii) Tax regime for life assurance also reformed

- pensions and general annuity businesses to be ring-fenced;
- relief for expenses of acquiring new life assurance business to be spread over seven years;
- rate of tax charged on income and capital gains attributable to policy holders reduced to 25 per cent;
- Life Assurance Policy Duty abolished.

(iii) Stamp Duty on shares abolished from [1 January 1990].

(iv) Annual limits on 1978 approved employee share schemes increased to £2,000 or 10 per cent of pay up to limit of £6,000. Monthly limits for 1980 SAYE scheme increased from £100 to £150.

(v) Annual limit on investment in Personal Equity Plans increased from £3,000 to £4,800 - doubling original 1986 limit. Of this, up to £2,400 (formerly £750) may be invested in unit and investment trusts. A number of other restrictions also abolished.

(vi) New tax relief introduced for employers' payments into qualifying employee share trusts (ESOPs).

<u>Positive</u>

(i) Major reform to encourage saving introduced last year with independent taxation. Removed great disincentive for married women to save.

(ii) Measures encourage wide range of different savings methods, but especially share ownership. Also remove bias towards institutional saving that has accumulated over past 30 years.

(iii) <u>Pensions</u> proposals build on Government's earlier moves to widen pensions' choice and encourage private provision. Remove anomaly that tax rules effectively limited pensions paid. Put relief for pensions on same basis as others eg MIR. Also reduce incentive to save through pension funds rather than investing directly in equities.

(iv) <u>Life assurance proposals</u>

- remove distortive effect on savers by limiting 'up-front' relief on initial costs that used to be available to life assurance policy holders but not to investors directly in shares;
- remove distortions that old system produced in incidence of tax as between one Life Office and another.

Widening tax base also enables tax rates to be reduced. So existing 35 per cent and 30 per cent rates will both, from 1 April 1990, be reduced to 25 per cent.

(v) Stamp Duty abolition will remove major cost for those investing directly in equities. Will also eliminate aspect of tax system which puts British financial services sector at disadvantage compared with some of its competitors.

(vi) Reforms to PEPs will make them simpler to administer and more attractive to first time investors; should lead to considerable increase in PEP take-up and substantial widening and deepening in share ownership.

(vii) Changes to employee share schemes limits will give substantial further boost to existing share schemes.

(viii) ESOPs

Defensive

(i) Package really does nothing for personal savings

(ii) Does not stand up well to judgement against criteria laid down in Tax Reform pamphlet.

(iii) Measures encourage rich at expense of poor? Why not encourage 'direct' saving eg in bank and building society deposits?

(iv) Why not go for expenditure tax?

(v) Stamp Duty reform benefits only city fat cats/institutions. All benefit will be capitalised before reform takes effect. And why keep for houses? Illogical to tax (through Stamp Duty) and relieve (through MIR) same transaction?

(vi) How can pensions package possibly be a simplification? And how can it be radical if not preceded by a Green Paper - or have you reneged on that promise?

(vii) Why just 'tinkering' with existing schemes; should try more radical options eg on PEPs.

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BUDGET AND BUSINESS

Factual

(i) Main Corporation Tax rate maintained at 35 per cent. Small companies' rate maintained at 25 per cent.

(ii) Small companies' profits limit raised to £150,000 and limit for marginal relief raised to £750,000.

(iii) VAT changes to comply with ECJ judgment (announced 6 February). VAT will be charged on non-domestic construction (from); water and sewerage services supplied to business (from); fuel and power supplied to businesses (from); news services (but not newspapers) (from); and certain items of protective clothing.

(iv) VAT bad debt relief introduced from 1 August 1989 for all debts over 18 months old that have been written off in traders' accounts.

(v) VAT registration rules simplified so that now refer to past, rather than expected future turnover. Registration threshold raised to £23,600. VAT default surcharge limit reduced from 30 per cent to 20 per cent.

(vi) Close company apportionment rules basically abolished.

(vii) Package of modifications to Profit Related Pay regime introduced.

(viii) ITV levy.

(ix) Suspension of Control of Borrowing Order from midnight on Budget Day.

Positive

(i) CT regime unchanged. Gives stability for companies. Main CT rates among lowest in world. Benefits of 1984 reform evident from greatly improved profitability and performance of company sector.

(ii) Small companies' limits unchanged since 1983. Time now ready to change them. Will help [ ] smaller businesses.

(iii) Bad debt relief proposals will help many businesses both administratively and financially. Build on reforms of VAT introduced in 1987 (cash accounting and annual accounting for smaller businesses).

(iv) VAT registration reforms introduce major simplification. Registration threshold raised by maximum permitted by EC.

(v) Changes in close company apportionment rules remove 20 pages of tax legislation. Contribute to Government's general approach of simplfying tax system.

(vi) Changes to PRP will encourage more firms to join schemes that give workers more direct sense of identification with firms that employ them and promote greater degree of pay flexibility.

(vii) Suspension of COBO important deregulatory measure which frees markets and underlines Government's confidence in future of London as financial centre. Sweeps away last vestige of post-war apparatus for direction of capital by state.

Defensive

(i) Tax burden on companies increasing.

(ii) VAT on sewerage and water/ fuel and power creating trouble for major privatisations.

(iii) Why have you waited for so long to allow bad debt relief?

(iv) Increases in small companies' CT limits no more than indexation that should have taken place anyway. Why not reduce rates?

(v) VAT deregulation package boon for cowboys and fiddlers.

(vi) Why impose new levy on ITV just when facing competition from cable and satellite.

(vii) PRP is a flop. Why keep tinkering with it?

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SPENDING TAXES

Factual

(i) Tax on unleaded petrol reduced by 3.3p a gallon. Tax on 2-star and 3-star leaded petrol increased by 5p a gallon. Other road fuel duties (4-star leaded and DERV) unchanged.

(ii) No changes in alcoholic drinks or tobacco products duties.

(iii) VED for cars unchanged. Number of rates reduced from over 70 to 5. VED on buses and coaches and certain heavy rigid lorries increased to cover road track costs.

(iv) VAT rate unchanged. Coverage changed in line with ECJ judgment (see above).

(v) Number of VAT measures to help charities.

(vi) Car Tax abolished for vehicles purchased for leasing to disabled.

Positive

(i) Reduced duty on unleaded petrol adds to 10p gallon differential introduced over last two Budgets. UK now highest differential in EC except for Denmark. Considerable environmental benefits from motorists switching to unleaded fuel.

(ii) VED structure simplified and rationalised. Also further step towards making all classes of vehicles cover their road track costs.

(iii) Number of further VAT reliefs introduced for charities.

Defensive

(i) What possible justification, given health risks, for not increasing alcohol and tobacco duties at least in line with inflation? What happened to "presumption" of indexation?

(ii) What has happened to idea of shifting from direct to indirect tax?

(iii) Why pick on poorer motorists driving older cars by increasing price of 2-star petrol.

(iv) Why increase VED on buses? They (a) reduce congestion and (b) burn diesel, so less polluting.

(v) Pledges on further extension of VAT base?

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FROM M NEILSON
DATE 22 MARCH 1989

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
PS/Sir P Middleton
Mr Scholar
Mr Culpin
Mr Odling Smee
Mr Ilett
Mr Woodfield o/a
Mr Barker
Mr Kuczys I/R
Mr Walker I/R

BUDGET: PEP MANAGERS' REACTIONS

You asked for a brief report on PEP managers' reactions to the Budget package.

2. Our informal contacts very much reinforce what has been said in the press. PEP managers are very pleased with what has been done, particularly on raising the unit/investment trust limit and the simplifications. But a number have expressed disappointment that there is no element of up front relief in the package.

3. Clearly, plan managers have a vested interest in being positive about the changes; if they express doubt in public, it will undermine their own marketing campaigns.

4. But most clearly think the Budget package gives them something they can market successfully. Lloyds will be putting in a major marketing effort, and will continue to run their market leading managed PEP. The Bradford and Bingley and Barclays are happy with the changes. Fidelity and Framlington, who withdrew from the PEP market last year, have announced that they intend returning to the market. Inland Revenue have had enquiries from a number of other potential PEP managers, and from a number of unit and investment trust managers. Paul Bateman, chief executive of Save and Prosper, privately expressed doubt whether the package will in fact be enough to get PEPs going properly, but said that he would

be making very positive noises in public, and that Save and Prosper would be putting a considerable marketing effort into PEPs, emphasising in particular the opportunity to invest £7,800 this year.

5. The clear message is therefore that there will be a substantial marketing drive on PEPs following the Budget changes, concentrating on the £7,800 that can be invested this year, and on unit (and probably investment) trust only PEPs. We do not yet have the details of precisely what new PEP products the main plan managers will be marketing, but will be collecting this immediately after Easter, and will put up a further note then. It does look likely however that a number of PEP-linked mortgage products will be appearing soon.

M NEILSON

LIST OF QUESTIONS

The list is in six sections.

I General Questions

II Savings (General)

III Other Budget tax measures. (Covers everything which will be in Table 1.1 and Chapter 4 of the FSBR - but not the more detailed material in the Annex to Chapter 4; nor non-tax measures such as Keith and taxpayer confidentiality).

IV Life Assurance

V Pensions

VI Why didn't you? - Items <u>not</u> in the Budget.

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I: QUESTIONS: GENERAL

1. Missed opportunity. PSBR in 1989-90 may be smaller than 1988-89 outturn, but a lot bigger than you thought right for 1988-89 in your 1988 Budget. If tax cuts in 1988 did not harm economy, if monetary policy looking after inflation,

- why so cautious now?

- shows second thoughts about 1988 strategy?

2. What is aim for PSDR? Last year you announced a balanced budget aim.

- have you changed your stance on balanced Budgets?

- are you aiming to get the National Debt down?

- are you implicitly accepting that privatisation proceeds, land sales, etc are family silver and should not be in the arithmetic when you decide the fiscal stance?

3. In last two years, Government has said a lot about people standing on their own two feet, not relying on State. Now that personal savings rates have collapsed, we are told it doesn't matter because companies and the State are saving more and making up the difference. Are you being consistent?

4. Budget does nothing much overall to encourage personal savings. It gives away £[2½] billions in NICs, which will go straight into consumption. Won't this simply encourage inflation and trade deficits, and thus higher interest rates?

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5. Why doesn't Budget do something to discourage excessive pay increases?

6. Why doesn't Budget do something for the regions? Isn't it a Budget for the South-East?

7. Is there any justification for freezing excise duties, other than fiscal fine tuning of the RPI? If inflation's out of control, why not reduce VAT instead - would have benefited everyone, not just drinkers and smokers.

8. Last year you had a budget for high earners. But now you're giving them £3 more a week. Why?

9. Last year the "number one priority" was to get basic rate down to 20 per cent. Why have you given up on this?

10. What does the Budget do

- for the tax burden overall as proportion of GDP?

- for the tax burden of family on average earnings, half average earnings, etc?

- for the balance between direct and indirect taxation?

- for widening the tax base?

II: QUESTIONS - SAVINGS (GENERAL)

1. Whatever happened to the "Budget for Savings"?

2. Whatever happened to the "level playing field"?

3. Why does this piecemeal collection of measures include measures which increase the emphasis on institutional savings?

4. What thread, if any, runs through the thinking?

5. Why no reform of taxation of owner-occupied housing? Root of 1988 credit boom; and will be favoured further once domestic rates are abolished?

6. Why no bold, imaginative move, eg turning PEPs into general ration of tax-privileged savings?

7. Why didn't you restrict reliefs to the basic rate?

8. Why no help for small man? Life Assurance, pensions attacked; nothing for "real" savings such as Post Office, Bank and Building Society deposits?

9. If you want to encourage share ownership, why not give relief for brokers' fees?

10. Why no front-end relief for PEPs? Why not Barclayshare?

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III: QUESTIONS - BUDGET TAX MEASURES

(Except Life Assurance (See Section IV); and Pensions (see Section V).

INCOME TAX

(a) Basic Rate

- What happened to the "number one priority" of getting rate down to 20 per cent?

- Income tax cuts a sign of a successful economy - is that why there aren't any this year?

(b) (if basic rate limit not raised by as much as basic rate allowance)

- where is the consistency in reducing higher rates to single 40% rate, and then making greater and greater proportion of middle managers pay it?

(c) Car benefit scales

- everyone resigned to large increase, so why not grasp nettle and get this out of way for good?

- which is long-term objective - make everyone pay tax on full value? What about "tools of the trade"?

- if principle is that there are to be few or no net losers, why don't you apply elsewhere in the tax system? What's so special about company cars?

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(d) Schedule E receipts basis

- move to putting tax system on a current year basis. Will you apply this elsewhere, eg to self-employed?

(e) Higher rate

- Have last year's higher rate changes paid for themselves?

EXCISE DUTIES

(A) Alcohol and tobacco

- what is Government's best estimate of number of deaths which will result from failure to index duties?

- shifts tax burden away from indirect taxes. Consistency with broad aims?

- why not tax drinks according to alcoholic strength?

(b) Leaded/unleaded

- how will you stop oil companies pocketing some of the differential favouring unleaded?

- why are you giving oil companies an incentive to do something that they are doing anyway?

- if you've really serious about lead, why weren't you tougher on company cars? - Less use of them would have cut lead, and also reduced congestion in cities.

(e) VED

- you've frozen VED on cars and petrol duties (except 2 and 3 star). You've hammered buses. And you've not hammered company cars. Why this bias against public transport? - means more cars on road, more congestion, more road accidents, more pollution; and higher fares.

- why not abolish VED, raise fuel duties? - would cure evasion overnight.

- why no help for UK commercial operators, who pay highest motoring taxes in EC?

VALUE ADDED TAX

(a) ECJ judgement on non-domestic construction, etc.

- just proves EC can force us to change our zero rates. What's next - VAT on food and children's shoes?

- changes will damage inner city development? Why not a longer transition period?

- new rules far too complicated, will lead to mistakes and administrative burdens?

- delay on fuel and power just another sop to privatisation?

- VAT on water, fuel and power creates problems for privatisation of water, electricity industries?

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(b) VAT pledge

- will you pledge now that there will be no more extensions to the VAT base? If not, what's next - newspapers?

(c) Deregulation package

- a boon for cowboys and fiddlers? (Compare pursuit of social security fraud).

STAMP DUTY ON SHARES

- why not abolish stamp duty now?

- reckless to announce a year ahead. Given trackrecord on forecasting, how do you know this will be prudent come 1 April 1990?

- surely, won't do much for wider share ownership? just a boost to city firms and large existing shareholders?

CORPORATION TAX

- high interest rates damaging companies. Overall tax burden on UK companies too high by international standards. Why no cuts in CT rates?

- what is your long-term aim for main CT rate, which is well out of line with basic rate income tax?

- basically all you've done for small companies is make up for the indexing which should have been done in your past Budgets. Why not a substantial real increase and indexed for the future?

- pre-trading changes just a dodge to help Euro Tunnel. I thought you said that project wouldn't be given special tax help?

NATIONAL INSURANCE CONTRIBUTIONS

- just an expensive way of putting right mistakes of 1985?

- still leaves cliffface at LEL. What's the point of spending £[2½] billion and not solving that?

- can you explain the logic of the different contribution rates for employers and employees?

- changes, coming on top of previous ones, not consistent with contributory principle. Why not face up to that, and abandon the contributory fiction?

- these changes don't and won't eliminate existing surplus on NIF, nor stop it growing. How can you justify that? Is the answer that the contributory principle is dead and NICs are just being used as a tax on employment?

- Another £3 a week for the well off. Why didn't you raise the UEL? Why not raise it to the basic rate limit?

- why have you done nothing for the self-employed?

- why have you done nothing for employers?

- compliance cost for employers?

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BUDGET

PENSIONERS' EARNING LIMIT

- unemployment still about 2 million. Why encourage old to block jobs needed by the young? Budget for the South-East?

- wouldn't it be better to spend the money on poor pensioners? What's happened to targeting?

PRIVATE MEDICAL INSURANCE

- Just a subsidy to private sector. When will you extend this relief to whole population?

- Why relieve insurance rather than hospital fees?

SECRET

CHARITABLE GIVING

- Why no reliefs for one-off gifts?

- Why not extend payroll giving to self-employed?

ESOPS

B.L.O.

- May please a few enthusiasts, but what evidence of any <u>real</u> demand for this from companies?

- Do you really expect companies to try to implement ESOPs with such a complex set of bureaucratic rules?

- Don't you agree that if you really want to boost ESOPs this half-hearted set of measures won't do it?

SECRET

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EMPLOYEE SHARE SCHEMES

- If you are doing this, why do you need ESOPs as well?

PROFIT RELATED PAY

- You announced one panic measure before the Budget. Now more. How big a flop is PRP?

- Is there any evidence that PRP has saved a single job, or increased any employee's identification with his employer?

- If PRP's any good, why are so many companies giving it up once they've tried it?

PEPS

- Thought this Government was against institutionalised savings ? Why have a big boost to unit trusts?

- Raising the limit just means fat cats reorder their portfolios to pick up the tax relief. Isn't limit already high enough for ordinary people you say you've trying to attract?

RELOCATION EXPENSES

- Doesn't this just hamper labour mobility?

- Why tax this - isn't it part of getting the job, not remuneration?

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BUDGET SECRET

B.L.O.

SECRET

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UNIT TRUSTS

- If tax harmonisation is irrelevant to 1992, why are you panicking over unit trusts?

- Why have unit trusts suddenly become the Government's preferred savings medium? Why give them this advantage as well as preferential PEPs treatment?

DEEP DISCOUNTED BONDS

- Why are you abolishing COBO? Does variable/non variable distinction make any sense? Some variable bonds have capital component - why tax that as income? Does index linked bonds let-out really solve this?

CLOSE COMPANIES

- Why such vindictive action (penal rate) on close companies? Is aim to kill them off? What about close property companies?

CAPITAL GAINS TAX

- If capital gains to be taxed at income tax rates, why not integrate them fully?

- Why can't CGT losses be charged against income? - You've conceded that unincorporated business can offset income losses against capital gains, so why not the reverse?

- Why didn't you permit wider CGT rollover relief? - CGT inhibits reinvestment.

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- Why didn't you extend retirement relief to landlords?

- Abolishing gifts relief is contrary to policy of encouraging lifetime giving?

INHERITANCE TAX

- Why not abolish IHT completely? The wealthy and well-advised don't pay this voluntary tax.

- 40 per cent starting rate far too high for modest estates - why not align with basic rate of income tax?

- Why not 100% business relief?

- How does IHT burden compare in real terms with CTT in 1975?

- Why not increase threshold in line with house prices?

ITV LEVY

- Why make this change when ITV companies being exposed to satellite/cable competition? Isn't it fighting yesterday's tax battles?

IV: QUESTIONS - LIFE ASSURANCE

1. In past Budgets you've had a go at Lloyd's; at general insurers' trading, reserves etc; now you are having a go at Life Assurance, and threatening more in 1990.

- why this assault on the insurance industry?

2. Burden of Budget measures comes on top of £700m cost of FSA (£200m on red tape, £500m on new commissions).

- why impose all these burdens at the same time?

3. Doesn't the package discriminate against companies distributing through independents?

4. Is taxation of accrued gains for pensions business first step towards taxing accrued gains of Life Funds?

5. What is planned for 1990? What consultation? Will changes be retrospective to 1 January 1990?

6. You clearly put options A and B in the consultative document as a smokescreen. Meant no meaningful consultation on what you really intended to do. Will you consult properly on the 1990 changes?

7. Is option A dead? Is option B?

8. Industry want Revenue to be much quicker in refunding taxes deducted at source on exempt pension business. Will the Revenue cooperate?

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9. What will this do to commissions and premium levels?

10. What will this do to cost of endowment mortgages?

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V: QUESTIONS - PENSION REFORMS

1. Why didn't you issue a Green Paper before doing this?

2. Second attack on lump sum in two years. When's the next step?

3. What's the point of changes which affect so few, don't really bite until next century?

4. Why didn't you go further to promote personal pensions, downgrade occupational schemes?

5. Do you plan to issue a Green Paper on pensions? If not, do you pledge no further changes?

6. Why did you index the limit? Why indexed to prices, not earnings?

7. If it's right to freeze MIR, why is it wrong to freeze the new pensions limit? (and vice versa).

8. How will public services deal with these changes?

9. Why do those in Final Salary schemes only get affected when they change jobs, whereas those in Personal Pensions get affected immediately?

10. Compounds mistakes of 1987. Changes will affect labour mobility more and more as time goes by? What happened to "freeing up the labour market"?

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VI: WHY DIDN'T YOU

- Abolish Inheritance Tax? - which is voluntary for the well-off and well-advised?

- Limit reliefs to basic rates?

- Raise mortgage interest relief?

- Index mortgage interest relief limit? (you're indexing the new pensions limit)

- Abolish mortgage interest relief?

- Limit mortgage interest relief to the basic rate of tax?

- Abolish stamp duty on house sales?

- Increase stamp duty on house sales?

- Introduce a lower rate of income tax at the bottom end?

- Abolish Car Tax when you could afford to?

- Do more to encourage investment?

- Do something effective on savings? eg tax free savings ration?

- Do something for war widows?

- Do more than you have for the elderly? [There has been a very heavy postbag on help for the old.]

- Give tax relief for creches at work? For child care for working parents more generally?

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- face up to sovereign immunity problem, and deal with Kuwaiti abuses?

- stand up to the Greek shipowners on residence? What makes them, other foreigners so special?

- do more in this Budget instead of stacking up so much for the 1990 Budget?