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PART A

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PART A

1987 BUDGET
STARTER

19-11-87

DD's 25yrs NA?
7/11/96

THIS FOLDER HAS BEEN
REGISTERED ON THE
REGISTRY SYSTEM

SECRET AND PERSONAL

Inland Revenue

Policy Division
Somerset House

FROM: M F CAYLEY
DATE: 8 JANUARY 1987

1. MR HOUGHTON

2. CHANCELLOR OF THE EXCHEQUER

REFORM OF CAPITAL GAINS TAX (STARTER 173): COMMENCEMENT TIME

1. This note discusses what should be the time form which the reform - if it went ahead - should commence.

2. As we have indicated in earlier minutes, there would in our view be overwhelming arguments for making the reform effective from Budget Day. (But any changes in the income tax rate schedule would not of course apply until the new tax year). If the start were left to April, there would be acute turmoil in the markets in the last weeks of March as those who would be worse off sought as far as possible to forestall the effects of the reform. The resulting peak of disposals would lead to a very temporary and short-term increase in tax receipts followed by a sizeable reduction - possibly as much as several hundred million pounds a year.

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cc		
	Chief Secretary	Mr Battishill
	Financial Secretary	Mr Isaac
	Economic Secretary	Mr Painter
	Sir P Middleton	Mr Houghton
	Sir T Burns	Mr Beighton
	Mr Cassell	Mr McGivern
	Mr Scholar	Mr Cayley
	Miss Sinclair	Mr Hamilton
	Mr Cropper	Mr Johns
		Mr Michael
		PS/IR

3. The more difficult question is from what time on Budget Day the new rules would apply. The choice would be between midnight preceding Budget Day or the midnight of Budget Day itself. We have considered the possibility of an intermediate option, namely to make the change effective from the precise time of your announcement. We have discussed this with the Bank. Their view (and ours) is that this is not possible. Taxpayers would often not have access to the necessary information and for many assets, both financial and non-financial, evidence of the time of transaciton would not exist because for a high proportion of disposals neither we nor taxpayers would be able to establish the precise time at which a disposal occurred.

4. During the 1986 Budget Debates Mr Moore said that in future some changes might apply from the start of Budget Day (see attached press release), although he did not specifically refer to capital gains tax. The CGT reform is a measure for which there seem to us to be clear reasons for adopting this course. Were the start point to be midnight on Budget Day, there would be a period of some hours in which forestalling could take place on a large scale. Dealers would doubtless stay at their desks through the evening. The markets might have problems in coping with the potential volume of deals over so short a period. In practice those who were able to take advantage of forestalling would tend to be the larger corporate investors and a few very wealthy individuals and trusts: smaller investors would generally not get much of a look-in.

5. A (small) minority of those who were net gainers from the change would have Budget Day disposals: they would of course welcome the reform commencing from the start of Budget Day.

6. The main argument against the reform being effective from the midnight preceding Budget Day would be criticism of retrospection. Some people would be worse off in respect of

disposals made, say, on the morning of Budget Day, and they might argue that they had made the disposal on the basis that the present system would apply.

7. It was precisely to anticipate this criticism that Mr Moore's statement was made: it was designed to put people on warning that some changes which increased tax might be effective from the start of Budget Day, and that they entered into transactions on that day at their own risk.

8. The decision on this issue will be very sensitive and significant amounts of tax could be at stake if the start were delayed to the midnight of Budget Day itself. For our part, we feel that if the reform proceeds this year the balance of considerations points to making it effective from the midnight preceding Budget Day. The Bank concur in this judgement.

Michael Cayley

M F CAYLEY

It is difficult to see any alternative to making the changes effective from midnight preceding Budget Day. It must surely now be fairly widely recognised among those who operate in this field (thanks to last year's statement and the Press Release) that dealings and disposals on Budget Day itself are subject to a specific additional uncertainty - the effect of the Chancellor's proposals on them. Arguably this should now be built into the rational expectations of those dealing on the day.

B T HOUGHTON
8 January 1987

INLAND REVENUE

Press Release

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

[0x] 20 March 1986

FUTURE BUDGET DAY TAX CHANGES

In the course of his speech during the Budget debate last night, the Financial Secretary to the Treasury, the Right Hon John Moore MP, said:

"I have now a slightly technical matter that concerns arrangements for bringing Budget changes into operation, which affect income tax and corporation tax. Every year, some changes have to take effect more or less immediately. For those which work to the taxpayers' advantage, the normal rule is that they take effect on or after Budget day, but for those changes that work the other way - by imposing or increasing tax - the practice has been to apply the changes after Budget day. In most cases, this works well enough, but there may be occasions when some people engage in forestalling, which could be costly to the Exchequer, by doing business very quickly on Budget night. To allow this would be neither fair nor sensible, and it may be necessary in future to make changes effective from the start of Budget day. I thought it right to draw the attention of the House to this change, which may be used in a future Budget."

(Hansard, 19 March 1986, cols 377 and 378)

CONFIDENTIAL

Thanks. Mr B cannot now write him.

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

FROM: LJH BEIGHTON
DATE: 8 JANUARY 1987

CHANCELLOR OF THE EXCHEQUER

BUDGET DAY TAX CHANGES

1. During the Budget debate on 19 March 1986, the previous Financial Secretary announced (copy attached) that in future the Government reserved the right to make Budget changes effective from the start of Budget Day (rather than from the start of the following day) to prevent forestalling immediately following the Speech. An announcement was necessary since making use of this valuable flexibility would entail some minimal retrospection so that it was right to put people on warning that activity undertaken on Budget Day risked being affected by Budget changes.

2. When considering the draft announcement, you asked (Mr Kuczys' note of 19 March 1986) Mr Battishill to consider why in future all changes could not take effect from the start of Budget Day and whether this approach would not be clearer, simpler and lead to less argument than "picking and choosing". (Meanwhile the terms of the draft announcement were amended so as to leave the point open.) This note considers that question as we move toward the 1987 Budget. The most important starter

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cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Graham (Parly Counsel)
PS/Customs & Excise

Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr Lewis
Mr Corlett
Mr Houghton
Mr McGivern
Mr Taylor Thompson
Mr Pitts
Mr Calder
Mr Johns
Mr McManus
PS/IR

where the commencement date needs to be decided is Budget Starter 173 (changes to capital gains tax) on which Mr Cayley is minuting you separately today.

3. The announcement on 19 March 1986 related only to income and corporation tax changes needing to take effect more or less immediately. As explained in Mr Battishill's note of 27 February 1986, it was common practice to make CTT changes effective for transfers "on or after Budget Day". This practice was followed for the change from CTT to IHT. It came under criticism in connection with the measures against gifts with reservation. The practice was defended on grounds of consistency, precedent and the need to prevent forestalling. But it was necessary during the passage of the Bill to make a minor transitional easement for certain existing insurance policies so that the new provisions did not fully apply to them until the date of Royal Assent. This was because there were major structural changes to the tax and many cases in the pipeline. The circumstances were unusual but they could recur.

4. Special considerations also apply in the case of stamp duty. Documents have to be stamped in accordance with the law at the date of execution. This means that stamp duty changes which increase the rate of duty cannot be given immediate effect from Budget Day. The Stamp Duty Reserve Tax which has been introduced this year should, however, ease the problem: in some cases at least it should be possible to adapt it to catch Budget Day transactions.

5. On indirect taxes, I understand that practice varies. Excise duty changes conventionally take place at different times within the first few days after the Budget, because of differing commercial practices or repricing needs of the industries or organisations concerned: hydrocarbon oil duties and, from 1987, alcoholic drink duties from 6 pm on Budget Day, vehicle excise duty from the day after Budget Day and tobacco duties from the third day after Budget Day. VAT changes take longer. For a rate change at least 6 days are allowed to let

traders, particularly retailers, reprice stocks. For changes in coverage there may be up to two or three months delay where trade consultations or extended preparation is necessary. This means that there is scope for post-Budget forestalling on VAT (depending on what the changes are), but it cannot practicably be avoided. Customs and Excise tell me that these timings are generally accepted as reasonable, and they see no reason to make any general changes on their side along the lines envisaged for income tax and corporation tax.

6. As far as income tax and corporation tax are concerned changes needing immediate effect are only a small minority of changes. The normal and natural approach for income tax changes is to make them apply for the income tax year for which the tax is being reimposed, or alternatively from Royal Assent after the legislation has been fully debated and passed. For corporation tax the equivalent date is the start of the financial year. For some changes there are policy reasons to introduce them over a longer timescale (eg the 1984 corporation tax and capital allowance changes) or there is a practical need for a longer interval for the Revenue and/or the outside world to prepare (eg Personal Equity Plans). Immediate effect is generally only appropriate for those few changes where there is a serious risk of forestalling or a need to stop a massive loss of revenue. This is the reason why in his separate submission on Budget Starter 173, Mr Cayley is recommending making the change effective from the start of Budget Day. In other cases the inconvenience for the taxpayer in having to make an instant change, administrative considerations, and criticism of "taxation by Press Release" will all point to a longer timescale.

7. Other types of Budget measure with yet other commencement dates include:

i. retroactive provisions taking effect from the date of a pre-Budget announcement or where a relief is to be backdated. A number of this year's Budget starters

are likely to fall into this category eg certain secondments to educational institutions;

ii. the entry into effect of provisions which are automatically indexed eg Section 8 IHT Act 1984 which indexes IHT bands with effect from 6 April each year;

iii. provisions which are deferred (eg appointed day provisions).

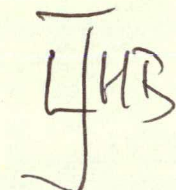
8. Commencement dates consequently need tailoring closely to the circumstances of the particular change. The complexities are illustrated by the recently announced changes to be introduced in the 1987 Finance Bill about what is meant by a "material interest" in a close company, as it affects the right to participate in an approved employee share scheme, or to obtain interest relief on loans for purchasing the company's ... shares (press release attached). In this case the relieving provisions are retrospective; some other changes take effect from the date of announcement on 13 November 1986; and some will only apply where employees cease to be beneficiaries under trusts (eg by disclaimer) after 13 November 1986.

9. So, there seems no scope for uniformity on the date of introduction of Budget measures. This leaves the, rather more limited, issue of whether for those anti-avoidance changes where more-or-less immediate effect is appropriate, there should be a uniform policy of introducing changes from the start of Budget Day or a policy of "picking and choosing".

10. "Picking and choosing" does run some risk of creating anomalies, either real or apparent. One interest group may complain if their tax avoidance device is stopped with effect from the start of Budget Day whereas another group's device is only stopped from the next day. But in a limited number of cases retrospection, even by a matter of hours is impossible. This is the case, for example, where a taxpayer has an obligation to act differently at the time of a transaction as a

result of a Budget change. This is so where tax has to be withheld at source. One example of this in the 1986 Budget was the restriction of reliefs for charities. Part of this measure involved introducing a requirement for companies making a covenanted donation to charities to deduct tax from the payment (Section 30(2) FA 1986). This could not apply to payments on Budget Day before the announcement was made and therefore it took effect from the next day. There could be other cases where Ministers might feel that even though retrospective effect was practicable it would give rise to undue complaint, even though the retrospection was only a matter of hours. We have not been able to identify specific examples of this but experience shows that an enormous diversity of circumstances can arise in which quick action is required and there can be problems if Ministers' hands are tied too tightly. Even on the capital taxes, it might be advisable to keep open the possibility of a date later than Budget Day itself.

11. I think all this makes it difficult to go much beyond the terms of the statement already made. There will be a few occasions where implementation from the start of Budget Day is impossible or unduly contentious; and the majority of Budget changes will in any case have other operative dates. The tax avoidance industry is now on warning that activity on Budget Day might well fall foul of Budget changes (the previous Financial Secretary's warning was publicised in a press release on 20 March). A more rigid formulation could undesirably restrict Ministers' freedom of action to respond to particular circumstances.



L J H BEIGHTON

[Dr. McDonald]

Conservative Members, that we see that the Liberals and Social democrats are not here to say anything. It appears that Banquo—my hon. Friend the Member for Bolsover (Mr. Skinner)—has also turned up at the feast to tell us of the absence of Social democratic and Liberal parties. It is not surprising that they are not here because they have nothing relevant to say about the needs of our economy and our manufacturing industry.

Mr. Willie W. Hamilton: To be fair, only nine hon. Members who support the Government are present at the moment.

Dr. McDonald: After gathering so many Tory Members at the last election, it is unfortunate that not many are here to hear the second to last Budget before the next election.

The Budget is immensely disappointing and it does nothing for manufacturing industry or exports, nothing to make up the gap in the balance of payments, nothing for the poor and nothing for the unemployed. Despite the Prime Minister's promise, there are only yet more tax cuts for the rich.

9.33 pm

The Financial Secretary to the Treasury (Mr. John Moore): We have had a wide-ranging debate. We have had contributions on the overall strategic judgment and on all aspects of the economy. There have been detailed speeches on topics ranging from the Health Service to the North sea to Scotland.

I share the views of the hon. Member for Thurrock (Dr. McDonald) about the extraordinary absence throughout the major part of our proceedings of the parties which are supposed to represent what they regard as part of the Opposition. The hon. Lady was right to draw attention to that. I had assumed that the right hon. Member for Glasgow, Hillhead (Mr. Jenkins) would be present for the closing speeches. I had wanted to make some references to his speech, but I had better restrict myself to his description of my right hon. Friend's Budget as a pudding that had some good plums but no theme. He was reminding us of a quotation by the late Sir Winston Churchill. I find the concept of a pudding with no theme more fitting to the policies of the alliance than the serious decision-making process in which he once participated, when he was in Government. Its absence from the conclusion of the second day of the Budget debate shows the lack of seriousness with which the alliance views the House of Commons.

I have now a slightly technical matter that concerns arrangements for bringing Budget changes into operation, which affect income tax and corporation tax. Every year, some changes have to take effect more or less immediately. For those which work to the taxpayers' advantage, the normal rule is that they take effect on or after Budget day, but for those changes that work the other way—by imposing or increasing tax—the practice has been to apply the changes after Budget day. In most cases, this works well enough, but there may be occasions when some people engage in forestalling, which could be costly to the Exchequer, by doing business very quickly on Budget night. To allow this would be neither fair nor sensible, and it may be necessary in future to make changes effective from the start of Budget day. I thought it right to draw the attention of the House to this change, which may be used in a future Budget.

The Budget continues the process of radical reform started by my right hon. Friend's predecessor as Chancellor of the Exchequer, my right hon. and learned Friend the Foreign Secretary, and welcomed by my hon. Friend the Member for Darlington (Mr. Fallon). It completes the corporation tax reform package of 1984, and following this, the main corporation rate will be 35 per cent. for those paying mainstream corporation tax and for small companies, 29 per cent. My hon. Friend the Member for Darlington, and my hon. Friend the Member for Broxbourne (Mrs. Roe) in a thoughtful and distinguished speech, drew the attention of the House to the Green Paper on the reform of personal taxation which has clearly been associated with the Budget. I know that hon. Members may not have had time to read the Green Paper, but it is an important contribution to the next stage of the reform of the taxation system. I trust that the House will not mind if, as there have been references to it, I take a little time to discuss certain aspects of the Green Paper. General and genuine consultation and a full debate outside and inside the House on this Green Paper will be beneficial.

Hon. Members on both sides of the House find the present system quite unacceptable. It discriminates against women in marriage, denying them independence and privacy, and placing tax penalties on marriage, which must be changed. The question is as to what kind of independent taxation it should be changed, and two basic kinds are generally argued for. There is what might be called independent taxation, with transferable allowances, which is the argument outlined in the Green Paper, and there is the argument for mandatory separate taxation—MST. I shall consider both briefly, as they are germane to the overall Budget debate.

I wish to show why we see transferable allowances as clearly superior. The Green Paper goes into this in some detail. First, they recognise the key role and importance of marriage. Secondly, they remove all discriminatory features from the present system. Thirdly, they offer independence and privacy for all and—this is crucial—the flexibility of transferability as well. This is particularly effective in recognising the life cycle of couples in marriage and their changing needs. For almost all couples one partner is dependent upon the other at some time—often at a time of greatest need, for example the birth of the first child, or when a wife may give up her job when her husband's job forces him to move.

Fourthly, transferable allowances recognise that an allowance is not much use without an income to set it against. There have been several criticisms of these proposals, with two basic criticisms. One is that the new system will be complicated. I am not sure that I fully accept that because——

Mr. Campbell-Savours: What has this to do with the Budget?

Mr. Moore: This has a great deal to do with it. I have sat throughout the debate, and I shall endeavour to make my own speech on a rather critical part of the overall tax system.

The first criticism is that they were complicated. Anybody who looks through our tax system could, when he looks at it with some care, regard the already existing

CHAIRMAN

INLAND REVENUE

Press Release

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

[3x] 13 November 1986

CLOSE COMPANIES: APPROVED EMPLOYEE SHARE SCHEMES AND INTEREST RELIEF

"

The Financial Secretary, Mr Norman Lamont, MP announced today some technical changes to the close company and approved employee share scheme legislation which the Government propose introducing in the 1987 Finance Bill.

Their main purpose would be to make minor changes to the rules for deciding whether, where shares are held in a trust, an employee or director has a "material interest" in a close company, and consequently whether he can participate in an approved employee share scheme, and obtain interest relief on loans for purchasing the company's shares.

The relief available to most approved employee share schemes would be unaffected by the proposed changes; but in some cases the proposals would ease rules which may have operated in the past to prevent this relief being given.

Following the changes close company interest relief would not be available for future loans where a material interest had been artificially created with a token shareholding to enable purchasers of the company's shares to qualify for this relief.

"

In answer to a Written Parliamentary Question:

"To ask Mr Chancellor of the Exchequer if he will make a statement on the "material interest" rules in Sections 285 and 303 Income and Corporation Taxes Act 1970, in particular as they apply to approved employee share schemes."

/the Financial

testing whether he has a "material interest". (The legislation excepts from such aggregation shares in approved occupational pension schemes and in trusts exclusively for the benefit of employees or employees and directors of the company).

Circumstances to which the proposed changes would apply

5. The amendments are directed at two situations in which it has been suggested that the present rules may be unnecessarily restrictive:

a. a nominal holding of shares in a company (whether originally close or not) might be settled for the benefit of its employees and a (possibly) wide class of other beneficiaries, whose personal shareholdings may have the effect, through the aggregation rules, of conferring a "material interest" on various individuals, including the employees. The suggestion is that the latter would in that event be barred from participating in any approved share schemes established by the company; and the company might become a close company in this way.

b. where a trust contains a substantial holding of shares in a close company, and its employees are among the potential beneficiaries, they may similarly have a "material interest". This might result, for example, from a longstanding trust created by a member of a family company under which its employees have only a remote interest, or from a discretionary trust under which the employees are potential but perhaps secondary beneficiaries.

Proposed Changes

6. The change proposed to Section 303 ICTA would remove any doubt about the situation at 5(a). Where an individual has an interest under a trust the proposed amendment would dissociate the personal shares of trust beneficiaries, other than those of the individual concerned and of his close relatives and his partners, so that they no longer need to be counted in determining whether he had a "material interest". It would operate not only in relation to approved employee share schemes but also for close company interest relief, and for all the other tax legislation to which the definition in Section 303 applies.

7. Two minor changes are proposed to the employee share scheme legislation to assist employees in the situation described in paragraph 5(b). In some cases relief under approved share schemes may have been given where technically it was not due because an interest of the kind described in paragraph 5(b) had been overlooked. The first change would put matters right in such cases for the past, where neither the employee nor his associates have had any benefit from the trust. In such cases the shares held in the trust would be disregarded, for the period up to today, in deciding whether the employee had a material interest in the company concerned.

/8. For

Starting dates

15. For all purposes except interest relief the change to Section 303 (paragraph 6 above) would take effect from 6 April 1986. For interest relief that change would only apply to interest on loans made after today. Entitlement to relief for existing loans would be unaffected.

16. The changes to the approved employee share scheme legislation (paragraphs 7 and 9) would apply to all trusts whenever created. The change described in paragraph 7 would apply to all previous periods for which it could be relevant. Disclaimers or releases executed from today will, provided the amended 12 month rule is satisfied, be effective immediately to allow participation in an approved scheme. Similarly the exercise of a power to exclude employees from a trust (in the circumstances at paragraph 13 above) would after today have the same effect. If the 12 month rule as amended is not satisfied, such disclaimers, releases or exclusions will have effect only a year after they are made.

17. For close company interest relief, where there is a disclaimer (or release) or the exercise by the trustees of the power to exclude the employee, he will be treated as no longer having a "material interest" via the trust for the purposes of interest paid after the date of the disclaimer, release or exclusion.

Approved Share Schemes: Position until amending legislation is enacted

18. To avoid any possibility of minor or remote interests under a trust upsetting the operation of existing approved employee share schemes, or the setting up of new ones, prior to the enactment of legislation along these lines, Ministers have authorised the Inland Revenue to operate these reliefs after today as though the legislative changes (paragraphs 6, 7 and 9) had already been enacted.

FROM: A W KUCZYS
DATE: 9 Janaury 1987

MR BEIGHTON - INLAND REVENUE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Graham - Parly Counsel
PS/IR
PS/C&E

BUDGET DAY TAX CHANGES

The Chancellor was grateful for your minute of 8 January, with which he agrees.

A W KUCZYS

BUDGET CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

From: N C MUNRO
Date: 12 February 1987

ECONOMIC SECRETARY

FRIENDLY SOCIETIES: TAX-EXEMPT LIFE OR ENDOWMENT BUSINESS

1. During your meeting yesterday on Friendly Societies, I undertook to let you have a short note on a technical defect in the friendly societies' tax legislation. As I mentioned, we drew your attention to this in our minute of 7 March 1986.

2. Although there was, and still is, no pressing need to rectify the problem, you indicated (Mr Neilson's minute of 11 March 1986) that remedial action could be taken in the 1987 Finance Bill if (as you now propose) it contained other friendly society legisation.

---

c.c Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State
Mr Cassell
Mr Scholar
Mrs Lomax
Miss Sinclair
Mr M A Hall
Mr Murphy
Mr Cropper
Mr Ross-Goobey
Mr Graham (Parliamentary Counsel)
Mr Bridgeman (RFS)
Mr Wilson (RFS)

Mr Isaac
Mr Beighton
Mr Corlett
Mr Newstead
Mr Munro
Mr Doherty
Mr McNicol
PS/IR

SM5 CSM20

The defect

3. Briefly, the point is this. Since 1985 friendly societies have been able to issue tax-exempt non-qualifying life or endowment policies. The intended tax treatment of these policies was:-

- no tax on the build-up within the fund

- an income tax charge at basic and higher rates on the investor's profit from the policy.

But because some crucial words were omitted from the legislation (Section 41(9) of the 1985 Finance Act) profits arising from friendly society tax-exempt, non-qualifying policies will suffer no tax if held by a basic rate taxpayer. And, in certain circumstances, even higher rate taxpayers could escape a basic rate charge.

The remedy

4. Subject to the views of Parliamentary Counsel, we think a two-line phrase inserted into Section 41(9) will remedy this problem. Since no such policies have been issued (so far as we know), and since there is no danger of forestalling, the amendment could apply with effect from Royal Assent.

An additional defect

5. My note of 7 March 1986 also gave details of a weakness in the qualifying rules for life or endowment policies in general. This allows a non-qualifying policy issued to a child to be converted into a qualifying policy. The scope for abuse stems from the fact that a policy taken out purely for investment can subsequently benefit from the favoured treatment (ie tax-free profits on maturity) meant for "genuine" life assurance.

6. The remedy for this weakness is less straightforward than for the first defect. A significant amendment would be necessary to the qualifying rules for life assurance in Schedule 1 of the Taxes Act. And a complete remedy would need to extend to policies issued by a life office as well as to taxable and tax-exempt business written by friendly societies. For these reasons and because we have found no evidence so far that the weakness has been exploited, we do not recommend remedial action in this year's Finance Bill.

Summary

7. We therefore recommend:

- a brief measure in this year's Bill to remedy the defect outlined in paragraph 4 above

- no action now to deal with the weakness described in paragraph 6.

We should be grateful for confirmation that you are content for us to proceed in this way.

N C MUNRO

(X5) RP

FROM: G R WESTHEAD
DATE: 13 February 1987

NOTE OF A MEETING HELD IN ECONOMIC SECRETARY'S OFFICE 11.15 AM, WEDNESDAY 11 FEBRUARY 1987

Those Present:		
	Economic Secretary	Treasury
	Mr Hall	Treasury
	Mr Murphy	Treasury
	Mr Bridgeman-Chief Registrar	Registry of Friendly Societies
	Mr Wilson	Registry of Friendly Societies
	Mr Munro	Inland Revenue
	Mr McNicol	Inland Revenue

The Economic Secretary thanked the Registry for all the work they had done leading to Mr Wilson's submission of 22 January. He said he was in favour of changing the tax exempt limit on Friendly Societies' life business from one focussing on gross sum assured to a premium basis, as set out in Mr Wilson's submission. However, this was subject to there being no awkward consequences for the insurance market. Additionally there should be no improvement in the position of the more commercial Friendly Societies as a result of the change. The commercial societies only existed due to anomalous tax concessions and their position should not be enhanced. The Economic Secretary thought the change proposed by the Registry was on about the right scale. He would want it presented so that it was seen to deal with traditional societies' key difficulties. If commercial societies reacted strongly, traditionals would need to be mobilised to show their strong support for it. He would probably want to meet representatives of the

traditionals at a later stage to warm them to his proposals.

2. The Economic Secretary stressed the importance of handling the change well and getting the timing right. It had to be decided whether to announce the change in the Budget, in the post-Budget debate, or at a post-Budget Friendly Societies' function. Mr Bridgeman suggested that there was a case for a Budget day announcement, or one in the Budget debate. The Economic Secretary might also present the good news, along with the effect of the Life Directive and the Financial Services Act at the 100th Anniversary dinner celebrating the first meeting of Friendly Societies' annual conference, scheduled to take place on 24 March.

It was agreed that 1 September 1987 would be a suitable date for implementation; this would be after the Parliamentary passage of the relevant Finance Bill clauses.

Mr Hall asked whether Friendly Societies would be able to take advantage of the tax change, or whether they would still be in long-term decline. Mr Bridgeman admitted the majority of societies would remain in decline, although there would be benefits at the margin.

Future Legislation and the Morgan Report

3. Mr Wilson said that Friendly Societies were currently labouring under the difficulty of having to comply with the implications of several separate pieces of legislation, including the Friendly Societies Act, the EC Life Directive and the Financial Services Act. Friendly Societies legislation was becoming increasingly entangled. There was a case for substantive separate

legislation on the same lines as that for Building Societies.

Mr Hall thought there were advantages in asking an outsider to do a study on Friendly Societies. It would bring together all those strands which the movement, if left to itself, appeared incapable of doing. Mr Bridgeman disagreed. He thought commissioning a study group would oblige Ministers to produce proposals for new Friendly Societies legislation when all that might prove necessary was some tidying up of existing legislation. He thought it better to monitor developments over the next two years and see how Societies coped with the Financial Services Act and EC Life Directive. There would be a case for considering a more radical review and possibly new legislation in about two years time with action being left to the Parliament after next. Mr Bridgeman pointed out that Friendly Societies were losing out through the lack of a proper representative body to co-ordinate their views on policy and direction. The Economic Secretary said it would be useful to have a view from the Friendly Societies themselves as to how they saw themselves developing into the 1990's. There was no point in embarking on legislation without a clear steer. On a practical level, it was unlikely that the Government would be able to legislate in the next Parliament.

4. The Economic Secretary wished to distance himself from the prospect of early legislation and had been maintaining a suitably vague line in response to representations he had received as a result of the Morgan Report. The suggested form of words in dealing with such queries would need redrafting accordingly. He did not wish to commit even the next Parliament to dealing with this, irrespective of who was in office. It was important to be on a very sound technical footing before taking this forward.

Not only was the subject of Friendly Societies incomprehensible to the world at large and very difficult to explain to Parlimentarians, but there were also few political, fiscal, social, or cultural benefits to be reaped from early legislation. It did not help that collectively Friendly Societies did not seem to know in what direction they were headed.

Pensions

5. Mr Munro pointed out that the existing legislation would prevent some recently established Friendly Societies from doing certain types of personal pension business. Agreement to amend section 27 of the 1974 Finance Bill would remedy this. It was likely that it would redistribute business which would otherwise be done elsewhere, but not increase it. The Economic Secretary was content.

This change would mean that the only distinction between old and new societies would be the prohibition on new societies from doing tax exempt juvenile business. This could be defended on tax policy grounds; it would be an easy and obvious tax loophole.

1985 Finance Bill Loophole

6. Mr Munro drew attention to a loophole in the 1985 Finance Bill, which meant that it was not at present possible to stop commercial societies issuing tax-exempt non-qualifying life or endowment policies. This had been mentioned last March and the Economic Secretary had said he was disposed to closing the new loophole in the 1987 Finance Bill. The Economic Secretary now said that he would like to take another look at this.

Joint Study Group Report

7. Mr Wilson said that he had been approached by Friendly Societies who wanted to make use of information in the Joint Study Group Report. The Economic Secretary had no objection provided it was made clear that Societies should not use the information before the Budget.

8. Concluding the meeting, the Economic Secretary confirmed that he was content with the two changes to the Friendly Societies regime to be made the 1987 Finance Bill. He would discuss presentation with the Chancellor. Meanwhile he gave Mr Munro authority to instruct Parliamentary Counsel to begin drafting.

Guy Westhead

GUY WESTHEAD

Assistant Private Secretary

Distribution

Those present
PS/Chancellor
Mr Cassell
Mrs Lomax
Ms Sinclair
Mr D Walters

FROM: N WILLIAMS
DATE: 3 March 1987

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Scholar
Miss Sinclair
Mr Graham OPC
PS/IR

Content

BUDGET STARTERS: COMMENCEMENT DATE

1. The Financial Secretary has read Mr Johns' minute of 26 February. He has also seen Miss Sinclair's minute of 27 February. (Both below)

2. Subject to the Chancellor being content, the Financial Secretary's view is that a uniform approach should be adopted this year for the Revenue Starters, by putting them all onto a start of Budget Day basis.

3. He agrees with the Revenue's recommendation, however, that we should keep open the possibility that some measures might not follow this precedent in a later year.

N Williams

NIGEL WILLIAMS
(Assistant Private Secretary)

BUDGET CONFIDENTIAL

FROM: MISS C E C SINCLAIR
DATE: 27 February 1987

FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State
Mr Scholar
Mr Romanski
Mr Haigh

Mr Isaac
Mr Beighton - IR
Mr M Johns

PS/Customs & Excise

Mr P Graham
- Parliamentary Counsel

BUDGET STARTERS: COMMENCEMENT DATE

Mr Johns' minute of 26 February asks whether you would like to put all the Revenue Budget day starters on to a start of Budget day basis.

2. You may like to be reminded that this would not be possible for the Customs Budget day starters on excise duties, nor for the proposed change in farmers' lorry VED.

2. There is no reason why this should stop you from choosing a single starting point for all the Revenue Budget day changes. But we will not be able to argue that all the Budget day changes will be taking effect from the start of that day.

CAROLYN SINCLAIR

BUDGET CONFIDENTIAL

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

(x) (5)

28

FROM: M A JOHNS
DATE: 26 February 1987

FINANCIAL SECRETARY

BUDGET STARTERS: COMMENCEMENT DATE

1. Last year the Chancellor asked us to consider the rules for the starting date of Budget changes and suggested there might be merit in adopting a uniform rule that all changes given immediate effect should take effect from the start of Budget Day rather than the close of Budget Day (Mr Kuczys' note of 19 March 1986). In Mr Beighton's note of 8 January we suggested that there would be occasions where implementation from the start of Budget Day would be impossible or unduly contentious. We recommended resting on your predecessor's statement on 19 March last year (attached) that "it may be necessary in future to make changes effective from the start of Budget Day" while retaining freedom of action to respond to particular circumstances. The Chancellor agreed with this approach (Mr Kuczys' note of 9 January).

2. You may like now to review where we have got to on the commencement dates of this year's starters. There are currently 14 starters which will take effect from Budget Day. On seven of these we propose introduction with effect from the start of Budget Day. These are:

---

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State
Mr Scholar
Miss Sinclair
Mr Graham (Parliamentary Counsel)

Mr Isaac
Mr Painter
Mr Beighton
Mr Cleave
Mr Johns
PS/IR

BS 173A Capital Gains: companies (including ring fence consequentials)

BS 135B Pensions: exploitation of tax relief

BS 104 IHT rates and bands

BS 165 IHT business relief

BS 169 IHT Heritage Maintenance Funds

BS 177 IHT Inheritance in Possession Trusts

BS 185 Restriction of ACT set off in respect of oil company preference dividends

There is also one potential late starter relating to controlled foreign companies on which Mr Bryce is minuting you for which, if you decide on action, commencement from the start of Budget Day will be appropriate.

3. The most likely area of controversy among these is BS 173A, company capital gains. Ministers looked at this issue specifically (Mr Cayley's note of 8 January) and have accepted that to avoid forestalling commencement from the start of Budget Day was essential. Otherwise, BS 135B, 185 and the possible new starter are anti-avoidance measures where action from the start of Budget Day seems appropriate following your predecessor's warning. BS 104, 165, 169 and 177 follow past inheritance tax practice.

4. On the other seven starters so far drafting has been on the basis of commencement at the close of Budget Day, not because of any particular practical difficulty or risk of controversy but because this follows precedent and there is no particular advantage in commencement at the start of Budget Day. The starters concerned are:

BS 129 PRT Cross Field Allowance

BS 159 PRT Treatment of Research

BS 122 Trade Union Provident Benefits

BS 123 BES

BS 168 Restriction of Revenue direction

BS 149 CT Payment dates

BS 176 Interest payments between companies.

5. If you wanted to adopt a uniform approach this year you could, by converting these starters onto a start of Budget Day basis. In that case we would nevertheless recommend that you keep open the possibility in a later year some measures might not follow this precedent.

CONCLUSION

6. I would be grateful if you could let me know whether you are content with the split of commencement dates as set out above or whether you would like any changes, eg to put them all onto a start of Budget Day basis.

M. A. Johns

M A JOHNS

[Dr. McDonald]

Conservative Members, that we see that the Liberals and Social democrats are not here to say anything. It appears that Banquo—my hon. Friend the Member for Bolsover (Mr. Skinner)—has also turned up at the feast to tell us of the absence of Social democratic and Liberal parties. It is not surprising that they are not here because they have nothing relevant to say about the needs of our economy and our manufacturing industry.

Mr. Willie W. Hamilton: To be fair, only nine hon. Members who support the Government are present at the moment.

Dr. McDonald: After gathering so many Tory Members at the last election, it is unfortunate that not many are here to hear the second to last Budget before the next election.

The Budget is immensely disappointing and it does nothing for manufacturing industry or exports, nothing to make up the gap in the balance of payments, nothing for the poor and nothing for the unemployed. Despite the Prime Minister's promise, there are only yet more tax cuts for the rich.

9.33 pm

The Financial Secretary to the Treasury (Mr. John Moore): We have had a wide-ranging debate. We have had contributions on the overall strategic judgment and on all aspects of the economy. There have been detailed speeches on topics ranging from the Health Service to the North sea to Scotland.

I share the views of the hon. Member for Thurrock (Dr. McDonald) about the extraordinary absence throughout the major part of our proceedings of the parties which are supposed to represent what they regard as part of the Opposition. The hon. Lady was right to draw attention to that. I had assumed that the right hon. Member for Glasgow, Hillhead (Mr. Jenkins) would be present for the closing speeches. I had wanted to make some references to his speech, but I had better restrict myself to his description of my right hon. Friend's Budget as a pudding that had some good plums but no theme. He was reminding us of a quotation by the late Sir Winston Churchill. I find the concept of a pudding with no theme more fitting to the policies of the alliance than the serious decision-making process in which he once participated, when he was in Government. Its absence from the conclusion of the second day of the Budget debate shows the lack of seriousness with which the alliance views the House of Commons.

I have now a slightly technical matter that concerns arrangements for bringing Budget changes into operation, which affect income tax and corporation tax. Every year, some changes have to take effect more or less immediately. For those which work to the taxpayers' advantage, the normal rule is that they take effect on or after Budget day, but for those changes that work the other way—by imposing or increasing tax—the practice has been to apply the changes after Budget day. In most cases, this works well enough, but there may be occasions when some people engage in forestalling, which could be costly to the Exchequer, by doing business very quickly on Budget night. To allow this would be neither fair nor sensible, and it may be necessary in future to make changes effective from the start of Budget day. I thought it right to draw the attention of the House to this change, which may be used in a future Budget.

The Budget continues the process of radical reform started by my right hon. Friend's predecessor as Chancellor of the Exchequer, my right hon. and learned Friend the Foreign Secretary, and welcomed by my hon. Friend the Member for Darlington (Mr. Fallon). It completes the corporation tax reform package of 1984, and following this, the main corporation rate will be 35 per cent. for those paying mainstream corporation tax and for small companies, 29 per cent. My hon. Friend the Member for Darlington, and my hon. Friend the Member for Broxbourne (Mrs. Roe) in a thoughtful and distinguished speech, drew the attention of the House to the Green Paper on the reform of personal taxation which has clearly been associated with the Budget. I know that hon. Members may not have had time to read the Green Paper, but it is an important contribution to the next stage of the reform of the taxation system. I trust that the House will not mind if, as there have been references to it, I take a little time to discuss certain aspects of the Green Paper. General and genuine consultation and a full debate outside and inside the House on this Green Paper will be beneficial.

Hon. Members on both sides of the House find the present system quite unacceptable. It discriminates against women in marriage, denying them independence and privacy, and placing tax penalties on marriage, which must be changed. The question is as to what kind of independent taxation it should be changed, and two basic kinds are generally argued for. There is what might be called independent taxation, with transferable allowances, which is the argument outlined in the Green Paper, and there is the argument for mandatory separate taxation—MST. I shall consider both briefly, as they are germane to the overall Budget debate.

I wish to show why we see transferable allowances as clearly superior. The Green Paper goes into this in some detail. First, they recognise the key role and importance of marriage. Secondly, they remove all discriminatory features from the present system. Thirdly, they offer independence and privacy for all and—this is crucial—the flexibility of transferability as well. This is particularly effective in recognising the life cycle of couples in marriage and their changing needs. For almost all couples one partner is dependent upon the other at some time—often at a time of greatest need, for example the birth of the first child, or when a wife may give up her job when her husband's job forces him to move.

Fourthly, transferable allowances recognise that an allowance is not much use without an income to set it against. There have been several criticisms of these proposals, with two basic criticisms. One is that the new system will be complicated. I am not sure that I fully accept that because——

Mr. Campbell-Savours: What has this to do with the Budget?

Mr. Moore: This has a great deal to do with it. I have sat throughout the debate, and I shall endeavour to make my own speech on a rather critical part of the overall tax system.

The first criticism is that they were complicated. Anybody who looks through our tax system could, when he looks at it with some care, regard the already existing

BUDGET CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

(18)

FROM: N C MUNRO

3 March 1987

PS/Economic Secretary (Mr Westhead)

FRIENDLY SOCIETIES : TAX EXEMPT LIFE AND ENDOWMENT BUSINESS
STARTER 412

1. We discussed your minute of 2 March.

2. The amendment to Section 41 Finance Act 1985 imposes a tax charge (albeit a charge which should have been there at the outset). So a resolution is needed - which has to be published on Budget Day.

3. There are three options:

- to drop the amendment now, on the grounds that the loophole in Section 41 has not been exploited.

- to leave the question open, in which case the Budget resolution would have to be drafted in very wide terms.

- to agree the amendment now, in which case a narrower, more specific, Budget resolution would suffice.

---

cc Principal Private Secretary
PS/Financial Secretary
Mr Cassell
Mrs Lomax
Miss Sinclair
Mr M A Hall
Mr Murphy
Mr Cropper
Mr Graham (Parliamentary Counsel)
Mr Bridgeman (RFS)
Mr Wilson (RFS)

Mr Isaac
Mr Beighton
Mr Corlett
Mr Newstead
Mr Munro
Mr Doherty
Mr McNicol
PS/IR

4. A widely-drawn resolution might increase the scope for a general Opposition campaign on behalf of friendly societies. If so, it may be preferable to take the decision now - one way or the other. We have no strong views either way.

N C MUNRO

2812/03

Tony
PP

FROM: J J HEYWOOD
DATE: 3 March 1987

MISS HILL

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Mr Cassell
Mr Monck
Mr Scholar
Mr Sinclair
Mr M Williams
Mr Cropper
Mr Graham OPC
Mr Pitts IR
PS/IR

PRT PRICING (BS114): LEGISLATION

The Financial Secretary has discussed with you your submission of 24 February.

2. He accepts your recommendations (a)-(e) in paragraphs 21.

3. He commented that draft regulations should be made available to interested parties by (at latest) Committee Stage.

JEREMY HEYWOOD
Private Secretary

Yes, chuy.

Thanks.

Ch

I think there has been a misunderstanding here: Tony Battishill had always intended a power to do this in exceptional cases. He would now like to reflect/consult a little longer on the idea of applying this to all changes. In the meantime, he has suggested some drafting changes to the passage in the FST's speech, to leave this point open for now. These are pencilled in below, along with some minor changes the FST wanted to make anyway. Content with this?

AWK 19/3

PS/ Does 'x' say "angst"? against

bf 4.3.87

McGIVERN - IR → FST 26/2

RING FENCE ACT.

1. Cathy
2. RP

Reference ....

FROM : Miss C Evans
DATE : 4 MARCH

MR HEYWOOD

cc PS / Chancellor
Mr Scholar
Mr Turnbull
Mr White
Mr Ritchie

TAX AND EXPENDITURE AS PER CENT GDP

I attach the figures requested by the Secretary of State for Transport for his interview for Newsnight tonight.

Carys Evans

CODE 18-77

Taxes and NICs as % of GDP

1946[1]	37
1959-60	28.4
1964-65	25.7
1974-75	35.7
1986-87	37.9

General Government Expenditure as % of GDP

1945[2]	about 60
1959	34½
1964-65	35½
1974-75	48
1986-87	43¼

(1) earliest available figure

(2) Figure as % of GDP not available. Estimate derived from recorded figure of 66% for GGE as % of GNP. Using GNP instead of GDP adds several percentage points, so rounds down to about 60 per cent.

MR 2/3

BUDGET CONFIDENTIAL

FROM: A W KUCZYS
DATE: 4 March 1987

MR JOHNS - IR

PS/FST

cc: PS/~~CST~~
PS/EST
PS/MST
Mr Scholar
Miss Sinclair
Mr Graham OPC
PS/IR

BUDGET STARTERS: COMMENCEMENT DATE

The Chancellor has seen your note of 26 February, Miss Sinclair's of 27 February, and Nigel Williams' of 3 March. He agrees with the Financial Secretary.

AWK

A W KUCZYS

3746/039

PS: RJP

FROM: G R WESTHEAD
DATE: 4 MArch 1987

MR MUNRO - IR

cc PS/Chancellor
PS/Financial Secretary
Mr Cassell
Mrs Lomax
Miss Sinclair
Mr Hall
Mr Murphy

Mr Graham - Parly Counsel

Mr Bridgeman - RFS

PS/IR

FRIENDLY SOCIETIES: TAX-EXEMPT LIFE OR ENDOWMENT BUSINESS

The Economic Secretary has seen and was grateful for your further note of 3 March on this.

2. On the basis that he expects the Friendly Society's Budget changes to be generally welcomed, the Economic Secretary is content for the amendment proposed to be definitely included in the Finance Bill and therefore for a specific Budget resolution to be drafted for Budget Day.

Guy Westhead

GUY WESTHEAD
Assistant Private Secretary

COVERING BUDGET CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

From: C S McNICOL
Date: 5 March 1987

1. MR CORLETT
2. MR ISAAC
3. ECONOMIC SECRETARY

FRIENDLY SOCIETIES; TAX EXEMPT LIFE AND ENDOWMENT BUSINESS: STARTER 412

1. I attach for your approval the Budget Day Press Release announcing this year's changes to the tax treatment of friendly societies.

2. Treasury (FIM 1) and the Registry are content with this draft.

C S McNICOL

---

c.c Chancellor
Chief Secretary
Financial Secretary
Minister of State
Mr Cassell
Mrs Lomax
Mr Culpin
Mr M A Hall
Miss O'Mara
Mr Pickford
Mr Murphy
Mr Cropper
Mr Graham (Parliamentary Counsel)
Mr Bridgeman (RFS)
Mr Wilson (RFS)

Mr Isaac
Mr Beighton
Mr Corlett
Mr Newstead
Mr Munro
Mr Doherty
Ms Tyrrell
Mr McNicol
PS/IR

CSM5 CSM35

DRAFT

INLAND REVENUE
Press Release

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

[3x] 17 March 1987

FRIENDLY SOCIETIES: REVISED TAX-EXEMPT LIMIT

The Chancellor proposes in his Budget to change the limit on tax-exempt life or endowment assurance business carried on by friendly societies. For contracts made on or after 1 September 1987, the limit will be based on annual premiums of £100 instead of (as now) a gross sum assured of £750.

The change is designed to help older, traditional friendly societies (who primarily issue long-term policies to provide retirement or death benefits) and to encourage the less well-off to make such provision. The position of newer, commercial societies (who normally sell 10 year endowment policies) will be effectively unchanged.

Details

1. The revised limit will apply to life or endowment contracts made on or after 1 September 1987 by a registered friendly society. Profits from such policies will be exempt from tax as long as the premiums on them do not exceed £100 a year.

2. Where premiums are payable more often than once a year, 10 per cent of the premium may be disregarded in applying the £100 limit. This will enable friendly societies to issue tax-exempt policies with premiums of, for example, £2 a week or £9 a month.

3. From 1 September 1987, an individual will be able to invest up to £100 a year in tax-exempt, "qualifying" life or endowment assurance with a friendly society. Qualifying policies do not normally attract a tax charge when they mature.

4. The Finance Bill will also rectify an omission in the 1985 Finance Act so that, as always intended, gains from any non-qualifying policies which may be issued by a friendly society attract a basic rate charge.

/Notes for Editors

CSM5 CSM34

Notes for Editors

1. This year's proposed change will significantly increase the scope of traditional friendly societies to offer long-term assurance policies to their members.

2. At present, friendly societies are exempt from tax on the profits of life or endowment assurance up to a limit of £750 gross sum assured. For such policies to be "qualifying" for tax purposes, this sum must be at least 75 per cent of the premiums payable and premiums must be payable evenly over at least 10 years.

3. The combination of the 75 per cent rule and the £750 limit restricts the maximum premium for a 10 year qualifying endowment policy to £100 a year. The newer, commercial friendly societies have concentrated on such business.

4. Older friendly societies tend to issue policies with a much longer term - often 30 years or more - to cover funeral expenses or to provide a modest benefit on retirement. The annual premiums required to assure a gross sum of £750 over such a period are much lower than £100 and, in consequence, so is the society's per capita premium income. So these policies are not economic for many older societies.

5. The revised limit will allow tax-exempt, qualifying policies with premiums of up to £100 a year to be issued even where the policy term exceeds 10 years. For example, it will enable a 30 year tax-exempt, qualifying policy to have a gross sum assured of up to £2,250. This change will help older, traditional societies most and encourage the less well-off to provide for retirement and death benefits. For commercial societies, the new limit is equivalent to the current one, so their position is effectively unchanged.

BUDGET - CONFIDENTIAL

28

PS/Economic Secretary

From: A Wilson (RFS)

Date: 9 March 1987

FRIENDLY SOCIETIES TAX EXEMPT LIFE AND ENDOWMENT BUSINESS: STARTER 412

1. This minute is to confirm my conversation with you on 6 March, when I told you that the Chief Registrar, who had not previously seen the proposed Budget Day Press Release accompanying Mr McNicol's minute to the Economic Secretary of 5 March, suggested that it be amended. The statement that the position of the newer societies would be unchanged was factually incorrect. It will be open to them to sell policies with a longer maturity than 10 years, taking advantage of the new form of limit. The new limit will redress the former imbalance between the effect of the existing limits on the 10 year 'investment' type endowment contracts, designed to maximise tax advantages, being the main product marketed by

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cc: PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Mr Cassell
Mrs Lomax
Mr Culpin
Mr M A Hall
Miss O'Mara
Mr Pickford
Mr Murphy
Mr Cropper
Mr Graham (Parliamentary Counsel)
Mr Bridgeman (RFS)
Mr Isaac
Mr Beighton
Mr Corlett
Mr Newstead
Mr Munro
Mr Doherty
Ms Tyrrell
Mr McNicol
PS/IR

the newer 'commercial' societies on the one hand, and the much longer term contracts sold by the traditional societies, on the other.

2. The changes suggested by Mr Bridgeman are as follows:

(i) Delete the last sentence of the (second) introductory paragraph and substitute the following:

"It is equivalent to a significant increase in the old limit for such policies. The changed limit is exactly equivalent to the existing one in respect of the ten year endowment policy for mainly investment purposes, which has been the main product marketed by the newer commercial societies."

(ii) Amend paragraph 5 of the 'Notes for Editors' to read as follows:

"The revised limit will allow tax-exempt qualifying policies with premiums of up to £100 a year to be issued irrespective of the length by which the policy term exceeds 10 years. For example, a man aged 30 next birthday could typically obtain a friendly society endowment policy (without profits) of around £5,375 gross sum assured for an annual premium of £100 over a 35 year term. This change will help friendly societies to encourage the less well-off to make modest, tax efficient, provision for retirement and death benefits".

3. Inland Revenue officials are content with the approach of these proposed changes. Incidentally, the amended figure of £5,375 (above) approximates the (actual) figure of £5,376 taken from the "without profits" table of Tunbridge Wells Equitable Friendly Society, as being reasonably typical. The previous £4,500 (excluding bonuses) was from a typical "with profits" table. The "without profits" figure is, on reflection, a better indicator.

[b:PS/ES]

COVERING BUDGET CONFIDENTIAL

3761/17

FROM: P D P BARNES
DATE: 9 March 1987

MR MCNICOL, IR

cc: PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Mr Cassell
Mrs Lomax
Mr Culpin
Mr M Hall
Miss O'Mara
Mr Pickford
Mr Murphy
Mr Cropper
Mr Graham, OPC
Mr Bridgeman, RFS
Mr Wilson, RFS
Mr Isaac, IR
Mr Corlett, IR
PS/IR

FRIENDLY SOCIETIES: TAX EXEMPT LIFE AND ENDOWMENT BUSINESS: STARTER 412

The Economic Secretary was grateful for your minute of 5 March, and for the attached press release. I attach a revised press release incorporating the Economic Secretary's comments. Changes sidelined.

PB

P D P BARNES
Private Secretary

3761/12

DRAFT PRESS RELEASE

FRIENDLY SOCIETIES: REVISED TAX-EXEMPT LIMIT

The Chancellor proposes in his Budget to change the limit on tax-exempt life or endowment assurance business carried on by friendly societies. For contracts made on or after 1 September 1987, the limit will be based on annual premiums of £100 instead of (as now) a gross sum assured of £750.

The change is designed to help older, traditional friendly societies, who primarily issue long-term policies to provide retirement or death benefits. It is equivalent of a very substantial increase in the old limit for the policies.

Details

1. The revised limit will apply to life or endowment contracts made on or after 1 September 1987 by a registered friendly society. Profits from such policies will be exempt from tax as long as the premiums on them do not exceed £100 a year.

2. Where premiums are payable more often than once a year, 10 per cent of the premium may be disregarded in applying the £100 limit. This will enable friendly societies to issue tax-exempt policies with premiums of, for example, £2 a week or £9 a month.

3. From 1 September 1987, an individual will be able to invest up to £100 a year in tax-exempt, "qualifying" life or endowment assurance with a friendly society. Qualifying policies do not normally attract a tax charge when they mature.

4. The Finance Bill will also rectify an omission in the 1985 Finance Act so that, as always intended, gains from any non-qualifying policies which may be issued by a friendly society attract a basic rate charge.

/Notes for Editors

Notes for Editors

1. This year's proposed change will significantly increase the scope of traditional friendly societies to offer long-term assurance policies to their members.

2. At present, friendly societies are exempt from tax on the profits of life or endowment assurance up to a limit of £750 gross sum assured. For such policies to be "qualifying" for tax purposes, this sum must be at least 75 per cent of the premiums payable and premiums must be payable evenly over at least 10 years.

3. The combination of the 75 per cent rule and the £750 limit restricts the maximum premium for a 10 year qualifying endowment policy to £100 a year. The changed limit is exactly equivalent to the existing one in respect of the 10-year endowment policy for mainly investment purposes which has been the main product marketed by the newer commercial societies.

4. The revised limit will, however, allow tax-exempt, qualifying policies with premiums of up to £100 a year to be issued for terms exceeding 10 years. Older friendly societies tend to issue policies with a much longer term - often 30 years or more - to cover funeral expenses or to provide a modest benefit on retirement. The annual premiums required to assure a gross sum of £750 over such a period are much lower than £100, so the new limit on annual premiums will provide scope for the traditional societies to issue such policies with much higher sums assured.

5. This change should encourage the traditional friendly societies in assisting their members to make modest but tax-efficient provision for retirement and death benefits. For example, £100 per annum would typically provide a man aged 30 with an endowment policy (excluding bonuses) of around £4,500 gross sum assured over a 35 year term.

3671/030

BUDGET CONFIDENTIAL

FROM: P D P BARNES
DATE: 10 MARCH 1987

MR McNICOL - IR

cc PS/Chancellor
Mr Cassell
Mrs Lomax
Mr Culpin
Mr Wilson - RFS
Mr Isaac - IR
Mr Corlett - IR
PS/IR

FRIENDLY SOCIETIES: TAX EXEMPT LIFE AND ENDOWMENT BUSINESS: STARTER 412

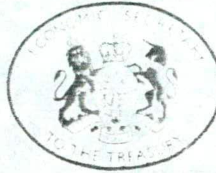
We spoke. As I said, the final sentence of the second paragraph of the revised draft press release attached to my minute of this morning should read: 'It is the equivalent of a very substantial increase in the old limit for such policies.'

PB

P D P BARNES
PRIVATE SECRETARY

2389/041

BUDGET CONFIDENTIAL



FROM: M NEILSON
DATE: 12 March 1986

MR MCNICOL - IR

cc: Chancellor
CST
FST
MST
Mr Cassell
Mr Peretz
Mr Hall

Mr Saunders
Mr Cropper
Mr Davies
Mr Lord
Miss O'Mara
Mr Culpin
Mr Pickford
Mr Graham - PC
Mr Bridgeman - RFS
Mr Devlin - RFS

IR
Mr Corlett
Mr Isaac
Mr Battishill
Mr P D Hall
Mr Parker
Mr Munro
Mr G D Smith
Ms Tyrrell
Miss Murduck
PS/IR

C/ To note EST's decision and press release below McNicol's note. RO 12/3

BUILDING SOCIETIES: STARTER 165

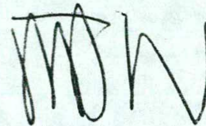
The Economic Secretary has seen your minute of 11 March. On the first point the Economic Secretary does not consider that there should be legislation in this year's Finance Bill to remove any doubts about our ability to charge tax on payments made by building societies in the 1985/86 tax year. This point was raised by the Woolwich Building Society, whom he saw last week. He does not think it likely that the Woolwich will pursue it further, nor that any societies would consider it to be in their interest to be taking the Government to Court with the new

BUDGET CONFIDENTIAL

building society regime so imminent. Even if they did, legal advice is that the Government would win. In any case if it does look as if there will be a problem on this, an amendment could be introduced at Committee Stage.

2. The Economic Secretary would like the first paragraph of the press release attached to your minute to be redrafted to read, "From 6 April 1986 building societies will for the first time be able to pay dividends gross in certain circumstances. The Chancellor proposes in his Budget that such dividends should be chargeable to tax under case (iii) schedule D in the hands of recipients."

3. The sentence in square brackets at the end of paragraph 3 of the press release obviously falls as a result of the decision set out above.



M NEILSON

Inland Revenue

Policy Division
Somerset House

BUDGET CONFIDENTIAL

FROM: C S MCNICOL
DATE: 11 MARCH 1986

1. Mr Corlett
2. Mr Isaac
3. Economic Secretary

BUILDING SOCIETIES: STARTER 165

1. This note deals with two related matters. The first is whether there should be legislation in this year's Finance Bill to remove any doubt about our ability to charge tax on payments made by building societies in the 1985/86 tax year. The second is the announcement needed on Budget Day of this year's minor legislative changes.

Legislation on payments in 1985/86 tax year

2. Following last week's meeting with Mr Cumming of the Woolwich you asked to see a draft of the legislation that would be necessary to clarify the position on payments made in the 1985/86 tax year.

3. I attach a draft from Parliamentary Counsel: the relevant provision is sub-section (1). ~~and the first half (highlighted) of sub-section (9)~~. The necessary amendment to Section 343(1A) of the Taxes Act is reasonably low key. But as it is the only amendment to sub-section (1A) it cannot unfortunately be completely subsumed within the remaining new provisions.

4. To recap very briefly, the issue concerns payments of interest and dividends made between the end of a society's accounting year ending in the 1985/86 tax year and 5 April 1986. In the opinion of both our Solicitor and Parliamentary Counsel (Mr Graham), the existing enabling legislation does give us authority to collect tax on these payments. But this view might be challenged in the Courts.

---

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State
Mr Cassell
Mr Peretz
Mr Hall
Mr Saunders
Mr Cropper
Mr Davies
Mr Lord
Miss O'Mara
Mr Culpin
Mr Pickford
Mr Graham (Parliamentary Counsel)
Mr Bridgeman (RFS)
Mr Devlin (RFS)
Mr Isaac
Mr Battishill
Mr P D Hall
Mr Painter
Mr Corlett
Mr Parker
Mr Munro
Mr G D Smith
Ms Tyrrell
Mr McNicol
Miss Murduck
PS/IR

5 The arguments for and against action this year are:

for - it would remove any doubt about the effectiveness of last year's legislation;

- it would avoid disruption in the flow of tax to the Exchequer

against - it could be criticised on grounds of retrospection

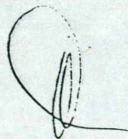
- it would attract Parliamentary attention appearing in isolation and not (as last year) as part of a balanced package for building societies.

6. May we have your decision as to whether this provision should be included in this year's Bill? You wanted to see what the provisions looked like before finally deciding.

Press Release

7. I attach for your approval a draft of the Budget Day Press Release announcing the 1986 changes.

8. Should you decide to include the provision on payments made in 1985/86, we suggest the highlighted words in paragraph 3 provide a suitably low-key announcement to this effect.



C S MCNICOL

[3x] 18 March 1986

BUILDING SOCIETIES COMPOSITE RATE: MINOR TECHNICAL CHANGE

The Chancellor proposes in his Budget to make a minor technical change to the tax treatment of interest and dividends paid by building societies. From 6 April 1986, dividends paid gross by building societies will be chargeable to tax under Case III of Schedule D in the hands of recipients.

This change will not affect the tax position of most investors, who receive interest from building societies net of tax under the composite rate scheme; nor will it alter the tax treatment of building societies themselves.

Details

1. Under provisions introduced in the 1985 Finance Act, building societies will, from 6 April 1986, be able to pay interest and dividends gross to individuals ordinarily resident outside the United Kingdom and to certain tax-exempt bodies (such as charities, friendly societies and pension funds).

2. Because Societies will now in certain circumstances be able to pay dividends gross, the provisions under which interest paid gross is chargeable in the recipient's hands to tax under Case III of Schedule D need to be extended to cover dividends. The rules dealing with the commencement and cessation of a Case III source of income will apply to income paid gross by building societies.

3. There will also be legislation to update two statutory references to "Arrangements" in Section 343 of the Taxes Act [and to clarify that the Revenue can collect tax on all payments of interest and dividends made in the 1985/86 tax year].

/NOTES FOR EDITORS

Notes for editors

Building societies composite rate scheme

1. Regulations made under the Finance Act 1985 have made a number of reforms to the Composite Rate Scheme. The most improtant changes are that societies will have to pay tax quarterly to the Inland Revenue and will be able to pay interest gross in certain circumstances.

2. The proposals in this year's Finance Bill will ensure that any charge on the investor receiving income gross will be under Case III of Schedule D.

11/25

Building societies' dividends and interest.

(1) In section 343 of the Taxes Act (building societies) subsection (1A) (which was inserted by the Finance Act 1985 and enables the Board to make regulations requiring societies to account for amounts representing income tax on certain sums) shall have effect and be deemed always to have had effect with the insertion after the words "in accordance with the regulations" of the words "(including sums paid or credited before the beginning of the year)".

(2) In subsection (2) of that section (treatment of building society payments for purposes of corporation tax)-

(a) in paragraph (a), for the words "the amount" there shall be substituted "any amount"; and

(b) in paragraph (b), after the words "any such dividends or interest" there shall be inserted "in respect of which the society is required to account for and pay an amount in accordance with the regulations".

(3) At the end of subsection (7) of that section (meaning of "dividend") there shall be added the words "but any sum which is paid by a building society by way of dividend and in respect of which the society is not required to account for and pay an amount in accordance with the regulations shall be treated for the purposes of Schedule D as paid by way of interest".

1985 c.54.

(4) In consequence of the amendments of the said section 343 effected by section 40 of the Finance Act 1985 (which include the new subsection (1A) referred to above),-

(a) in subsection (5) of section 16 of the Finance Act 1973 (amounts paid or credited to trustees of certain trusts) for the word "amounts" there shall be substituted "sums" and for the words from "with which" to "that year" there shall be substituted "being sums in respect of which the society is required to account for and pay an amount in accordance with regulations under section 343(1A) of the Taxes Act"; and

(b) in subsection (1) of section 6 of the Finance Act 1975 (amounts paid or credited to exempt pension funds) for the words from "among the sums" to "the Taxes Act" there shall be substituted "sums in respect of which a building society is required to account for and pay an amount in accordance with regulations under subsection (1A) of section 343 of the Taxes Act".

(5) Where a building society investment which is a source of income of any person (the "lender") is not a relevant investment but at any time after 6th April 1986 becomes such an investment, section 121 of the Taxes Act (special rules where source of income ceases) shall apply as if the investment were a source of income which the lender ceased to possess immediately before that time.

(6) Where a building society investment which is a source of income of any person ceases at any time after 6th April 1986 to be a relevant investment, section 120(3) of the Taxes Act shall apply as if the investment were a new source of income acquired by him immediately after that time.

BUDGET-CONFIDENTIAL

(7) Where a building society investment which was a source of income of any person immediately before 6th April 1986 was not on that date a relevant investment, section 120(3) of the Taxes Act shall apply as if the investment were a new source of income acquired by him on that date.

(8) In subsections (5) to (7) above "building society investment" does not include a quoted Eurobond (as defined in section 35(1) of the Finance Act 1984) but, subject to that, means any shares in, deposit with or loan to a building society (within the meaning of section 343 of the Taxes Act); and for the purposes of those subsections a building society investment is a "relevant investment" if dividends or interest payable in respect of it are sums in respect of which the society is required to account for and pay an amount in accordance with regulations under subsection (1A) of that section.

(9) Subsections (2) to (4) above have effect for the year 1986-87 and subsequent years of assessment.

BUDGET-CONFIDENTIAL

BUDGET - CONFIDENTIAL

FROM: A M W BATTISHILL
THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

17 March 1986

PS/FINANCIAL SECRETARTY

BUDGET DAY TAX CHANGES

The Financial Secretary asked me to provide a short draft passage about the implementation date for Budget changes affecting income tax and corporation tax. The draft below describes the present arrangements and gives notice that it may be necessary in exceptional cases in the future to back date some changes to the start of Budget Day where significant forestalling may be possible.

As we are asked to issue a press release on this perhaps you would let us know when the Financial Secretary has settled on a final text.

A M W BATTISHILL

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cc PS/Chancellor
PS/Minister of State
PS/Economic Secretary
Sir Peter Middleton
Mr Scholar
Mr Cassell
Mr Monger
Miss Sinclair
Mr Isaac
Mr Battishill
Mr Beighton
Mr Houghton
Mr Painter
Ms Tyrrell
PS/IR

If the House will allow me, I should like to spend just a moment or two on a more technical matter. This concerns the arrangements for bringing Budget changes into operation which affect income tax and corporation tax.

Every year some changes have to take effect more or less immediately. For those which work to the taxpayer's advantage the normal rule is that they take effect on or after Budget Day. But for those changes which work the other way, by imposing or increasing tax, the practice has been to apply the changes after Budget Day.

In most cases this works well enough. But there may be occasions when some people are able to engage in [costly] forestalling by doing business very quickly on Budget night. To allow this would be neither fair nor sensible, and it may be necessary in future to make [some] changes effective from the start of Budget Day. [where there would otherwise be a risk of significant tax loss.]

which cd be costly to the Exchequer

[My rt hon friend did not feel it necessary to apply this practice to any of his proposals this year. But] we thought it only right to inform the House that it may [exceptionally] be necessary to do so in the future.

RT8.35

A W KUCZYS
DATE: 19 March 1986

PS/FINANCIAL SECRETARY

cc PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr Cassell
Mr Monger
Miss Sinclair
Mr Battishill - IR
PS/IR

BUDGET DAY TAX CHANGES

The Chancellor has seen Mr Battishill's minute of 17 March, and the draft passage for inclusion in the Financial Secretary's winding up speech tonight. He had thought that in future <u>all</u> changes would take effect from the start of Budget Day. He wonders whether such an approach would not be clearer, simpler, and lead to less argument than "picking and choosing". He has asked, what is the case against it?

2. Mr Battishill is now considering this. Meanwhile, as you know, he suggested some amendments to the passage in the Financial Secretary's speech - which the Chancellor is content with - to leave the point open for now.

A W KUCZYS

1987 Budget Starter.

Check On

Compute + 637

Register ~~634~~. ~~635~~ 636

28

FROM: D N WALTERS
DATE: 27 MAY 1987

MR SHAW - IR
MS FRENCH - C&E
MR ROMANSKI

cc PS/Chancellor 12/2
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Mr Scholar
Miss Sinclair
Miss Evans
Mr Haigh

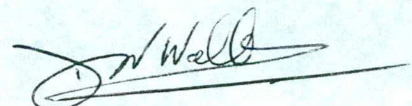
BUDGET STARTERS

I have been reviewing the operation of the last Budget Starters' exercise and considering whether any improvements could be introduced in the coming round. My main conclusion is that, while the last exercise was well directed in principle, in practice the volume of effort needed both here and in the Revenue Departments was unnecessarily onerous resulting in delays in submissions. In addition, the mechanics required large volumes of paper to be circulated which, in terms of use made, was probably not always cost effective.

2. Consequently, I have been considering a new more streamlined exercise and have produced the attached, hopefully self-explanatory, draft guidance which sets out my proposals for a revised arrangement. I would be grateful for any comments and/or suggestions. My guiding light has been the need to produce a helpful document for Ministers and senior management while keeping the mechanics simple.

3. Once arrangements have been agreed for the coming exercise I think we will need to consider whether we can reduce even further some of the more tedious aspects of the job. I am conscious that in the last exercise we had the summary sheets reproduced in our Word Processing Unit when the Revenue Departments already had much of the information in a very similar form. Might it be possible, for example, for Customs and Inland Revenue to send over, say on a Friday night after they have finished their own checking, a disc holding the updated material which could then simply be run off at this end? I think that there is certainly room for savings here which we could discuss.

4. In the interim, I look forward to your comments on the attached.



D N WALTERS

BUDGET STARTERS: GUIDANCE

FP division allocate a number to each Budget Starter. This number remains unique to it throughout the Budget exercise. All papers and submissions on that Starter must include the number in their title.

Monitoring

2. A full list of Starters with supporting reference sheets will be presented to Ministers in October. This year's Starter's folder is to be in three sections:

(a) an index

(b) summary sheets

(c) reference sheets

Monitoring of progress is to be effected through updates of the summary sheets with the aim of providing Ministers and senior management with position reports at not more than fortnightly intervals. To ensure that monitoring is effective **all** submissions and papers on individual Starters **must** be copied to, inter alia, [D N Walters] in FP division.

The index

3. The Starters are to be grouped and allocated a number according to the type of taxation involved. For example income tax related Starters will be allocated a number between 100 and 149 and excise duty related Starters will be allocated a number between 1 and 30. The index will simply point up the numbers allocated to each taxation group. Details of each Starter will then be available in either the summary sheets or the reference sheets.

Summary sheets

4. These are to provide the main instrument for recording the current state of play. Information on what is to be included in each column is provided in the attached annex. Revised sheets will be circulated to Ministers and senior management on a regular basis.

The reference sheet

5. The purpose of this return is to provide a useful aide-memoire of the coverage of each of the Starters. The aim is to reduce to a minimum the need to reissue these sheets as

discussion of the Starter progresses. Consequently, entries should be worded wherever possible so as to preclude updating unless the scope of the Starter is amended. This is particularly important in the "description" and "miscellaneous comments" sections.

6. The description should explain the purpose and effect of the item in sufficient detail for it to be understood without supporting background material. An indication should be given as to whether or not the item is likely to be controversial. Where the cost (recorded on the summary sheets and not here) has already been taken into account in the forecast etc this should be stated.

7. The entry under the "classification" heading should show one of the following categories:

A - Budgetary proposals

B1 - Ministerial commitment to action

B2 - Ministerial commitment to consider

C - others

Use of the category C does not indicate a less important status for the Starter ie a completely new proposal without any Ministerial commitment should not be classifed other than "C" simply to denote a relative position to other Starters.

8. When reference sheets are submitted to FP, it would be helpful if the appropriate tax category (see the index) could be indicated.

Enquiries

9. Any question on the completion of the proformas should be directed as appropriate to Central Division in Inland Revenue, DPU in Customs and Excise or FP Division in the Treasury.

HM Treasury

BUDGET STARTERS: SUMMARY SHEET GUIDANCE

The Summary sheets are the main instrument for providing an update on the current position. The columns show the following information.

1. No. : The Starter number allocated by FP division.

2. Description : The title or a short identification of the Starter.

3. Status : The latest state of play as recorded by one of the following categories:

   I - definitely included
   I* - provisionally included
   D - definitely dropped
   D* - provisionally dropped
   UCM - under consideration (at least one submission received by Ministers)
   NSM - a first submission still to go to Ministers

4/5 Revenue £m : Estimate of cost(-) or yield(+) in the next two financial years. (The entry does not include a £ sign nor an "m" for millions.) Figures are only included for estimates of £5 million or over. For smaller figures either "neg" or "nil" is used. N/K denotes that an estimate is not yet possible. It is accepted for columns 4 to 8 that the figures are generally subject to margins of estimating error and for uncertainty. Only if these are significant is a qualifying note inserted in the comments column.

6/7 Staff effect : Estimate of staff effect compared to agreed provision. Figures are only included for estimates of 5 or over. For smaller figures either "neg" or "nil" is used. N/K denotes that an estimate is not yet possible.

8/9 Legislation : Column 8 provides the best current estimate of the length of legislation in terms of pages, lines and, as appropriate, schedules. N/K is used where it is not yet possible to make an estimate. Column 9 indicates instructions have been sent to Counsel. The entry shows either "Yes", "No" or "Yes(P) the latter denoting instructions sent on a provisional basis.

10 Other comments : Other points of significance or clarification of one of the other entries.

BUDGET STARTERS: INDEX

The following provides an indication of the taxation groups covered by the various starters. Details of the individual starters within the groups can be found in the summary and reference sheets.

Customs: Numbers 1-99

1-29	Excise duties
30-59	VAT
60-99	Other

Inland Revenue: Numbers 100-599

100-149	Income tax
150-199	Savings and Investment
200-249	Business taxation
250-299	Capital taxes
300-349	Stamp duty
350-399	Oil taxation
400-449	International taxation
450-499	Miscellaneous
500-599	[Spare]

Transport: Numbers 600-649

Treasury: Numbers 650-699

BUDGET STARTERS: SUMMARY SHEETS

Date

1	2	3	4	5	6	7	8	9	10
			Revenue £m		Staff Effect		Legislation		
No	Description	Status	cost(-) 1988/89	Yield(+) 1989/90	1/4/89	1/4/90	Length	Inst^{ns} to Counsel	Other Comments
599		UCM	+1000	+1000	+100	-100	2 Schedules	Yes (P)	

2-FORMc

Date of issue

BUDGET STARTER: REFERENCE SHEET

TITLE:

STARTER NUMBER: **CLASSIFICATION:**

DESCRIPTION

ORIGIN OF STARTER:

PCTA OR EQUIVALENT RESOLUTION REQUIRED:

MINISTER IN LEAD:

OFFICIAL IN LEAD: **TELEPHONE:**

OFFICIAL IN SUPPORT: **TELEPHONE:**

FP CONTACT: **TELEPHONE:**

MISCELLANEOUS COMMENTS:

3361/41

28

FROM: N WILLIAMS
DATE: 28 May 1987

MR D WALTERS

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Scholar
Miss Sinclair
Miss Evans
Mr Haigh
Mr Romanski
Mr Shaw IR
Ms French C&E

BUDGET STARTERS

1. Your minute of 27 May refers.

2. This office would welcome revisions of the kind you suggest. A combination of a basic reference sheet which would not need constant updating as the Starters exercise progresses, together with summary sheets, providing an 'at a glance' situation report on each Starter, would give the sort of information that this office would certainly find most useful.

3. We would therefore be quite content for revised arrangements of the sort you propose to be introduced in the coming round.

N Williams

NIGEL WILLIAMS
(Assistant Private Secretary)

Inland Revenue

Policy Division
Somerset House

FROM D Y PITTS

DATE 16 JUNE 1987

PS/ECONOMIC SECRETARY

OIL TAXATION

I understand that the Chancellor has asked the Economic Secretary to take responsibility for the direct taxation of oil exploration and extraction activities in the United Kingdom and on the United Kingdom Continental Shelf. We have two or three matters to put to him for decision in the next week or so. The purpose of the present note is to attach a summary of the special fiscal regime which applies, in case he would find this helpful as background reading.

D Y PITTS

c Mr Painter (without
Miss Hill attach-
Mrs Hubbard ment)

Mr Pitts

TAXATION OF UK OIL PRODUCTION

1. This note outlines the tax and royalty provisions applying to oil and gas fields in the UK, its territorial waters and designated areas of its Continental Shelf. Government revenues are made up of:

(a) Royalty at 12.5% of the landed value of the oil less, for oil production under licences allocated in the 1st to 4th offshore licensing rounds, the cost of conveying oil ashore and treating it. (There is no such deduction for 5th and subsequent rounds.) No royalty is payable for offshore fields outside the Southern Basin which received development approval on or after 1 April 1982. Special royalty rules apply to onshore fields.

(b) Petroleum Revenue Tax (PRT) at 75% of profits less various reliefs detailed at paragraphs 13-15 below.

(c) Corporation Tax (CT) on net revenues after deduction of royalty, PRT and expenses computed according to normal CT rules: a "ring fence" prevents this revenue from being eroded by losses and allowances from trades other than UK oil production (see paragraphs 22-23 below). The rate of CT is 35%.

2. Royalty is administered by the Department of Energy, except in Northern Ireland where there is a separate royalty regime administered by the Northern Ireland Department of Commerce. PRT and CT are administered by the Inland Revenue.

PETROLEUM REVENUE TAX

3. PRT is a special tax with special rules which reflect the circumstances of the oil industry. It is contained in Part I of the Oil Taxation Act 1975 (as amended).

Scope of the tax

4. PRT is charged on the profits from winning oil and gas under licence in the UK and on the UK Continental Shelf. Under the provisions of the Oil Taxation Act 1983 it is also charged on tariff receipts (less an allowance) for the use of shared assets, and on disposal receipts. Gas sold to the British Gas Corporation under certain contracts made not later than 30 June 1975 is exempt. (These were long-term contracts at prices which took no account of any possible PRT liability.)

The basic structure

5. In order to secure a reasonably early flow of tax to the Exchequer, PRT is charged on each oil field separately. This means that in general a company cannot defer paying tax on the profits of one field by off-setting against those profits the development costs of another field. The main

exception to this is that immediate PRT relief is given for offshore exploration and appraisal expenditure. In addition, there are provisions for offsetting losses on abandoned fields (see paragraph 10 below), and, following Finance Act 1987, for up to 10% of the cost of developing certain new fields to be set against PRT liabilities in existing fields.

6. PRT is charged on the profits before corporation tax and is deducted in computing profits for corporation tax. PRT is charged for chargeable periods of 6 months, running from January to June and from July to December each year. The pattern of payments is described in paragraphs 16-19 below.

How PRT is calculated

7. PRT is charged on the receipts from sales of the oil less the expenses incurred in finding, extracting, bringing it ashore and putting it in a saleable state; and on tariff and disposal receipts. Expenses are subject to claim and scrutiny before being allowed for PRT purposes. Once allowed, they are deductible immediately and in full, although there are special provisions for spreading the relief given for expenditure on which "uplift" (see paragraph 13 below) is allowed.

8. Subject to the operation of the "nomination scheme" introduced by Section 61 of the Finance Act 1987, oil which is sold in an "arm's length" transaction is subject to PRT on the actual price received. But some of the oil and gas produced is not sold in this way; instead it is refined or used for other purposes by the producing company or an associated company. In these cases the oil is to be valued for the purposes of PRT at market value (the rules for determining market value were likewise updated and amended in the 1987 Finance Act). The difference between opening and closing stocks (valued at half their market value) is brought into the calculation.

9. The expenses allowable against PRT are as follows:

(a) Licence royalties;

(b) Capital expenditure on the field, plus an "uplift" of 35% on certain expenditure (see paragraph 13 below);

(c) Operating costs for the field (but not interest payments).

10. In addition, exploration and appraisal expenditure on offshore fields without development consent, abortive exploration expenditure or a loss on an abandoned field incurred elsewhere in the North Sea by the same participator may be deducted in calculating the PRT profit of developed fields. Also, in Finance Act 1987, a cross field allowance was introduced to allow up to ten per cent of the cost of developing certain new offshore field to be deducted in

calculating the PRT profit of other developed fields. Since 1983, these cross field reliefs have not been allowed for past expenditures against purchased interests in mature fields.

11. If, after deducting any loss carried forward or backward from another period, the PRT calculation shows a net profit, an oil allowance representing up to 1/4 million tonnes is given for the chargeable period (see paragraph 14 below). This allowance is doubled for offshore fields outside the Southern Basin approved after 1 April 1982.

Special PRT reliefs

12. The provisions set out below are available to all fields to exempt some of their revenue from PRT. However, oil allowance and safeguard are of proportionately greater benefit to small and relatively less profitable fields.

13. First, an "uplift" of 35% is allowed on qualifying expenditure (broadly, initial exploration and development expenditures) up to the "pay-back" period for each field: that is, the period in which cumulative field income first exceeds cumulative allowable expenditure (including uplift), royalty, supplementary petroleum duty (now obsolete) and advance PRT (see paragraph 19 below). The uplift is intended to compensate for the fact that interest and other costs of financing are not deductible for PRT purposes.

14. Second, there is an oil allowance of 1/4 million tonnes of oil per chargeable period per field which is free of PRT, subject to a cumulative total of 5 million tonnes per field - see paragraph 11 above. That is to say, in each chargeable period of 6 months, an allowance in money terms equivalent to 1/4 million tonnes is available to reduce the PRT profit after account has been taken of all other deductions. If for any chargeable period the allowance cannot be utilised (eg because expenditure reliefs exceed total profits), it cannot be carried forward (or backward). The oil allowance is doubled for offshore fields outside the Southern Basin approved on or after 1 April 1982 (ie 1/2 million tonnes per chargeable period, up to a cumulative limit of 10 million tonnes per field).

15. Third, there is a safeguard provision which gives automatic protection for the periods up to "payback" (see paragraph 13 above) and for half as many periods again. In any of these periods, if the PRT charge would otherwise reduce the return on a field before corporation tax to less than 15% of cumulative "upliftable" expenditure measured on the basis of historic cost, the charge is to be cancelled. A tapering provision ensures that the PRT charge will not be more than 80% of the amount (if any) by which the return exceeds 15% of the capital expenditure to date.

HOW PRT IS PAID

Instalment payments

16. Since the end of 1983 the bulk of PRT (and advance PRT) has been collected in 6 equal monthly instalments (based on 75% of the previous chargeable period's liability), starting 2 months after the beginning of the period. The instalments are credited against the payment on account due 2 months after the end of the period.

Payments on account

17. A payment on account is due at the time of the submission of each chargeable period's return, 2 months after the end of the period (ie on 1 September and 1 March). This payment on account is based on the gross revenues, valuations and royalties shown in the return, expenditure incurred and claimed (with appropriate "uplift" - see paragraph 13 above) - whether or not so far allowed, allowances (such as oil allowance and safeguard) and losses.

Assessments

18. PRT assessments are normally issued by 31 May and 30 November each year, and payment is then due within 6 months after the end of the relevant chargeable period. At that stage, the difference between the amount of the payment on account and the assessed PRT is paid to or repaid by the Inland Revenue (with interest - see paragraph 20 below) as appropriate.

Advance Petroleum Revenue Tax (APRT)

19. Between 1983 and 1986 advance payments of PRT were required in the early periods of an oil field's production, even though there may not yet have been any PRT to pay on that field. APRT was originally charged at 20%, but the rate was reduced gradually, and by 1986 was only 5% on gross profit, less an oil allowance of 1/2 million tonnes per period. APRT is allowable as a deduction in computing "payback" (see paragraph 13 above). Payments of APRT may be set off against any current PRT liability or may be carried forward without limit for set-off against subsequent PRT liabilities; within 5 years of the first payment for that field become repayable at that point.

The last payment of APRT was for the chargeable period ending December 1986. But in the case of many fields the PRT liability up to then had not been sufficient to absorb all the APRT paid. The APRT Act 1986 provided for the immediate repayment of this unused APRT, up to a limit of £m15 per participator per field, for all fields which had not reached payback by July 1986.

Interest

20. Interest on overdue instalments is payable from the date on which payment was due. Interest on overdue PRT or APRT not payable by instalments is payable from 2 months after the end of the relevant chargeable period, as is interest due to the taxpayer on tax overpaid. Interest paid or received is not deductible or chargeable for PRT or corporation tax purposes. The interest rate is variable by Treasury Order and is currently 8.25% per year.

Discretionary Royalty Relief

21. Apart from the tax reliefs already mentioned there is a discretionary provision in the Petroleum and Submarine Pipelines Act 1975 under which the Secretary of State for Energy is empowered with the consent of the Treasury, to refund royalties in whole or part in order to provide an incentive for a licensee to develop or continue production from a field which would not otherwise satisfy normal commercial criteria. Although royalties are allowed as a deduction against PRT and corporation tax, refunds do not give rise to any extra liability to PRT or corporation tax.

CORPORATION TAX

The ring fence

22. Under the normal rules for corporation tax (CT) there were a number of ways in which the Government's CT take from UK oil companies could have been eroded. The most important example was that companies could have set off against North Sea income losses and capital allowances from other activities carried on either by the same company or by an associated company in the same group.

23. The effect of the "ring fence" erected by Part II of the Oil Taxation Act 1975 is to prevent the CT yield from the North Sea from being reduced by this and other means. Losses, allowances and deductions for interest attributable to other activities cannot be set against profits from UK oil and gas production, nor can advance corporation tax (ACT) on dividends paid to associated companies be set off against mainstream CT liability on those profits. The "ring fence" does not however prevent North Sea losses or allowances being set against profits from other activities.

24. Apart from these "ring fence" restrictions, the normal CT rules apply. CT is charged on a company basis, not a field basis. PRT is deductible in calculating the profits liable to CT. Capital allowances are available: in particular, most oil exploration expenditure qualifies for the 100% scientific research allowance; development expenditure usually qualifies for plant and machinery allowances; and the acquisition of licence interests will qualify for the 10% allowance under the new Mines and Oil

Wells Allowances code.

EFFECTIVE MARGINAL RATE OF TAX

25. The effective marginal rate of tax is currently 85.8% for fields which pay royalty and 83.75% for fields which do not (see paragraph 1(a) above).

INLAND REVENUE
POLICY DIVISION 7
16 June 1987

Inland Revenue

Policy Division
Somerset House

FROM: MRS C B HUBBARD
DATE: 22 JUNE 1987

1. MR PITTS I have added a note at the end. 23/6

2. ECONOMIC SECRETARY

PRT: SAFEGUARD AND DEFERRED EXPENDITURE CLAIMS

Tony Have you seen this? – I haven't.

1. Mr Pitts' note of 16 June sent you some background reading on the North Sea Fiscal Regime, which describes the main rules and reliefs in the taxation of UK oil production income.

2. This note is about a defect in the Petroleum Revenue Tax (PRT) expenditure rules which we think requires legislation to put right. I described it briefly at your meeting on 17 June. It concerns the deferment by companies of claims for expenditure so that relief is not "wasted" by being given in an assessment for the chargeable period in which the expenditure is incurred, when PRT payable for that period is in any case cancelled by "safeguard" relief (para 6 below). In short, in such a "safeguard" period, claiming relief for expenditure incurred in that period in time for it to be allowed in the corresponding assessment does not actually reduce PRT payable because the effect of "safeguard" is to cancel any PRT liability. If expenditure claims are deferred until later and thus moved to a chargeable period where

cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Mr Cassell
Mr Scholar
Mr Williams
Miss Sinclair
Ms Leahy
Mr Wilson
Mr Graham - Parliamentary Counsel
Mr Painter
Mr Pollard
Mr Beighton
Mr Pitts
Mr Elliss - OTO
Mr Cleave
Mr Beauchamp - OTO
Mrs Hubbard
Miss Hill
Mr Pang
Dr Parker
Mr Evans
PS/IR

the expenditure would actually reduce PRT liability, it is obviously advantageous for the companies to do so in such a situation. There is no rule to stop the companies doing this and we have discovered that some companies are now actually deferring expenditure claims for this reason. If left unchecked this could be costly for the Exchequer (para 12 below).

BACKGROUND

3. Under the existing PRT legislation, expenditure for which relief is claimed is taken into account in the next assessment or loss determination after the claim is allowed by the Oil Taxation Office (the "allowed basis") rather than as is the usual rule for other taxes, in the assessment for the period in which the expenditure is incurred (the "incurred basis"). These distinctive arrangements were the result of a quite deliberate decision when the original legislation (the Oil Taxation Act 1975) was brought in. The intention was to prevent delays in settling expenditure claims from affecting the flow of tax.

4. Expenditure may still be (and in practice most usually is) relieved in the assessment for the period in which it is incurred, but only if both the company gets its claim in in time and the Oil Taxation Office is able to settle it in time. Because claims can be large and complicated, it was not thought right to risk interrupting the tax flow while they are sorted out.

5. It also follows that there is nothing to stop a company deferring making a claim although a claim has to be made within 6 years of the end of the claim period in which the expenditure is incurred. But it will not usually be to its benefit to do so.

6. Safeguard is an overriding relief which limits the amount of PRT payable for chargeable periods up to payback and for half as many chargeable periods again. In any of these periods, if the PRT charge would otherwise reduce the return on a field before corporation tax to less than 15 per cent of cumulative upliftable expenditure measured on the basis of historic cost,

the charge is to be cancelled. A tapering provision ensures that the PRT charge will not be more than 80 per cent of the amount (if any) by which the return exceeds 15 per cent of the cumulative upliftable expenditure.

7. Safeguard is only applied where it is to a company's advantage. To decide that, the PRT (if any) due under the safeguard rules is compared with the PRT due under the normal rules. Under the latter, PRT is charged at a rate of 75 per cent on the "assessable profit" after taking account of allowed expenditure and any uplift which is both claimed and allowed.

8. In 1983 the industry made representations concerning the "allowed basis" for expenditure relief and - inter alia - interaction with the uplift and safeguard provisions. They sought legislative changes which broadly would have given expenditure relief in the first assessment made after the time when it is claimed irrespective of the time when it is allowed by the Revenue. In essence, they were looking to secure earlier and more predictable effective relief for expenditure claimed. Ministers rejected these proposals which would have represented a fundamental shift in the present arrangements for PRT expenditure relief in favour of the industry but at the expense of the Exchequer (because any tax repaid when an assessment was reopened to take account of subsequently allowed expenditure would be repaid with interest). Though the point discussed in this note was not a factor in that decision: if conceded it would still have left companies with the choice of deferring claims when to their advantage, or making claims in time for expenditure to be allowed, in effect, on an incurred basis (ie, the best of both worlds).

The Current Problem

9. The present issue also has to do with the question of when relief is given for expenditure, but in this case not because of the time taken by the Revenue to settle the claims, but because claims are not made by the companies at the "obvious" (but, as

explained, not obligatory) time, viz soon after the period in which the expenditure is incurred.

10. A simplified example is probably the best way of illustrating what is now happening in some fields. A field has cumulative upliftable expenditure already allowed of £600m. For the chargeable period ended 31 December 1986 its receipts from oil production are £80m and operating costs incurred in that period are £20m.

(a) Under the normal rules, PRT liability without the benefit of safeguard would be:

Receipts	£80m
Less expenditure incurred, claimed and allowed	£20m
Assessable profit	£60m
PRT at 75%	£45m

(b) If no relief for expenditure incurred in the period is claimed in time for it to be allowed in the assessment for that period, PRT liability would be:

Receipts	£80m
PRT @ 75%	£60m

(c) But where the period is one to which "safeguard" applies, there is no PRT liability on either basis. The calculation of safeguard relief on the (a) basis is:

(i) return on field calculated as

adjusted profit	£60m
cumulative upliftable expenditure	£600m
15% thereof	£90m

The return of £60m is less than 15% of cumulative upliftable expenditure (£90m) and the PRT charge is therefore cancelled;

and on the (b) basis is:

(ii) return on field (as adjusted profit in (b))

	£80m
cumulative upliftable expenditure	£600m
15% thereof	£90m

The return of £80m is still less than 15% of the cumulative upliftable expenditure (£90m) and the PRT charge is also cancelled.

There is thus no actual benefit derived in (c) (i) from claiming the expenditure incurred in that period of £20m in time for it to be allowed in the assessment for that period. Nor of course is there any benefit in not claiming it at all. But it is advantageous to delay claiming if thereby it gets allowed not in the assessment for the safeguard period in which the expenditure was incurred, but in some later period where it can be used to actually reduce PRT payable. The later period may be a safeguard period where PRT is payable subject to the 80% taper, or a period where the safeguard limitation no longer applies. There is nothing in the present rules to prevent a company deferring its claims in the hope of achieving this result. If (but see 12 below) assessments are made for each chargeable period (ie six monthly) at the normal time, it can rely on achieving its objective.

Is this offensive?

11. The safeguard provision was an overriding relief intended to ensure that PRT would not reduce a participator's return on capital in any chargeable period below 15% (Since 1981, the duration of safeguard relief has been limited to the number of chargeable periods up to payback and half as many again.) However, it was intended to operate as a longstop after all other available reliefs and allowances had been utilised (ie safeguard was not intended to replace other reliefs which could then be used at a later date). This view is to some extent supported by a rule (S.9(4) OTA 75) in the safeguard provisions relating to elections to have expenditure spread over a number of periods instead of being wholly relieved in the next assessment made after the expenditure is allowed. It was intended to prevent more safeguard relief being obtained by moving expenditure relief by way of a spreading election from a period to which the safeguard reduction applies. (There is also a

provision (paragraph 11 of Schedule 3 OTA 1975) which counters any benefit derived from deferring expenditure claims in order to advance the availability of the oil allowances). The companies are thus exploiting a defect in the safeguard provisions which if unchecked could cost the Exchequer up to £m35.

The Revenue response

12. The matter is of current importance because we have now been made aware that certain expenditure claims have been deferred for the second half of 1986 in (three fields) because of this safeguard quirk. For the time being we believe that there is an effective administrative counter to this. In the normal course of events we would have raised assessments for the chargeable period ending 31 December 1986 in these fields at the end of May 1987 - doing this however simply ensures that the companies' aim (ie to get the expenditure allowed in a later chargeable period) is achieved. We have therefore delayed making assessments for this chargeable period in the fields concerned. There is no immediate tax effect since, because of safeguard relief, the assessments would have shown no PRT liability for the chargeable period to 31 December 1986. The courts have confirmed (in a different context) that the Revenue has a choice as to the timing of assessments. The effect of delaying making the assessment is that we can - when subsequent expenditure claims are eventually made - then raise it at a time when we can bring the expenditure incurred in the second half of 1986 (or an equivalent amount) into the assessment for that period.

13. However, two companies have expressed concern at this approach. First, they argued that there was a case for taking no action at all. The current situation had arisen because of last year's sharp fall in the oil price and "safeguard" had been introduced to protect a company's rate of return on capital in just such a situation. However, we do not find this argument convincing; "safeguard" has in fact done its job by cancelling any PRT due in the period and the companies are in fact seeking to obtain a "double" benefit by moving the expenditure to a later

period. Second, they claimed that delaying assessments would create problems because of the interaction with other parts of the PRT code. For example, one field has paid substantial Advance Petroleum Revenue Tax (APRT) which is due for repayment after 1 March 1988 and it would be difficult to quantify the amount of this repayment if assessments have not been brought up to date by that time. This is because the amount repayable is calculated after taking account of any PRT payable in assessments made. We agree that delaying assessments indefinitely would cause problems and our current action should therefore be seen as a stop-gap pending legislation. One company also argued, in discussion, that any action which denied them the benefit of effective expenditure relief in safeguard will give an inducement to defer certain expenditure in such a period to a later one in which the expenditure can be relieved effectively. However, this possible knock-on effect has to be weighed against the possible tax loss of £m35 (para 11) of doing nothing.

Is it necessary to legislate?

14. Quite apart from the possible APRT problem if assessments are simply deferred, the companies have made it clear that if we believe that claims for expenditure incurred in this sort of case cannot be deferred, then the legislation should be changed to make this crystal clear. We also feel that the need for legislation is strengthened by our lawyers' advice that the administrative action of deferring assessments could be open to risk of judicial review, but we are proceeding in a manner which should hopefully minimise the risk of judicial review being sought. As an interim solution this risk is probably minimal but if there was to be no accompanying legislative change, two companies have already indicated that they would seek legal opinion about the possibility of challenge. This adds to the argument for regarding the delaying of assessments as a temporary measure only. Its efficacy also rests on our ability to spot the relevant cases before assessments are made and this could not be guaranteed.

The legislation

15. A possible legislative approach would be to say that where, after an assessment is made for a chargeable period in which PRT is reduced or eliminated by safeguard, a claim is made for expenditure incurred in the claim period which ends at the end of that chargeable period, then that expenditure is to be treated (when allowed or established on appeal as allowable) as having been claimed and allowed immediately before the raising of the assessment. To obviate the need for insignificant adjustments it may be appropriate to have a de minimis exception for expenditure which was less than 5 per cent of the expenditure incurred in the relevant period actually claimed and allowed before the making of the assessment.

Timing of Legislation

16. We believe that we can contain the situation for the time being by delaying assessments (para 12). Legislation in the immediate post-election Bill is not therefore essential but we think it is highly desirable in the 1988 Finance Bill. As it is not yet drafted, it would certainly not be possible, in any event, to introduce legislation in the post-election Bill as published, and the timetable for a new clause at Committee might be rather tight, given the amount of more pressing demands on Parliamentary Counsel's time.

Conclusion

17. We should be glad to know whether you:

a. endorse our approach of delaying assessments for the time being (para 12)

b. agree that the defect in the safeguard provisions should be blocked by legislation and

c. agree that legislation should be deferred until FB 1988 and

If you endorse these conclusions, the companies, in order to end uncertainty over the matter, would like a formal announcement of the intention to legislate in FB 1988 to be made as soon as possible. It affects their accounts and - with the amounts at stake - their financial planning and company decisions. We think this would be a sensible course to take and if you agree shall let you have a possible PQ and Answer.

18. We are of course at your disposal if you wish to discuss this rather complex issue.

CH

MRS C B HUBBARD

Having deliberately gone for the "allowed" basis for giving relief for PRT for expenditure, the Government would be open to the charge of both wanting its cake and eating it if we now deny companies that basis - as is proposed - when it benefits them. But it is proposed to do so only when it interacts with the special safeguard relief. The answer to the charge is that for companies to get this particular benefit is contrary to the rationale of the safeguard relief.

But they see themselves as following, rather than exploiting, the present rule and would like to know quickly if you intend to introduce legislation to change it. [initials] 23/6.

CONFIDENTIAL

FROM: P D P BARNES
DATE: 30 June 1987

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Cassell
Mr Scholar
Mr Williams
Miss Sinclair
Ms Leahy
Mr Wilson
Mr Graham - Parly Counsel

Mr Painter - IR
Mr Pitts - IR
Miss Hill - IR
PS/IR

PRT : SAFEGUARD AND DEFERRED EXPENDITURE CLAIMS

Mrs Hubbard's submission of 22 June (below) recommended that the Government should announce its intention to legislate to prevent companies using the safeguard provision to gain an unintended relief by deferring expenditure claims.

2. The sum involved is not great - the Inalnd Revenue estimate "up to £35 million" in aggregate - and this would fall into the hands of operators of fields which are currently the least profitable. Nonetheless, the Economic Secretary's advice is that we should announce our intention to close this loophole in the 1988 Finance Bill, and that, until then, the Revenue should continue their current practice of delaying assessments. The Economic Secretary thinks that this announcement should be made after the Report stage of this summer's Finance Bill, so as to avoid it becoming entangled with, and aggravating grievances over, the issue of CGT rollover relief.

PB

P D P BARNES
Private Secretary

3756/050

CONFIDENTIAL

FROM: P D P BARNES
DATE: 30 June 1987

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Cassell
Mr Scholar
Mr Williams
Miss Sinclair
Ms Leahy
Mr Wilson
Mr Graham - Parly Counsel

Mr Painter - IR
Mr Pitts - IR
Miss Hill - IR
PS/IR

PRT : SAFEGUARD AND DEFERRED EXPENDITURE CLAIMS

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PB

P D P BARNES
Private Secretary

C10/38

CONFIDENTIAL

FROM: A W KUCZYS
DATE: 10 JULY 1987

PS/ECONOMIC SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Mr Cassell
Mr Scholar
Mr Williams
Miss Sinclair
Ms Leahy
Mr Wilson
Mr Graham - Parly Counsel

Mr Painter - IR
Mr Pitts - IR
Miss Hill - IR
PS/IR

PRT: SAFEGUARD AND DEFERRED EXPENDITURE CLAIMS

The Chancellor has seen your minute of 30 June. He has raised no objection to the Economic Secretary's suggestion.

A W KUCZYS

3758/054

FROM: P D P BARNES
DATE: 14 July 1987

MRS HUBBARD - IR

cc PS/Chancellor
Mr Cassell
Mr Scholar
Mr Culpin
Mr Williams
Miss Sinclair

Mr Pitts - IR
PS/IR

PRT : SAFEGUARD AND DEFERRED EXPENDITURE CLAIMS

Mr Kuczys's minute of 10 July records that the Chancellor has raised no objection to the Economic Secretary's suggestion that we should announce our intention to legislate to prevent companies gaining unintended relief by deferring expenditure claims.

2. The Economic Secretary would be grateful if you could prepare a suitable press release for after the Report Stage of the Finance Bill. The Economic Secretary will, however, wish to reconsider any retrospective element in the proposed change before going ahead.

PB

P D P BARNES
Private Secretary

Inland Revenue

Policy Division
Somerset House

RP

FROM: MRS C B HUBBARD

DATE: 14 JULY 1987

1. MR PITTS seen in draft

2. MR PAINTER 14.7

3. ECONOMIC SECRETARY

PRT: SAFEGUARD AND DEFERRED EXPENDITURE CLAIMS

1. The Chancellor has agreed (Mr Kuczys's minute of 10 July) to your suggestion that the Government should announce, after Report Stage of the Summer Finance Bill, its intention to close the safeguard loophole in the 1988 Finance Bill. Until then, the Revenue should continue its practice of delaying assessments to protect the position.

2. I attach a draft Parliamentary Question and Answer, and a draft Press Release for your approval. The PQ could be tabled for answer next week once Report Stage is out of the way.

MRS C B HUBBARD

---

cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Mr Cassell
Mr Scholar
Mr Williams
Miss Sinclair
Ms Leahy
Mr Wilson
Mr Graham - Parliamentary Counsel
Mr Painter
Mr Pollard
Mr Beighton
Mr Pitts
Mr Elliss - OTO
Mr Cleave
Mr Beauchamp - OTO
Mrs Hubbard
Miss Hill
Ms MacFarlane
Dr Parker
Mr Evans
PS/IR

DRAFT PQ AND ANSWER

Q. Mr .... asked the Chancellor of the Exchequer if he is satisfied with the operation of the rules for the claiming and allowance of PRT relief for field expenditure incurred by oil companies before the end of a chargeable period where the special safeguard relief provision applies to reduce or cancel PRT payable.

A. No. Where the special safeguard relief reduces or cancels PRT liability calculated for a chargeable period under the normal rules, it can be advantageous for a company not to claim relief for field expenditure incurred before the end of such a period in time for it to be allowed in the assessment for that period. The expenditure is then available to be claimed against PRT liability for a later chargeable period. The safeguard relief is a special overriding relief designed to ensure that PRT - calculated after taking account of all other available reliefs and allowances - does not reduce a participator's return on capital in any chargeable period (up to a prescribed time limit) below 15 per cent. It was not intended that further benefit should be obtained by deferring field expenditure claims so that expenditure incurred before the end of a chargeable period where PRT is reduced or cancelled by safeguard is claimed and allowed against profits of a later chargeable period. The Government therefore propose to bring forward legislation in next year's Finance Bill which, broadly, will ensure that, where a claim for field expenditure, which was incurred before the end of a chargeable period where PRT is reduced or cancelled by safeguard, is delayed until after the making of an assessment for that chargeable period, the relief available for the expenditure will be cancelled or restricted as appropriate. The new rules will apply with respect to assessments made after today.

DRAFT PRESS RELEASE

PRT: SAFEGUARD AND DEFERRED EXPENDITURE CLAIMS

In reply to a Parliamentary Question today, asked whether he was satisfied with the operation of the rules for the claiming and allowance of PRT relief for field expenditure incurred by oil companies before the end of a chargeable period where the special safeguard relief provision applies to reduce or cancel PRT payable, the Economic Secretary Mr Peter Lilley gave the following written answer:

"No. Where the special safeguard relief reduces or cancels PRT liability calculated for a chargeable period under the normal rules, it can be advantageous for a company not to claim relief for field expenditure incurred before the end of such a period in time for it to be allowed in the assessment for that period. The expenditure is then available to be claimed against PRT liability for a later chargeable period. The safeguard relief is a special overriding relief designed to ensure that PRT - calculated after taking account of all other available reliefs and allowances - does not reduce a participator's return on capital in any chargeable period (up to a prescribed time limit) below 15 per cent. It was not intended that further benefit should be obtained by deferring field expenditure claims so that expenditure incurred before the end of a chargeable period where PRT is reduced or cancelled by safeguard is claimed and allowed against profits of a later chargeable period. The Government therefore propose to bring forward legislation in next year's Finance Bill which broadly will ensure that, where a claim for field expenditure, which was incurred before the end of a chargeable period where PRT is reduced or cancelled by safeguard, is delayed until after the making of an assessment for that chargeable period, the relief available for the expenditure will be cancelled or restricted as appropriate. The new rules will apply with respect to assessments made after today."

NOTE FOR EDITORS

Safeguard is an <u>overriding</u> relief which limits the amount of PRT payable for chargeable periods up to payback and for half as many chargeable periods again. In any of these periods, if the PRT charge would otherwise reduce the return on a field before corporation tax to less than 15 per cent of cumulative upliftable expenditure , the charge is to be cancelled. A tapering provision ensures that the PRT charge will not be more than 80 per cent of the amount (if any) by which the return exceeds 15 per cent of the cumulative upliftable expenditure.

Safeguard is only applied where it is to a company's

advantage. To decide that, the PRT (if any) due under the safeguard rules is compared with the PRT due under the normal rules. Under the latter, PRT is charged after taking account of expenditure (including uplift) which is both claimed and allowed. Where safeguard reduces or cancels PRT liability for a chargeable period it can be beneficial for companies not to claim relief for field expenditure incurred before the end of that period in time for it to be allowed in the assessment on the profits earned in that period, but to save it for a claim against PRT liability in a later period. This is contrary to the rationale of the safeguard relief and it is proposed to introduce legislation in next year's Finance Bill which will prevent any additional benefit accruing where PRT for a chargeable period is reduced or cancelled by safeguard, and a field expenditure claim is deferred to make the expenditure available for relief in a subsequent chargeable period.

3759/049

FROM: P D P BARNES
DATE: 22 July 1987

PS/CHANCELLOR

cc: Mr Cassell
Mr Scholar
Mr Culpin
Mr Williams
Miss Sinclair
Mr Pitts IR
Mrs Hubbard IR
Mr Evans IR
PS/IR

PRT: SAFEGUARD DEFERRED EXPENDITURE CLAIMS

Your minute of 10 July recorded that the Chancellor had no objection to the Economic Secretary's suggestion that we should announce after the Finance Bill our intention to legislate to prevent companies gaining unintended relief by deferring expenditure claims.

2. The Economic Secretary reconsidered this proposal in the light of the Finance Bill debates on retrospection. He concluded that it was intrinsically retrospective but could not be defended on the grounds used in the debates on Clauses 62 and 80 of re-establishing a previously accepted interpretation of the law.

3. The reason the proposed measure did not appear retrospective was because assessments of past income had been deferred by the Revenue. If legislation were introduced which applied to such delayed assessments, the Revenue's use of its administrative power to delay those assessments might be subject to judicial review. Revenue solicitors believe that leave for a hearing would almost inevitably be granted. And although the Revenue could mount a convincing defence of its use of such powers the aversion of judges to retrospection means that the Revenue could not be certain of winning.

4. The Economic Secretary therefore concluded that the retrospective element of the proposed change should be dropped. He proposes to suggest that the Oil Taxation Office now issue assessments to those companies that have deferred their expenditure claims.

5. The identified potential yield of up to £35 million from closing this loophole would have been entirely from the retrospective element - ie in respect of the delayed claims from second half 1986.

6. The subsequent rise in oil prices may have eliminated the scope for exploiting this loophole for the time being. The Economic Secretary has asked the Revenue to reassess whether there is any likelihood of the loophole being exploited in the future before deciding whether to go ahead and close it on a non-retrospective basis. There will probably be no need to announce our intentions in this respect before the Spring 1988 Finance Bill.

PB

P D P BARNES
PRIVATE SECRETARY

MR 2/57

CONFIDENTIAL

FROM: A W KUCZYS
DATE: 23 July 1987

PS/ECONOMIC SECRETARY

cc: Mr Cassell
Mr Scholar
Mr Culpin
Mr Williams
Miss Sinclair
Mr Pitts - IR
Mrs Hubbard - IR
Mr Evans - IR
PS/IR

PRT: SAFEGUARD DEFERRED EXPENDITURE CLAIMS

The Chancellor has seen your note of yesterday. He agrees with the Economic Secretary's decision.

A W KUCZYS

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM M A JOHNS

DATE 3 AUGUST 1987

ECONOMIC SECRETARY

PRT SAFEGUARD: DEFERRED EXPENDITURE CLAIMS

1. We have been considering the next steps following your decision (Mr Barnes' minute of 22 July to PS Chancellor), endorsed by the Chancellor (Mr Kuczys' minute of 23 July), not to legislate to prevent companies gaining unintended relief by deferring expenditure claims insofar as these claims relate to expenditure already incurred and to consider the position in relation to future expenditure for next year's Budget.

2. Following your decision, the Oil Taxation Office intend to make the assessments which were delayed from the end of May and I propose to write immediately to the companies concerned to tell them so. We will then examine the options for future legislation and our practice as regards the timing of assessments and we will send you a further submission shortly. This note is to outline the issues that will need to be considered in the review and to seek your approval on the line to take with the companies and the industry in the meantime.

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cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Mr Cassell
Mr Scholar
Mr Williams
Miss Sinclair
Mr Painter
Mr Pollard
Mr Beighton
Mr Johns
Mr Elliss
Mr Cleave
Mr Beauchamp
Mrs Hubbard
Mr Evans
PS/IR

3. As Mrs Hubbard explained in her note of 22 June (para 12), the Courts have confirmed that the Revenue has a choice as to the timing of assessments within the statutory 6 year time limit. We exercise this power to defer assessments in some circumstances where no retrospection arises and it could be costly if we were to cease to do so. In particular, the relevant Court case (Amoco (UK) Exploration Co v. CIR) arose because some companies were deferring claims for expenditure which, under normal timing, reduced the amount of oil allowance they would obtain early in field life. By deferring assessment of the receipts until claims for expenditure in the same period had been received we were able to achieve the original purpose of the legislation. The Courts validated this practice; there is no element of retrospection - the companies know and understand the position; and it is important that giving up the flexibility as respects expenditure in recent safeguard periods should not be done in a way which undermines our power to achieve the purpose of the legislation in oil allowance cases.

4. In safeguard cases, the objection of retrospection to deferring assessments would fall away once the companies were on warning for the future. We are advised it would not be an abuse of powers, vulnerable to judicial review, if we deferred future assessments where it was reasonable to do so provided the possibility had been made clear and companies had had a chance to make representations. If we did not use our powers in such cases we could be giving up tax which the intention of the legislation was to raise, and also weakening our ability to act in oil allowance cases: companies could argue we were discriminating unfairly between the two cases. We suggest, therefore, that it is important to make it clear to the companies and the industry that the decision not to defer assessments for past safeguard periods does not involve either a reversal of our practice of deferring assessments in oil allowance cases or giving up of the right to use our flexibility on timing in other contexts where claims for expenditure not yet incurred are involved.

5. But as Mrs Hubbard also explained in her note of 22 June (para 13) delaying assessments can only be a temporary and partial solution to the safeguard problem even as regards expenditure not yet incurred. Delay in assessments could in some circumstances produce undesirable delays in collecting tax (this does not arise in either the oil allowance cases or the present assessments because there is no tax due for the relevant period). And in some circumstances it could affect, arbitrarily, the amount of APRT refunds payable to the companies, (though this problem will disappear once all APRT repayments have been made).

6. Subject to further work, the options are likely to be between:

a. No legislation and maintaining a practice of deferring assessments in oil allowance cases but not in safeguard cases. This might be vulnerable in the Courts to allegations of inconsistency and would almost certainly need to be made explicit in a formal statement of practice.

b. No legislation and deferring assessments in both oil allowance and future safeguard cases. Again a statement would be needed and only a partial or temporary solution would be achieved in safeguard cases.

c. Legislation on the lines you considered earlier but applying to expenditure incurred after the date of an announcement.

7. To keep your options open until we have done more work it seems to us we must tell the companies that we are making assessments now because it has been decided not to counter their freedom of timing of claims on expenditure already incurred, but that the situation for the future is being reviewed. We suggest that the decision not to apply the change to past expenditure should be presented as one made in the light of current circumstances (eg the low oil price). As Mrs Hubbard explained at your meeting on 21 July, there have been occasions in the past (eg Section 113 of Finance Act 1984 which restricted exploration

and appraisal relief after a farmout) where the present Chancellor felt it necessary to introduce legislation to restrict relief for expenditure incurred but not claimed. The circumstances were very different but the problem is that the issue of retrospection can arise in so many circumstances, not all of which can be envisaged in advance. It may be wise not to limit your flexibility for the future more than is necessary.

8. So, if you are content, the line we would propose to take in writing to the companies is that the Revenue does have a choice over the timing of assessments, a choice fully upheld by the Courts. It was therefore proper for the Oil Taxation Office to delay the assessments. We referred the policy issue to Treasury Ministers who are still considering whether to amend the legislation for the future. They have, however, decided that in current circumstances any change should not affect expenditure which has already been incurred. The Board have therefore decided that it would not be appropriate to continue to delay the assessments in question. We will let them know the outcome of the review for the future as soon as possible. We would invite representations as to the possibility of legislation for the future or future practice to be taken into account in the review.

9. If we are to tell the companies directly affected that practice and legislation are under review, we ought also to inform other members of the industry. I suggest I should write to UKOITC and Brindex at the same time and invite representations by the end of September. The point is a very narrow one which only affects their members so there seems no need for wider publicity. Draft letters are attached.

10. So that companies know where they stand as regards claims for past expenditure to be taken into account in their payments on account on 1 September we need to write on these lines in the next day or two. They will also be anxious to know the rules affecting future expenditure and we would propose to report to you in the early Autumn as soon as we have their representations and can consider them. It is just possible that they will argue

that uncertainty will cause them to change their pattern of expenditure in a way contrary to the national interest. We do not think it all that likely but if they do advance such an argument we would consult the Department of Energy on their estimate of the risks and come back to you on the possibility of a further extension of the period during which they are guaranteed no delay in assessments.

11. I would be grateful for your confirmation that you are content with this approach. I am sorry that the companies' deadlines on claims means that an immediate decision is needed.

M. A. Johns

M A JOHNS

A Willingale Esq
UKOITC

PRT: EXPENDITURE CLAIMS DURING SAFEGUARD PERIODS

I am writing to inform you of a review we are making for Ministers of the legislation and practice relating to claims for expenditure during periods where the PRT safeguard provision (Section 9 Oil Taxation Act 1975) operates to reduce or cancel PRT payable .

As you know, the concept behind the safeguard is that PRT should be calculated on the normal basis but there is an override to reduce or eliminate that liability if profits fall below a certain level. It has come to our notice that some companies have been deferring claims for expenditure in periods where the safeguard will eliminate liability to PRT so that tax liabilities in later periods can be reduced in respect of the expenditure concerned.

Ministers have decided that in current circumstances it would not be appropriate to change the law to deal with what is, in effect, double relief as it affects expenditure already incurred, but have asked us to review the position as it affects future expenditure. As you will be aware, the Courts have decided that the Revenue also has a choice (within the statutory 6 year time limit) as to the time within which an assessment is to be made (Amoco (UK) Exploration Co v CIR (57TC p147-175)). In the light of Ministers' decision explained above, the Board have decided not to use this power to defer the timing of assessment for periods where

safeguard operates until after claims for expenditure have been received, in relation to expenditure already incurred. The position as regards both legislation and practice on the timing of assessments in such cases will, however, be reviewed for the future.

If there are any representations which your Association wish us to take into account in the review, I would be grateful if you could send them to me by the end of September 1987.

G Hearne Esq

Brindex

PRT: EXPENDITURE CLAIMS DURING SAFEGUARD PERIODS

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safeguard operates until after claims for expenditure have been received, in relation to expenditure already incurred. The position as regards both legislation and practice on the timing of assessments will, however, be reviewed for the future.

If there are any representations which your Committee wish us to take into account in the review, I would be grateful if you could send them to me by the end of September 1987.

3761/002

CONFIDENTIAL

FROM: G R WESTHEAD
DATE: 5 August 1987

MR JOHNS - IR

cc PS/Chancellor
PS/Financial Secretary
Mr Cassell
Mr Williams
Miss Sinclair

Mr Painter - IR
Mrs Hubbard - IR
Mr Evans - IR
PS/IR

PRT SAFEGUARD : DEFERRED EXPENDITURE CLAIMS

The Economic Secretary has seen and was grateful for your submission of 3 August.

2. The Minister is content with your proposals for a review. However, this is on the assumption that you have discovered there to be some likelihood of the loophole being exploited again in future - viz paragraph 6 of Mr Barnes's minute of 22 July. The Economic Secretary only sees the need for a review _if_ there is some evidence of possible future exploitation.

3. On a more detailed point, the Economic Secretary has asked that you make clear that the review is of companies' discretion on deferring expenditure claims.

Guy Westhead

GUY WESTHEAD
Assistant Private Secretary

CONFIDENTIAL

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

PPS p1

FROM M A JOHNS

DATE 6 AUGUST 1987

ECONOMIC SECRETARY

PRT SAFEGUARD: DEFERRED EXPENDITURE CLAIMS

In Mr Westhead's note of 5 August you say that you only see the need for a review if there is some evidence of possible future exploitation. I am afraid that it is difficult to get much firm evidence as the position depends critically on the oil price and the level of production period by period. While it looks as if only a few fields are likely to be affected with only a small loss of tax over the next few years I feel we need to do a fuller evaluation of the risks before I could advise Ministers whether it was safe to rule out change in relation to future expenditure. As it is the Summer leave period, this would take several weeks. Unfortunately, we have to write to the companies about past expenditure now for the reasons explained in paragraph 10 of my note of 3 August. If we tell the companies the position as regards past expenditure it will be difficult not to say either that you will review the position for the future or that you will not and that the policy you are adopting for past expenditure will also apply to future expenditure. So it seems to me the review has to be public knowledge, even if you feel the likelihood is that you will not be attracted to legislation.

---

cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Mr Cassell
Mr Scholar
Mr Williams
Miss Sinclair

Mr Painter
Mr Pollard
Mr Beighton
Mr Johns
Mr Elliss
Mr Cleave
Mr Beauchamp
Mrs Hubbard
Mr Evans
Mr G Parker
PS/IR

There is a further consideration that points in the same direction. Whether there is a risk of major abuse in future or not, we need in the Revenue to clarify our minds on the circumstances in which we should exercise the choice which the Courts have confirmed we have to defer assessments and those in which we should not. This clarification will be needed whether or not there is legislation (see the distinction between options a. and b.in paragraph 6 of my earlier note). Again the companies should be given the chance to make representations on the issue and we could be subject to criticism by the Courts or the PAC if we determined our practice in the absence of a full examination of the evidence and arguments.

Finally, you ask that the letters make clear that the review is of companies' discretion on deferring expenditure claims. The legislation you earlier had in mind would not remove or curtail companies' discretion but would cancel relief for expenditure on which claims were withheld and submitted later (see draft PQ and A attached to Mrs Hubbard's note of 14 July). A Revenue practice of deferring the timing of assessments under review would not even do that but would merely ensure that the relief was allowed against the profits for the period in which the expenditure is incurred rather than the period for which the companies hoped the claim would be effective. So I think the letter would need to be a little more general than the wording you suggest. Would it meet your point to amend the end of the first sentence of the third paragraph of the draft letters to UKOITC and Brindex as follows?

".... but have asked us to review the allowability of future expenditure incurred in a period where PRT is reduced or cancelled by safeguard, where claims are withheld and submitted after the normal date for making assessments for the period." We could amend the last sentence of that paragraph to say "As well as reviewing the legislation as described above, Revenue practice on the timing of assessments in such cases will also be reviewed for the future."

In the circumstances would you be prepared for me to write in these amended terms? Mr Evans is separately sending you a draft reply to Sir Archie Forster.

M. Scowfield
for M A JOHNS

3761/013

CONFIDENTIAL

PWP

FROM: G R WESTHEAD
DATE: 6 August 1987

MR JOHNS - IR

cc PS/Chancellor
PS/Financial Secretary
Mr Cassell
Mr Williams
Miss Sinclair

Mr Painter - IR
Mrs Hubbard - IR
Mr Evans - IR
PS/IR

PRT SAFEGUARD : DEFERRED EXPENDITURE CLAIMS

The Economic Secretary has seen and was grateful for your further note of 6 August explaining why it would not be practicable for the Inland Revenue to assess the likelihood of future exploitation of the PRT Safeguard loophole before writing to UKOITC etc announcing a review.

2. The Economic Secretary is content with your explanation and with the terms of your own intended letter to Mr Willingale at UKOITC, as amended by the revised paragraph on page 2 of your latest note. The Minister is also content with the draft letter provided for him to send to Sir Archibald Forster of ESSO. As we agreed, the Economic Secretary's letter to Sir Archibald will issue tomorrow morning at the same time as your own to Mr Willingale.

Guy Westhead

GUY WESTHEAD
Assistant Private Secretary

CE14

MCS 15/9

FROM: MISS C EVANS
DATE: 15 SEPTEMBER 1987

1. **MR SCHOLAR**

2. **MR ALLAN**

cc Miss Sinclair
Mrs Burnhams

BUDGET STARTERS

You asked about our timetable for meetings on minor starters. (Last year the Budget starters list went up on 24 October and the Chancellor's starters meeting was on 18 December.)

2. 18 December looks uncomfortably late - we would like to plan for an earlier meeting this year (although we cannot make it too early because junior Ministers need to do their sift). We plan to submit the starters list in the week beginning 19 October. I think we should defer a decision on the date of the meeting until we submit the list but I hope we can hold the meeting end November/early December. We will advise on this in our submission covering the list.

3. In the meantime, you might like provisionally to pencil in a meeting in the week beginning 26 October to enable Ministers to take a preliminary look at the list and eliminate any obvious non-runners.

CE

MISS C EVANS

1-10

Alex Are you content for me to cancel minor starters for 27 Oct & arrange one for end Nov as below? Julie 13/10

Julie Fine Alex

FROM: MRS T C BURNHAMS
DATE: 13 OCTOBER 1987

MR HEYWOOD
MR BARNES
MRS THORPE 13/2

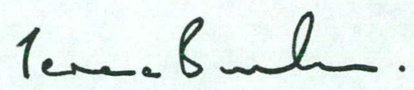
cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
Mr Scholar
Miss Sinclair
Miss Evans

MINOR BUDGET STARTERS

We now have details of starters for the 1988 Budget for the Revenue Departments and the Department of Transport and I intend to submit the first edition of the starters list to the Financial Secretary next week.

2. In view of the heavy workload which is anticipated for next year's Budget it would be helpful if the first reviews of the starters list were undertaken by the Financial Secretary and the Economic Secretary early in November this year - we suggest the week beginning 2 November. (The Paymaster General's Office have arranged a meeting to review the Customs' starters early in November.) This would then allow a reasonable interval before the Chancellor's initial meeting on minor starters which we suggest should be in the third week of November. (Miss Evans' note of 15 September suggested that you pencil in an initial sift by the Chancellor at the end of October but we do not think this will be needed.)

3. I would be grateful if you would make the necessary arrangements for these meetings. It would be helpful to give the Revenue early warning of all three meetings so that they can make sure that submissions reach you in good time.



MRS T C BURNHAMS

CONFIDENTIAL

From: SIR PETER MIDDLETON
Date: 14 October 1987

MINISTERS AND ADVISERS

cc Mr F E R Butler
Sir G Littler
Sir T Burns
Mr Scholar

BUDGET PURDAH

I have had a number of questions about arrangements in the period immediately ahead of the Budget. The Budget security instructions will be issued towards the end of the year in terms very similar to those which we used last year. Ministers might like to remind themselves of the sections dealing with contacts with the press. For forward planning purposes however I should be grateful if the following guidelines could be observed.

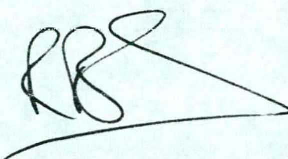
(a) Up to the end of the year, there are no restrictions. But we have started early this year on some sensitive issues and it is important that no hint should be given that will provide a basis for speculating about our intentions.

(b) From the beginning of January, increasing care should be taken in accepting invitations. Meetings where journalists and City scribblers are present should be avoided. But Ministers will still wish to undertake speaking engagements with non-budgetary themes. When attending informal gatherings where views on tax are likely to be put forward, it would be wise to have a Private Secretary present.

(c) From February onwards outside engagements should be accepted only on exceptional

occasions, cleared with me in advance. There is likely to be intense speculation ahead of this budget. And it is most important for Ministers, advisers and officials to be beyond suspicion.

2. For the benefit of new Ministers and advisers, I might add that the present procedures were established following a serious leak and subsequent police investigation. Since then the correct handling of privileged information has become an increasingly sensitive issue and the consequences of a leak are if anything more serious now.



pp P E MIDDLETON

2157/7

CONFIDENTIAL

FROM: J J HEYWOOD
DATE: 15 October 1987

MR ISAAC - IR

Our meetings
→ All Mins
→ Our Perm Sec (not essential)
→ Rev + Customs Ch'men (or Dep Chairman)
Must be after FST's meeting
16/10

cc: PPS
PS/Chief Secretary
PS/Paymaster General
PS/ Economic Secretary
Sir P Middleton
Mr Scholar
Miss Sinclair
Mrs Burnhams
Mr Painter - IR
Mr Beighton - IR
PS/IR
Mr Cropper

FINANCIAL SECRETARY'S MINOR BUDGET STARTERS

Last year we had a useful meeting in early December to review the "minor starters" on which the Financial Secretary is in the lead.

2. I think we should aim for a similar sort of meeting this year, perhaps in the week beginning 9 November. This would be slightly earlier in the Budget round than the corresponding meeting last year, but I think we all recognise that this year the main Budget proposals will take up a great deal more resources (and Finance Bill space). I am sure it would be useful for the Financial Secretary to have an early review of what else must be in the Bill and what other proposals are on the table.

3. If you agree with this, I would be grateful if you and Revenue colleagues could push through as many of the minor starters submissions as possible in the next 3 weeks.

J J HEYWOOD
Private Secretary

Inland Revenue

Policy Division
Somerset House

FROM: R B WILLIS
DATE: 20 OCTOBER 1987

pmp
JMOT said no longer required.
MGT 20/10.

CHANCELLOR OF THE EXCHEQUER

STAMP DUTY: £30,000 EXEMPT SLICE

You suggested as a Budget starter converting the existing stamp duty £30,000 threshold to a £30,000 exempt slice.

2. The cost of this would be around £m500 in 1988/89, and £m600 in 1989/90.

3. The arguments in favour of an exempt slice are mainly that it would reduce stamp duty for most homebuyers. There would (as now) be no duty on houses up to £30,000. Anyone paying more than £30,000 would see their bill reduced by £300. Eg someone buying at about the national average price would pay £100 instead of £400.

4. The main arguments against an exempt slice are:

(a) the revenue cost - getting on for twice the cost of increasing the threshold to £40,000;

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cc Financial Secretary
Sir P Middleton
Mr Scholar
Miss Evans

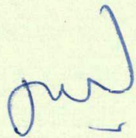
Mr Isaac
Mr Corlett (o/r)
Mr Beighton
Mr Gonzalez
PS/IR
Mr Willis

(b) it leaves buyers at and below the average price of a house still paying some stamp duty and thus still with a cause to complain;

(c) there is no staff saving to offset the pressures of extra work from increasing home prices on our running costs;

(d) there is no economic case for reducing stamp duty when, as seems likely, the saving feeds into higher house prices.

5. We will be letting you have a submission on stamp duty on property generally, and could keep alive in that the option of an exempt slice, together with other possible options ie no change, increasing the threshold and reducing the rate. But you may feel the revenue cost above argues against it as a front runner.



R B WILLIS

Inland Revenue

Policy Division
Somerset House

FROM: C STEWART

DATE: 20 OCTOBER 1987

1. MR ISAAC

2. FINANCIAL SECRETARY

TAX APPEALS AND OTHER PROCEEDINGS:
PLACE OF HEARING BY GENERAL COMMISSIONERS (BUDGET STARTER 451)

1. We minuted you last December about a possible Budget Starter for 1987 to resolve practical problems over the arrangements for hearings of appeal proceedings by General Commissioners in certain cases following a reorganisation of the local tax office network (Mr Corlett's minute of 3 December). You decided that this should be held over for 1987 but that it should be looked at again this year with a view to a possible publication of a consultative document this Autumn leading to legislation in 1988 (Mr Williams' note of 8 December).

2. This minute proposes that we should now issue a document.

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cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Dyer
Mr Jenkins (Parliamentary Counsel)
Mr Culpin

Mr Isaac
Mr Corlett
Mr Beighton
Mr Calder
Mr Hinson
Mr Pattison
Mr Yard
Mr Glassberg
Mr Stewart
Mr Scott
Mr Reeves
Mr Tharby
Mr Sisk
Mrs Gomes
Mr Willmer
PS/IR

Background

3. Most appeal and other "proceedings" under the Taxes Acts are heard in the first instance by the General Commissioners of Income Tax, who are local unpaid lay tribunals. (Some "proceedings" do not necessarily involve an appeal against an assessment - eg where the Revenue takes proceedings before the Commissioners for penalties.)

4. There are nearly 500 separate local bodies of Commissioners. They are appointed by the Lord Chancellor, or in Scotland the Secretary of State, and the areas for which they sit (known as Divisions) are fixed by those Ministers. Schedule 3 to the Taxes Management Act (TMA) lays down rules for deciding in which Division proceedings are to be heard. For corporation tax, and Schedule D tax on the profits of unincorporated businesses, for example, proceedings are to be heard by the Commissioners for the Division in which the company's or taxpayer's business is carried on, or in which its head office or principal place of business is situated.

5. In the past the system has fitted neatly with our own organisation under which business taxpayers' affairs have generally been dealt with in the local tax office in which the head office of the company/business is situated. Even in the case of a group of companies, each separate company was dealt with by its own tax office, frequently in different parts of the country depending on where each member company's head office was.

Concentration of work on groups

6. However, following a review of the work of tax offices which deal with the most complex commercial and industrial concerns, it was decided in 1985 that all the files for companies in a substantial group should be centralised in the parent's tax office. This was announced in a reply to a Parliamentary Question on 4 June 1985. By bringing the

whole of the group together in one tax office, we can deal with its tax affairs more effectively and look at the group as a whole. This affects something of the order of 500 groups, involving perhaps 20,000 separate companies in total. This arrangement will often suit the companies too because there will usually be group tax advisers dealing with all of them.

7. To balance the workload, some medium sized company cases were transferred into those offices dealing with groups, while some smaller and technically less demanding company and unincorporated business cases were transferred from these "group" offices into other tax offices (usually nearby).

Trusts

8. There is a similar situation for trusts. In order to make more effective use of resources, tax office work on trust cases was reorganised a few years ago and these are now centralised on a regional basis in about 50 tax offices.

Consequences for arrangements for appeal and other proceedings

9. One result of these reorganisations is that the tax office dealing with a particular case may be a long way away from the Division of Commissioners which would hear any proceedings on the case under the present rules. For example a company based in Liverpool may now be dealt with by a London tax office because its parent company is based in London, but proceedings would be heard in a Commissioners' Division in Liverpool. Over 200,000 companies, trusts and unincorporated businesses (including professions) currently have a boundary "mismatch".

10. This mismatch causes a number of problems. The passing of files and briefing details for the hearing between the tax office working the case and the tax office dealing with

the hearing - and frequent telephone contact between the two offices to check on, say, whether accounts, information etc have been submitted in the meantime - is clearly inefficient and runs the risk of error and delay. If it is an appeal case involving a contentious point in dispute, rather than, say, a delay in producing information to settle the appeal, the Inspector working the case will travel himself to handle the appeal rather than leave it to the local office and this will be time consuming and costly.

11. A high proportion of appeal proceedings are simple "delay" cases. In the absence of returns and accounts, an estimated assessment has been made by the Inspector, the taxpayer has appealed against it to keep the position open, and the Inspector has arranged for the appeal to be listed for hearing because that is often the only way to extract from the taxpayer the information needed to settle the appeal. If appeals of this type have to be listed in 'foreign' Divisions, away from the Inspector dealing with the case, it means increased costs for the Revenue in dealing with appeals which arise solely because of delay on the part of the taxpayer.

12. The cost of applying the present system to the redistributed files could be an additional 15-20 units of staff at Inspector level and this sits uncomfortably with scarce resources at Inspector level and the drive to reduce arrears of work and increase efficiency.

13. Involving two tax offices in this way can also increase costs for the taxpayer. In the majority of delay appeal cases, the taxpayer does not attend the appeal meeting, but supplies accounts or information to the tax office shortly before the meeting takes place. Where the appeal is listed for hearing in a 'foreign' Division, this will normally involve the taxpayer in contacting two tax offices - his own to ensure that the material he has sent is acceptable to the Inspector, and the office handling the appeal to ensure that they are aware of what he has done and will handle the appeal meeting accordingly.

Transfers out of London

14. Some of the 30 or so tax offices dealing with groups are due to be moved from London to provincial locations such as Bristol and Manchester. That was announced in your reply to a Parliamentary Question on 23 July. This increases the degree of "mismatch" between Commissioners' Divisions and the location of tax offices, because the Inspector dealing with some London-based groups will be in the provinces.

Possible solutions

i. Changing Commissioners' boundaries

15. It should be possible to deal with part of the problem thrown up by these reorganisations by using the Lord Chancellor's power to change the boundaries of Commissioners' Divisions. This would be the appropriate course where the problem is caused by transfers of the smaller cases between neighbouring tax offices; and we shall be pursuing it with the Lord Chancellor's Department. But this would not deal with the problems of the "group" or trust tax offices. For example, a group may have subsidiaries all over the country, and simple boundary charges cannot bring them all together into one Commissioners' Division. A different solution is needed in these cases.

ii. Present provisions for reaching agreement with Commissioners

16. There are provisions already in Section 44(2) of TMA under which the Revenue and the taxpayer can agree, with the consent of the Commissioners concerned, that proceedings should be heard in a different Division to that set out in Schedule 3. These are however very cumbersome to apply to a large number of routine proceedings, because for each

proceedings it is necessary to come to a separate agreement with the taxpayer and in addition consult both sets of Commissioners concerned.

iii. Agreement between the Revenue and the taxpayer

17. We also considered whether it might be possible to amend Section 44(2) in some way - say, to provide for "standing" agreements in appeal proceedings cases rather than, as at present, specific agreements for each individual appeal made by the appellant, and/or to remove the most time consuming element of the legislation - the need to seek the agreement of both sets of Commissioners. But while this would have attractions where, say, a composite agreement could be reached for a number of companies in a group in one exercise, even a streamlined procedure would still be time consuming in the context of those 'single' companies which are also dealt with in the "group" tax offices.

iv. Revenue direction, with right of objection for taxpayer

18. On balance therefore we believe that the best solution would be legislation to provide that the Board of Inland Revenue could make directions that proceedings would be heard by a different body of Commissioners from those at present specified in Schedule 3. These directions would link a particular group or trust tax office to a particular division of Commissioners.

19. Obviously it would be unacceptable to give the Revenue power to do this regardless of the taxpayer's view. The taxpayer would therefore need to be given the right to object to the effect of the Board's direction, and have the proceedings heard in the place given by the present rules.

20. The main objective would be to improve efficiency and avoid extra work within the Revenue. But in the case of groups of companies it may well suit the group (as well as

the Revenue) to have all proceedings heard in the area covering the group's head office, since the tax adviser or accountants dealing with the whole group's tax affairs will often be situated close to the parent company. It is true that this will no longer apply to group cases currently dealt with in London tax offices which are to be moved to the provinces under the recent proposals. Nevertheless it will often still be preferable for a group adviser to have all the proceedings for the companies in the group held in one Division rather than to have the proceedings for various companies in the group scattered at numerous locations up and down the country depending on the location of each member company's head office.

21. And the important safeguard for taxpayers and their agents is that anyone who will be inconvenienced by a move to an alternative Division can object to the Board's direction.

Cost savings

22. The extra cost of doing nothing and continuing the present system in group and trust tax offices following the various tax office reorganisations is estimated at between 15 and 20 Inspectors. The extent to which the increase can be avoided will depend on how many taxpayers accept the direction. While we cannot forecast the number of objections we expect that in many cases the direction would be unopposed. This is because it will be more convenient for the taxpayer to continue correspondence with his present Inspector, rather than having to contact both Inspectors which the present rules would involve.

Compliance costs

23. A taxpayer who found the place of hearing inconvenient would simply have to enter an objection. Apart from that, this proposal is likely to reduce the compliance costs for the taxpayer for the reasons given at paragraph 13.

Consultative Document

24. This is an issue on which it would be important to have outside views before deciding to legislate, and a draft consultative document is attached for this purpose. There is no objection to the issue of the document from officials in the Lord Chancellor's Department and the Scottish Office.

25. The document would be announced by way of an Inland Revenue Press Release. A draft of this is also attached.

26. We would be grateful for your approval to the publication of the draft consultative document containing these proposals and the announcement by Press Release.

CS.

C STEWART

DRAFT

TAX APPEALS AND OTHER PROCEEDINGS: PLACE OF HEARING BY GENERAL COMMISSIONERS

A CONSULTATIVE DOCUMENT

1. The Inland Revenue has been authorised by the Chancellor of the Exchequer to publish a consultative document on possible changes in the arrangements for determining which body of General Commissioners should hear certain appeals and other proceedings.

Present arrangements

2. Most appeals and other proceedings under the Taxes Acts are heard in the first instance by the General Commissioners of Income Tax, who are local unpaid lay tribunals. (Some proceedings do not necessarily involve an appeal against an assessment - eg where the Revenue takes proceedings before the Commissioners for penalties.)

3. There are nearly 500 separate local bodies of Commissioners. They are appointed by the Lord Chancellor, or in Scotland the Secretary of State, and the areas for which they sit (known as Divisions) are fixed by those Ministers. Section 44 and Schedule 3 to the Taxes Management Act 1970 (TMA) lay down rules for determining in which Division proceedings are to be heard. Proceedings relating to corporation tax and in connection with unincorporated trades, professions and vocations, for example, are to be heard by the Commissioners for the Division in which the company's or taxpayer's business is carried on, or in which its head office or principal place of business is situated.

4. In the past, the system has fitted neatly with the Inland Revenue's organisation under which taxpayer's affairs have generally been dealt with in the local tax office in which the head office of the company or business is situated. Even in the case of a group of companies, each separate company has been dealt with by its own tax office, frequently in different parts of the country, depending on where each member company's head office was.

Concentration of work on groups

5. However, following a review of the work of tax offices which deal with the most complex commercial and industrial concerns, it was decided in 1985 that all the files for companies in substantial groups should be centralised in about 30 tax offices. Bringing the whole of a group together in one tax office allows the Revenue to deal with the group's tax affairs as a whole, which is much more efficient than the previous arrangement. This consolidation will often be convenient also for the group's tax advisers, because they are now able to deal with a single tax office, rather than several offices. The reorganisation affected about 500 groups, involving some 20,000 separate companies. To balance the workload, some medium sized company cases and a few large unincorporated businesses were also transferred into these "group" offices.

6. It was announced on 23 July 1987 that a number of these "group" tax offices currently in London would be moved to provincial locations over the next few years. This was designed to reduce the level of resignations of Inspectors of Taxes, by increasing the number of posts outside London and requiring fewer Inspectors to move to London in future.

Trusts

7. There is a similar situation for trusts. In order to make more effective use of scarce resources work on trust cases has now been centralised in about 50 tax offices on a regional basis.

Consequences for arrangements for appeal and other proceedings

8. As a result over 200,000 companies, trusts and unincorporated businesses are currently dealt with by tax offices located outside the Division of General Commissioners who should hear any proceedings. The distances involved can be considerable. For example a company based in Liverpool may now be dealt with by a London tax office because its parent company is based in London; but the law requires that proceedings would have to be heard in a Division in Liverpool.

9. This mismatch between the place where a business's tax office and Appeal Commissioners are located causes a number of problems when a hearing is necessary. Files and briefing details for the hearing have to be passed between the tax office working the case and the tax office dealing with the hearing; and there may have to be frequent telephone contacts between the two tax offices to check on whether accounts or other information have been submitted in the meantime. This is clearly inefficient, and increases the risk of error and delay. If it is an appeal case, the appellant who is submitting accounts or information shortly before the hearing may well have to contact both tax offices. In addition, if the appeal involves a disputed point rather than, say, a delay in producing information to settle the appeal, the Inspector who works the case will himself have to travel to handle the appeal rather than leave it to the local office.

10. The involvement of two offices and the need to be in touch with both can also be inconvenient and costly for the taxpayer.

11. This is both time consuming and inefficient. The cost is estimated to be an additional 15-20 units of staff at Inspector level, which the Department cannot easily afford.

12. The resource cost of this is especially difficult to justify bearing in mind that a high proportion of appeal proceedings before General Commissioners are "delay" cases where, in the absence of returns and accounts, an estimated assessment has been made by the Inspector, the taxpayer has appealed against it to keep the position open, and the Inspector has arranged for the appeal to be listed for hearing because that is often the only way to obtain from the taxpayer the information needed to settle the appeal. Here the increased costs for the Revenue in dealing with routine proceedings arise in most cases because of delay on the part of the taxpayer.

13. The Lord Chancellor and the Secretary of State for Scotland have power to alter the boundaries of the Commissioners Divisions. These powers are exercised to make local adjustments where appropriate. But they cannot deal satisfactorily with the more wide-scale reorganisation of groups and trust cases.

14. There are already provisions (Section 44(2) of the Taxes Management Act) for the Revenue and the taxpayer to agree, with the consent of the Commissioners concerned, that proceedings should be heard in a different Division to that set out in Schedule 3. These are, however, very cumbersome to apply to a large number of routine proceedings because for each separate

proceedings it is necessary to come to an agreement with the taxpayer and consult both sets of Commissioners concerned.

A possible solution

15. The Government has therefore been considering how the rules might be amended to enable certain proceedings to be dealt with by the Commissioners with which the tax office normally deals, where that is also acceptable to the taxpayer.

16. The proposal is that the Board of Inland Revenue should be empowered to make directions that proceedings should be heard by a specified body of General Commissioners who are not those designated in Schedule 3. That might be more convenient and cheaper also for the taxpayer: for example, a nationwide group of companies dealt with by a single tax office may find it more convenient to have all their appeals dealt with in the same place. But if it was not convenient, the taxpayer would have the right to object to the direction and insist on the proceedings being heard by the Commissioners designated in Schedule 3.

17. The procedure could work as follows. The Board would make general directions - for example that proceedings before General Commissioners in cases dealt with by a "group" tax office in (say) Bristol should be heard by Commissioners in Bristol. In the event of an appeal being lodged against an assessment, the Inspector would notify the appellant of the Board's direction and of the taxpayer's right to object within 30 days of the notification. If the taxpayer lodged an objection to that direction the appeal would be heard in the Division determined under the present rules.

18. Similar arrangements would also apply to appeals other than appeals against assessments and proceedings other than appeals.

19. In present circumstances the intention would be to use the power of direction in relation to cases dealt with by "group" tax offices and trust tax offices.

20. The differing legal systems within the UK would have to be taken into account in exercising the proposed power. Thus directions would not transfer English cases to Commissioners in Scotland, Scottish cases to Northern Ireland etc.

Conclusion

21. It is envisaged that the necessary legislation for the proposal could be included in the Finance Bill 1988. The Government would welcome views on the proposals outlined in this paper. Comments should be forwarded by 31 December 1987 to

Board of Inland Revenue
Policy Division 2
Room 3
New Wing
Somerset House
Strand
LONDON
WC2R 1LB

DRAFT PRESS RELEASE

TAX APPEAL AND OTHER PROCEEDINGS: PLACE OF HEARING BY GENERAL COMMISSIONERS

1. The Inland Revenue are today issuing a Consultative Document outlining a solution to problems which have emerged in some cases over the arrangements for hearing appeal and other proceedings by General Commissioners. This follows reorganisation of the Inland Revenue's local tax office network.

2. Most appeal and other proceedings under the Taxes Acts are heard in the first instance by the General Commissioners of Income Tax, who are independent tribunals sitting for local areas known as "Divisions". The Taxes Management Act 1970 lays down rules for deciding in which Division proceedings are to be heard. For example, for corporation tax, and Schedule D tax on the profits of unincorporated businesses, proceedings are heard by the Commissioners for the Division in which the business is carried on, or in which its head office or principal place of business is situated.

3. In the past this system has fitted neatly with the Inland Revenue's organisation under which taxpayer's affairs have generally been dealt with in the local tax office in which the head office of the company or business is situated. However following recent reorganisations of tax office responsibilities - in particular to deal with substantial groups of companies and with trusts - the tax office dealing with a case may now be a very long way from the Division of Commissioners which would hear proceedings on the case under the present rules.

4. The Document considers the possibility of amending the present rules to enable certain appeal and other

proceedings to be dealt with by a different body of General Commissioners, where this is also acceptable to the taxpayer. For example, where a group of companies in different parts of the country are now dealt with by a single tax office the proposed change would make it possible for all the group's appeals to be heard in one place. The Document invites comments, which should be sent to the Inland Revenue by 31 December 1987.

5. Copies of the Document are now available (price ? post free) on application in person between the hours of 9.00 am to 4.00 pm Monday to Friday, or in writing, to the Reference Room of the Inland Revenue's Library, Room 8, New Wing, Somerset House, Strand, London, WC2R 1LB. Payment should only be made in cash or cheque or postal order (payable to "Inland Revenue").

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NOTES FOR EDITORS

7. One result of recent reorganisations of tax office responsibilities - undertaken to improve efficiency and overcome staffing problems - is that the tax office dealing with a case may now be a very long way from the Division of Commissioners which would hear proceedings on the case under the present rule. For example, one step taken by the Department was to bring all the companies in a substantial group together in the parent company's tax office, thus allowing the Revenue to deal with the group's tax affairs as a whole which is much more efficient than the previous arrangement. This consolidation has often been convenient for the group's

tax advisers as well because they are now able to deal with a single tax office, rather than several offices. But although the companies in a group may now be dealt with in a single tax office, nevertheless proceedings may still have to be heard all over the country because the subsidiary companies' offices are widely scattered.

8. There is a similar situation for trusts where work has been centralised on a regional basis.

9. As a result of reorganisations, over 200,000 such cases are currently dealt with by tax offices located outside the Division of General Commissioners who should hear any proceedings; the distances involved can be considerable. This mismatch causes a number of problems. The passing of files and briefing details for a hearing between the tax office working the case and the tax office dealing with the hearing - and frequent telephone contact between the two offices to check on, say, whether information has been submitted - is clearly inefficient and costly and also runs the risk of error.

10. The involvement of two offices and the need to be in touch with both can also be inconvenient and costly for the taxpayer.

11. A possible solution would be to amend the rules to enable certain proceedings to be dealt with by the Commissioners with which the tax office normally deals, where that is also acceptable to the taxpayer. The Board of Inland Revenue could be empowered to make directions that proceedings should be heard by a specified body of General Commissioners who are not those designated in the present rules. If that was not convenient also for the taxpayer he would have the right to object to the direction and insist on the proceedings being heard by the Commissioners in accordance with the present rules.

12. In present circumstances the intention would be to use the power of direction in relation to cases dealt with by "group" tax offices and trust tax offices so that it would only affect companies, trusts and a small number of large unincorporated businesses.

939.TXT

CONFIDENTIAL

FROM: J J HEYWOOD
DATE: 23 October 1987

MR STEWART IR

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Dyer
Mr Jenkins OPC
Mr Culpin
Mr Isaac IR
PS/IR

TAX APPEALS AND OTHER PROCEEDINGS: PLACE OF HEARING BY GENERAL COMMISSIONERS (BUDGET STARTER 451)

1. The Financial Secretary was most grateful for your submission of 20 October.

2. He is content for you to issue the consultative document and press release.

J.H.

JEREMY HEYWOOD
Private Secretary

3767/041

SECRET

PUP

FROM: P D P BARNES
DATE: 27 October 1987

PS/SIR P MIDDLETON

cc PS/Chancellor
Mr Scholar
Mr Michie

TASK FORCE ARRANGEMENTS

We spoke.

2. You said that you thought Sir P Middleton would have no objection to the Economic Secretary taking Task Force documents home if it was necessary for him to do so, provided that he adhered to the stipulated security arrangements.

PB

P D P BARNES
Private Secretary

CONFIDENTIAL

FROM: P D P BARNES
DATE: 26 October 1987

MR JOHNS - IR

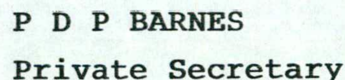
cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
Mr Cassell
Mr Scholar
Mr Williams
Miss Sinclair
Ms Leahy
Mr Jenkins - Parly Counsel

Mr Painter - IR
Mrs Hubbard - IR
Miss Hill - IR
PS/IR

OIL TAXATION ACT 1983 : BS NO. 352 AND OTHER TARIFF RELATED ISSUES

The Economic Secretary was grateful for your submission of 21 October.

2. The Economic Secretary agrees with your advice that none of the issues mentioned is a runner for the 1988 Finance Bill, both for the reasons you give and because he expects to receive more fundamental proposals about pipeline tax after his UKOOA lunch. The Economic Secretary thinks it may be better to deal with all these issues in 1989.



P D P BARNES
Private Secretary

4372/037

CONFIDENTIAL

pmp

FROM: J J HEYWOOD
DATE: 29 October 1987

PS/CHANCELLOR

cc: PS/Chief Secretary
PS/Postmaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Monck
Mr Scholar
Mr Cropper
Mr Tyrie
Mr Painter - IR
PS/IR

STARTER 208: ENTERPRISE ZONES

You and copy recipients should be aware that my Task Force secret minute to you of 28 October had the wrong copy list. The minute was not copied to Mr Burgner, Mr Williams or Mr Driscoll, since these people are not on the Task Force Secret list.

2. I would be grateful if you and others could ensure that my incorrect copy list is not used on the copy list for any response to my minute.

3. Apologies for this error.

J.H.

J J HEYWOOD
Private Secretary

FROM: R WILLIS

Inland Revenue

Policy Division
Somerset House

FINANCIAL SECRETARY

30 OCTOBER 1987

STAMP DUTY: CHANNEL TUNNEL: STARTER 302

This submission seeks your approval for an Inland Revenue Press Release (flag A) announcing the proposal to legislate in the next Finance Bill on the stamp duty and reserve tax on Units in Eurotunnel. It is intended for issue on Thursday 5 November when Eurotunnel will publish the pathfinder prospectus for the Equity 3 offer.

2. The Press Release describes briefly the difficulties which would arise if the UK and French shares which make up Eurotunnel; Units had to be looked at separately for stamp duty and the reserve tax, and the proposed solution you decided on 13 October. This will in effect treat a Unit as a single UK security. The draft has been agreed with the companies' advisers.

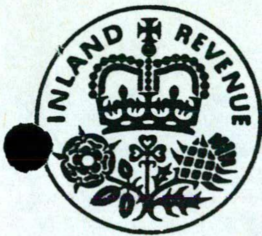
---

cc PS/Chancellor
PS/CST
PS/PMG
PS/EST
Mr Cassell
Mrs Lomax
Miss Sinclair
Mr Ilett
Mr R Evans
Mr Cropper
Mr Jenkins (Parl. Coun.)
Mr Isaac
Mr Corlett (o/r)
Mr Beighton
Mr Johnston
Mr Pipe
Mr Adderley (o/r)
PS/IR
Mr Willis

3. The companies are currently intending to go ahead with the offer on the original timetable. But if the publication of the prospectus on 5 November is postponed we will know in time to halt the Press Release and the Written Answer on which it is based.

4. If you are content to proceed on this basis I should be grateful if your Private Office could make arrangements through the usual channels for the arranged Question and Answer (flag B).

R WILLIS



INLAND REVENUE

Press Release

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

[3x] 5 November 1987

EUROTUNNEL: STAMP DUTY AND STAMP DUTY RESERVE TAX

The Government have announced proposals to simplify the way stamp duty and stamp duty reserve tax (SDRT) apply to the Units which Eurotunnel are offering for sale to the public. The intention is to treat the Units in the UK as if they were a single UK share.

The Financial Secretary to the Treasury, the Rt. Hon. Norman Lamont MP, announced the proposals today in the following reply to a Parliamentary Question:

> "The Eurotunnel group will be offering for sale to the public Units comprising one share in Eurotunnel PLC and one share in Eurotunnel SA. They will require that these shares are issued and transferred together, as a single Unit, in order to link UK and French participation in the tunnel project. This arrangement would however give rise to complex charges to stamp duties and stamp duty reserve tax. The taxes would sometimes apply to the Unit and sometimes to the Eurotunnel PLC share only. These results were not envisaged when the legislation was introduced, and would complicate dealings in the Units. The next Finance Bill will therefore include proposals to make the Unit the chargeable security for stamp duty and reserve tax purposes, and to remove the initial charge to bearer instrument duty on the issue of Units and Warrants to acquire units abroad.
>
> The intention of these changes is to treat the Units for stamp duty and the reserve tax in the same way as a single share."

/NOTES FOR EDITORS

NOTES FOR EDITORS

Stamp duty

1. Stamp duty is generally charge at 0.5% on documents which transfer shares. Stamp duty will be payable on transfers in the UK on the whole price of Eurotunnel Units in the usual way.

Stamp duty reserve tax

2. Stamp duty reserve tax (SDRT) was introduced in 1986. It applies to various transactions in securities where stamp duty would not normally be paid - eg:

   - shares bought and then resold before they are actually transferred to the buyer

   - shares held by a nominee who acts both for buyer and seller

   - renounceable documents.

3. Shares in Eurotunnel PLC will be chargeable securities for SDRT. But shares in Eurotunnel SA would not necessarily be chargeable because it is not a UK company. This would lead to the odd result that Units were quoted at a single price on the Stock Exchange, bought and sold as indivisible securities because the companies' articles require them to be transferred together, but had to be split into their component shares for stamp duty and SDRT. The proposed legislation will remove these difficulties. It will allow investors, dealers and the Stock Exchange to treat the Unit as a single security for stamp duty and SDRT purposes.

Bearer instrument duty

4. Shares in Eurotunnel PLC will be delivered in France (and some other countries) in bearer form to meet the requirements of those markets for bearer Units. This would attract bearer instrument duty at the rate of 1.5%. As the bearer shares in France correspond to the Eurotunnel SA shares included in the Units in the UK, the proposal is to relieve them and bearer warrants from UK duty.

5. The charge to bearer instrument duty will apply on any subsequent conversion of registered Units to bearer Units.

Scope of the proposals

6. The proposals reflect the novel arrangements chosen for the Equity 3 offer by Eurotunnel. However if other companies were to adopt the same arrangements in the same circumstances then the same proposals would apply.

ANNEX B

DRAFT QUESTION FOR WRITTEN ANSWER ON 5 NOVEMBER 1987

To ask Mr Chancellor of the Exchequer if the Units offered for sale by Eurotunnel will be subject to stamp duty and the stamp duty reserve tax.

DRAFT REPLY

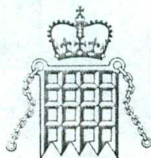
The Eurotunnel group will be offering for sale to the public Units comprising one share in Eurotunnel PLC and one share in Eurotunnel SA. They will require that these shares are issued and transferred together, as a single Unit, in order to link UK and French participation in the tunnel project. This arrangement would however give rise to complex charges to stamp duties and stamp duty reserve tax. The taxes would sometimes apply to the Unit and sometimes to the Eurotunnel PLC share only. These results were not envisaged when the legislation was introduced, and would complicate dealings in the Units. The next Finance Bill will therefore include proposals to make the Unit the chargeable security for stamp duty and reserve tax purposes, and to remove the initial charge to bearer instrument duty on the issue of Units and Warrants to acquire units abroad.

The intention of these changes is to treat the Units for stamp duty and the reserve tax in the same way as a single share.

FROM: P TREVETT

CONFIDENTIAL

DATE: 2 November 1987



HM CUSTOMS AND EXCISE
VAT CONTROL DIVISION D
ALEXANDER HOUSE 21 VICTORIA AVENUE
SOUTHEND-ON-SEA X SS99 1AJ
TELEPHONE SOUTHEND-ON-SEA (0702) 348944 ext

PAYMASTER GENERAL

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Cassel
Mr Scholar
Miss Sinclair
Mr Michie
Mr Cropper
Mr Jenkins (Parliamentary Counsel)

BUDGET STARTER NO 35 : AMENDMENTS TO SCHEDULE 1, VAT ACT 1983

1. Following our decision not to appeal the VAT Tribunal ruling in the case of Merseyside Cablevision Ltd, you gave your approval, Mr Judge's note of 4 September, for us to proceed with the necessary amendments to paragraphs 5(1) and 11(1)(b), and the repeal of paragraph 10, of Schedule 1. These amendments will fully align UK law with the provisions of the EC Sixth VAT Directive.

2. In consultation with other interested Divisions, we have almost completed our review of policy as regards voluntary and intending trader registration and expect to issue revised control, guidelines within the next month. A particular problem has been identified in the course of the review. Of late we have met an ever

Internal Distribution

CPS
Mr Knox
Mr Finlinson
Mr Jefferson Smith

Mr Nissen
Dr McFarlane
Mr Keefe
Mr Tracey

Mr Taylor (VAD)
Mr Bazley
Mr Allen (DPU)
Mr Topping

increasing number of cases where traders, particularly in the building industry, have applied for, and in good faith have been allowed, obligatory registration by virtue of paragraph 1(b) of Schedule 1. The traders have declared that they are already making taxable supplies and that in the coming twelve months they expect to exceed the annual threshold. In such circumstances registration is approved unconditionally.

3. Subsequently, and normally as a result of an input tax credibility enquiry, it is found that at the time the application was made the trader was not in fact making taxable supplies so that registration by virtue of paragraph 1(b) was inappropriate. In the meantime, however, having obtained registration, the traders have been making claims for repayment of significant amounts of input tax. Investigation of the traders' activities has shown that some have made no taxable supplies since registration, while others have made only exempt supplies, e.g. short term leases of newly constructed buildings.

4. In such circumstances our practice has been to invalidate the registration ab initio, in order to safeguard the revenue against erroneous claims to repayment of input tax, on grounds that the trader was not making taxable supplies by way of business. This has led to several contentious and complex appeals (Merseyside Cablevision was one such case).

5. Invalidation of the registration of a trader who has made only exempt supplies is totally in accord with the principles of the EC Sixth VAT Directive. In cases where the trader has not made any taxable supplies, invalidation frequently results in the trader claiming that he still intends to do so. In such situations, application for intending trader registration should have been made in the first instance under paragraphs 5(1) or 11(1)(b) of Schedule 1. This application, before being allowed, would have been subject to the provision of objective evidence to support the declared intention of making taxable supplies, and to the trader's acceptance of the conditions regarding recovery of input tax repaid in the event of no taxable supplies, or only exempt supplies, being made. Nevertheless, and notwithstanding that the original application was incorrect, the Tribunals have contemplated whether in such circumstances the Commissioners, as an alternative to invalidation, ought to have substituted an intending trader registration for the original obligatory registration. Furthermore, the President has suggested privately that, under the present law, the trader having obtained registration,

cancellation of that registration should be from a current date. Whilst we do not agree with that view, the clear inference is that the Tribunal would confirm a trader's entitlement to repayment of input tax incurred during the period of registration, provided no exempt supplies had been made. A ruling on this basis would be most costly to the revenue. It would probably necessitate an appeal by us to the High Court to establish whether a registration could be invalidated ab initio, a point on which the law is at present silent.

6. In an endeavour to avoid such difficulties, and to put the matter beyond doubt, we believe that, as part of our revision of the voluntary and intending trader requirements, it would be prudent to introduce a new provision into Schedule 1 so that the position is clearly defined in law.

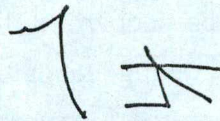
7. What we have in mind is that, where an obligatory registration is found subsequently to be incorrect, because at the time the application was made the trader was not making taxable supplies, the Commissioners will be required to reconsider the application under the amended provisions of paragraphs 5(1) and 11(1)(b) and, if satisfied, substitute an amended registration under either of those provisions from the original date of registration. If the Commissioners are not so satisfied as to the bona fides of the application, the registration would be invalidated ab initio. This we believe would be eminently fair both to the taxpayer and to the revenue, and is a necessary anti-avoidance measure forming part of the package amending the rules on voluntary and intending trader registration.

CAPITAL ASSETS

8. In the Budget starter, we have included the correction of a minor omission in the wording of paragraphs 1(5) and 2(3) of Schedule 1, as introduced by Section 14(2) and (3) of the Finance Act 1987. The purpose of the new paragraphs was to incorporate into UK law the requirements of Article 24(4) of the Sixth VAT Directive, namely that for the purposes of calculating turnover disposals of tangible or intangible assets shall be disregarded. Previously this requirement was catered for by an extra-statutory concession. Unfortunately, the reference in both paragraphs to "supplies of goods that are capital assets of the business" restricts the provision to tangible assets so that it does not fully meet the EC requirement. I am afraid that we failed to spot this inconsistency, which was

brought to our attention by the City of London Law Society on the day that the Bill received Royal Assent. We were unable, therefore, to introduce a Government amendment. Although in practice the error is unlikely to create difficulty, as traders operating around the level of the registration threshold are unlikely to have significant disposals of intangible assets, and administratively we have instructed our staff to treat the new provisions as applying to all capital assets, we believe that it would be prudent in this further revision of Schedule 1 to make the necessary amendment. Simple deletion of the words "of goods" in both paragraphs will do the trick.

9. We estimate that the further amendments proposed in paragraphs 8 and 9 above will take up an additional 6 lines of Finance Bill space. We would be grateful to know whether you are content with our proposals and that we can now complete our instructions to Parliamentary Counsel to draft the necessary clauses.



P TREVETT

4373/06

pp

FROM: N M DAWSON
DATE: 3 November 1987

MR WILLIS IR

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Cassell
Mrs Lomax
Miss Sinclair
Mr Ilett
Mr Dyer
Mr R Evans
Mr Cropper
Mr Jenkins OPC
PS/IR

STAMP DUTY: CHANNEL TUNNEL: STARTER 302

1. The Financial Secretary has seen your minute of 30 October and is content with the press release announcing the proposal to legislate in the next Finance Bill on Stamp Duty and Reserve Tax on units in Eurotunnel.

2. I would be grateful if Mr Dyer could make arrangements for the arranged question to be laid down.

Nigel Dawson

NIGEL DAWSON
Diary Secretary

CONFIDENTIAL FROM: R B WILLIS

Inland Revenue

Policy Division
Somerset House

10 NOVEMBER 1987

1. MR ISAAC

2. FINANCIAL SECRETARY

STAMP DUTY: £30,000 THRESHOLD: STARTER 300

The attached paper considers the pros and cons of an increase in the £30,000 threshold for stamp duty on transfers of land and buildings and of the other main options in this area: reducing the 1% rate, converting the threshold into an exempt slice, and doing nothing.

2. The revenue costs and staff effects of these options are summarised in Table 1 at the front of the paper. Table 2 is a summary of what seem to be the main forces acting for and against some change to stamp duty on property.

3. The Chancellor indicated on 20 October that converting the £30,000 threshold into a £30,000 nil rate band (option 3 below) was the lowest priority in the package then being considered. It is also the stamp duty option which requires the largest increase in the staff and running costs of the

---

cc		
cc	Chancellor	Mr Isaac
	CST	Mr Painter
	PMG	Mr Corlett (o/r)
	EST	Mr Beighton
	Sir P Middleton	Mr Calder
	Mr Cassell	Mr O'Connor
	Mr Scholar	Mr Nield
	Miss Sinclair	Mr Gonzalez
	Mr Instone	Mr Pipe
	Mr Cropper	Mr Adderley
	Mr Jenkins (Parl. Counsel)	Mr Pape
		PS/IR
		Mr Willis

CONFIDENTIAL

Stamp Office. Only an increase in the threshold (option 1 below) would help to offset the pressures on running costs from increases in the numbers of conveyances liable to duty, and, in the wider departmental context, from other Budget starters. The extra work for the Stamp Office is shown clearly in the increasing number of transactions liable to duty (figure I below) as average house prices increase (figure II below).

4. We assume final decisions on stamp duty rates and the threshold are unlikely until nearer the Budget. But it would be helpful if you could indicate now any options which can be put to one side and any options (or variations on them) on which you would like more detailed information.

R W.

R WILLIS

CONFIDENTIAL

TABLE 1

STAMP DUTY ON LAND AND BUILDINGS

PRESENT POSITION	Revenue (£m)		Staff cost	
	1988/89	1989/90	(1/4/87)	
	1,290	1,670	90	
SUMMARY OF OPTIONS	cost (-) / yield (+)		Staff effects	
	1988/89	1989/90	1/4/89	1/4/90
1. increase £30,000 threshold to				
(a) £40,000	-300	-400	-10	-10
(b) £50,000	-480	-640	-20	-20
2. reduce rate from 1.0% to 0.5%	-600	-800	+15	+15
3. exempt first £30,000 slice of all transfers	-550	-700	+15	+15
4. do nothing	nil	nil	+10	+10

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TABLE 2

MAIN FORCES FOR AND AGAINST AN INCREASE IN STAMP DUTY £30,000 THRESHOLD

for an increase	against an increase
increase in house prices (55%+ since threshold set in 1984)	revenue cost
policy of encouraging home ownership	no economic justification if feeds into higher prices
Pressure on Inland Revenue running costs	Stamp duty cheap to collect
encourages mobility of labour	effects on mobility small because i) rate low and ii) most people buy within a few miles of their existing home
	does not help directly the rented sector
popular with home buyers	relatively few complaints about stamp duty
link with £30,000 ceiling on mortgage interest relief (if changed)	link with £30,000 ceiling on mortgage interest relief (if unchanged)
comparisons with shares (rate 0.5%)	shares traded more often than houses
	further relief for owner-occupiers on top of MIR, abolition of rates, CGT exemption

FIGURE I

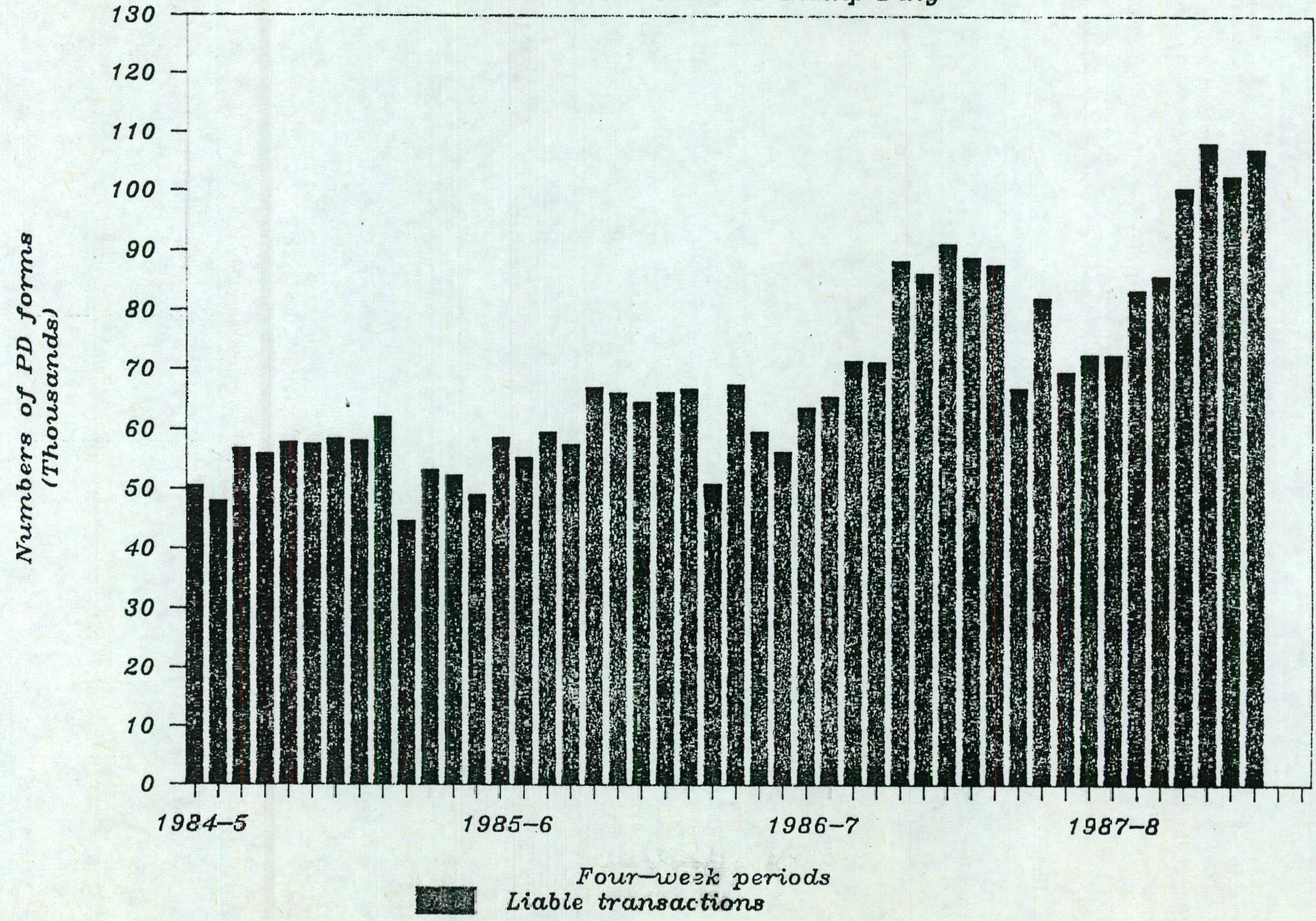
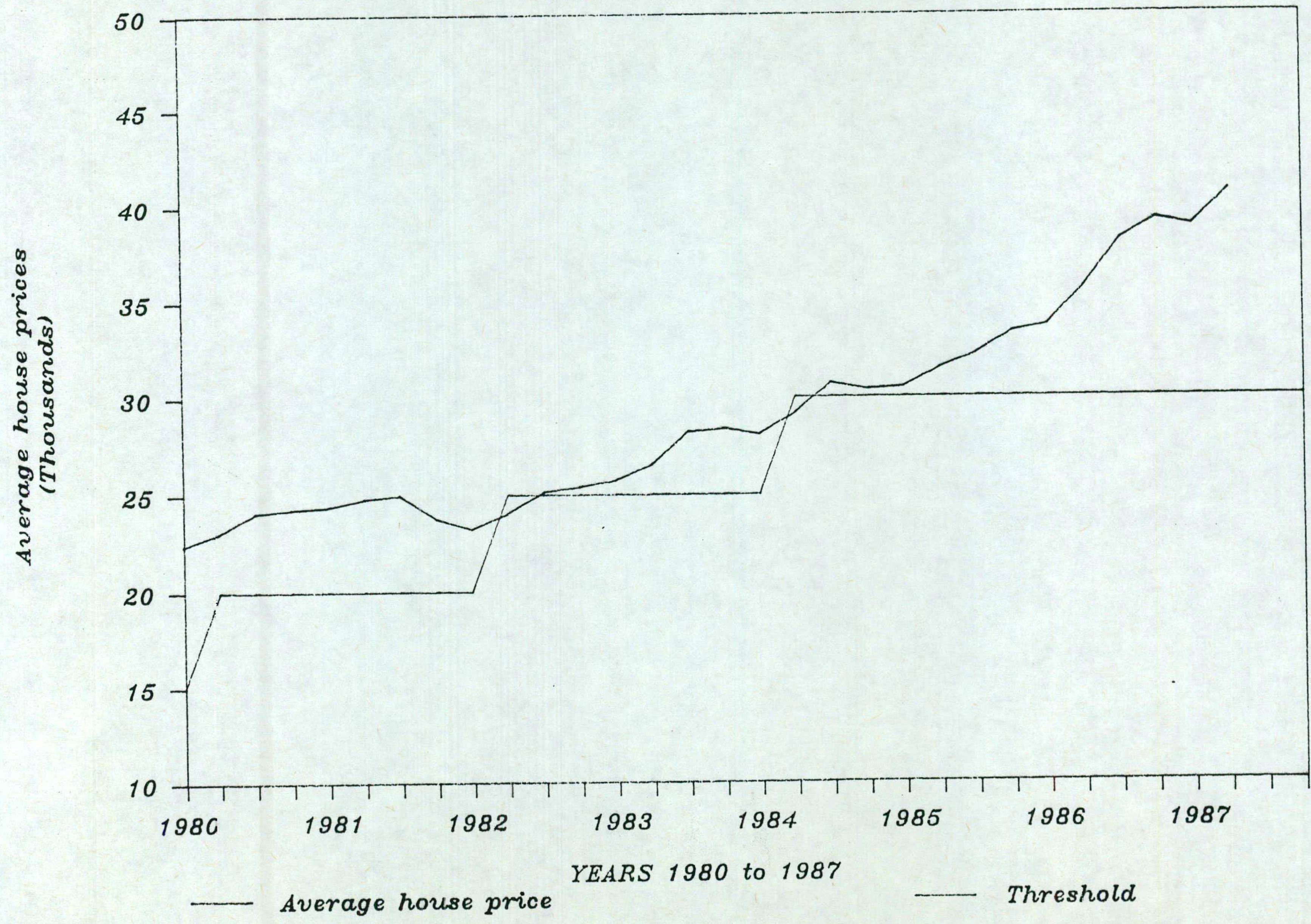


FIGURE II

GROWTH IN UK AVERAGE HOUSE PRICES

Source : BSA Bulletin



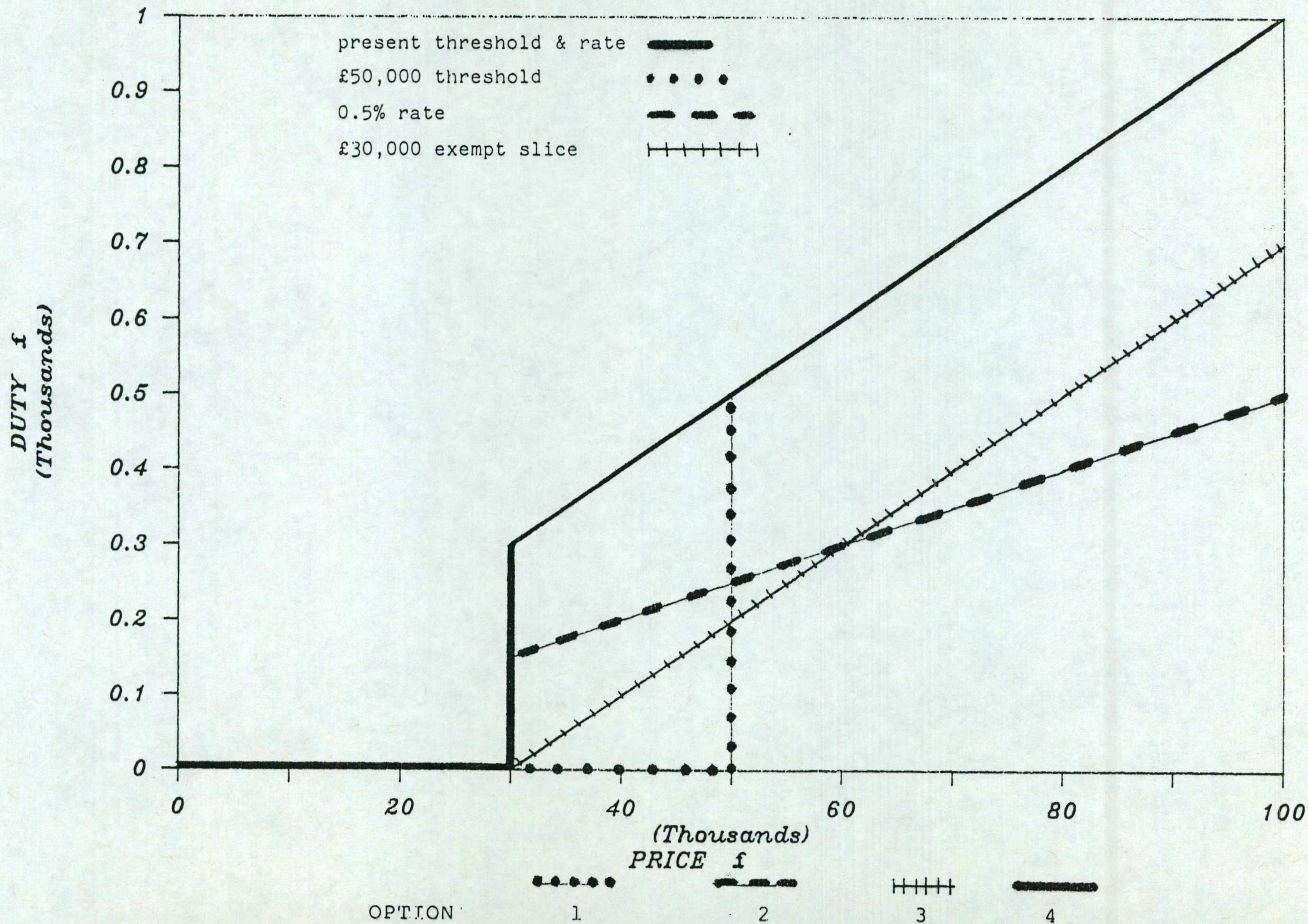


FIGURE 3

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STAMP DUTY ON LAND AND BUILDINGS

INTRODUCTION

This note:

i. summarises the present stamp duty on land and buildings

ii. reviews how we reached the present position

iii. looks at the pros and cons of options for changing stamp duty.

WHERE WE ARE NOW

2. Stamp duty at 1% is payable on transfers of land and buildings. There is a threshold of £30,000. When the value is below £30,000 there is no duty. When the value is above £30,000 the charge is 1% on the <u>full</u> amount - eg £350 on a house costing £35,000.

3. We expect to collect duty from about 1.2 million conveyances in 1987/88 (both domestic and commercial).

HOW WE GOT HERE

4. Since 1979 there have been 3 increases in the threshold for stamp duty, and 2 changes to the rate. The table below shows these changes.

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TABLE 3

CHANGES IN STAMP DUTY — THRESHOLDS AND RATES

	threshold (£)	rates
1974	15,000	0.5% up to £20,000 1.0% " £25,000 1.5% " £30,000 2.0% above £30,000
1980	20,000	0.5% up to £25,000 1.0% " £30,000 1.5% " £35,000 2% above £35,000
1982	25,000	0.5% up to £30,000 1.0% " £35,000 1.5% " £40,000 2% above £40,000
1984	30,000	1.0%

5. There is no statutory requirement to increase the threshold in line with inflation.

ARGUMENTS FOR AND AGAINST CHANGE

6. Possible arguments for changing stamp duty on land and buildings are:

i. it no longer achieves its objectives:

This is not a powerful argument because stamp duty is primarily a cheap way of raising revenue. It is based on the pragmatic view that we can tax any document which transfers property because the document is not valid in Court unless it is stamped.

Looked at this way, as a source of revenue, stamp duty is highly effective (because revenues rise with the value of property) and cheap to collect.

ii. <u>it adversely affects markets</u>

there is no clear evidence that stamp duty on land and buildings creates significant distortions or reduces mobility of labour. It is likely that a large part of any reduction in stamp duty would feed through into higher property prices. Even if this were not so a reduction of 1% would make little difference, and even less difference to the gaps between house prices in different parts of the country.

iii. <u>it discourages home ownership:</u>

this is true only to the extent that stamp duty is truly an additional expense. As in (ii) above we would expect in practice reductions in stamp duty to fuel higher prices.

iv. <u>it is unpopular:</u> of course. But not as unpopular as most taxes. Stamp duty gives rise to relatively few representations and complaints. Most people seem to see it as one of the unavoidable costs (along with eg solicitors fees, land registry fees and removal costs) of moving, albeit a cost which is an out-and-out tax with no other justification.

v. <u>the environment has changed:</u> the average price of a house has increased by over 55% since the £30,000 threshold was set: from £28,000 (below the threshold) in March 1984 to over £44,000 in August 1987. This has made many more transactions liable

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to stamp duty (see figures I and II above). By doing nothing the tax is being applied lower down the housing ladder.

vi. Inland Revenue running costs: the increased number of transactions which are liable to stamp duty has created more work for the Stamp Offices. They have increased productivity, and plan further increases, but with no change in the work load they will need an extra 10 staff (above PES baselines) at clerical and executive levels in 1988/89. This is a significant fraction of the Offices' total resources of 315 staff. And there is unlikely to be room after the Budget to switch staff from other work to the Stamp Office. x

7. The main arguments against an increase in the stamp duty threshold are:

a. the loss of revenue which is cheap to collect;

b. the extra pressure it would put on the £30,000 ceiling on mortgage interest relief: the two figures have coincided only recently (and to some extent by chance). There is no particular link between stamp duty and mortgage interest relief to make a common figure logical. But presentationally an increase in one would add to the pressure to change the other.

8. The case for an increase in the stamp duty threshold therefore rests on the arguments for being seen to reduce the tax burden on first time buyers and others buying at or below average house prices; and the need to avoid additional manpower costs in the Inland Revenue (in the context of a Budget which is likely on balance to add to the Revenue's running costs).

x This depends, of course, on decisions yet to be taken in a wider context. CEA

OPTIONS

Option (1) increase the £30,000 threshold

9. An increase to £40,000 would remove about half the conveyances otherwise liable to duty next year. An increase to £50,000 would remove over a million conveyances from duty. £50,000 put the stamp duty threshold back in about the same position
relative to average house prices as it was in 1984.

10. The main advantages of this option are:

a. it is the most cost-effective way of reducing stamp duty for first-time buyers (although the impact varies greatly from the South East where £50,000 will buy few homes to the North where it will buy a large house);

b. by taking people out of duty altogether it has arguably the greatest impact on those who (rightly or wrongly) perceive stamp duty as a major cost of home ownership.

c. it reduces the running costs of the Stamp Office.

Option (2) reduce the rate from 1% to 1/2%

11. There was not much additional pressure on stamp duty on land in 1986 when the rate of duty on shares was reduced to 0.5% while the rate on land stayed at 1.0%. However that was in the context of a Budget which brought other share transactions within stamp duty and SDRT in a revenue-neutral package. If the rate on shares was reduced again (eg to 0.25%) we would expect pressure on the 1% rate on land.

12. The gap between the rates on land and on shares also creates an incentive to "securitise" property and transfer shares rather than the underlying land. We have seen no evidence of people exploiting the 0.5% gap between the rates by using transfers of securities. But the risk exists, and would increase if the gap between the rates increased.

13. It could therefore be argued that:

a. the same 0.5% rate for property and for shares would be fairer;

b. a lower rate would make the transition into duty less dramatic (the bill on £30,000 would be £150 as against £300 now); and

c. it fits in with a tax strategy of low rates and few exemptions.

14. The disadvantages are that a lower rate of 0.5%:

a. loses half the yield

b. does nothing to slow the growth in the number of conveyances liable to duty; and so

c. requires more staff and running costs to collect less duty. The Stamp Office would need to examine the same number of documents, and collect duty in the same growing number of cases.

<u>Option (3) exempt first £30,000 slice from duty</u>

15. Unlike other major taxes the stamp duty threshold is not a nil rate band or exemption. If duty is payable it is payable on the whole amount.

16. Converting the £30,000 threshold into an exempt slice would:

a. help all who pay stamp duty (by reducing their bill by £300)

b. smooth the transition into duty; and

c. probably seem fairer.

17. The disadvantages are:

a. it leaves the same number of people paying duty and therefore the same number with a cause to complain;

b. it creates more work for the Inland Revenue, and for solicitors and other advisers: the difference between an exemption and a threshold may be small, but with over a million conveyances each year the Law Society and others have emphasised the importance of keeping stamp duty simple.

<u>Option (4): no change</u>

18. The case for change is strong if Ministers do not wish stamp duty to continue to spread to less expensive homes.

19. There is however an alternative viewpoint: that stamp duty should become a tax on expenditure which (like VAT) applies equally (and at a low rate) to all transactions of a kind, because it is better to raise revenue by indirect taxes than by taxes on income.

DISTRIBUTIONAL EFFECTS

20. Figure III shows the stamp duty payable under each of the 4 options.

21. For any given sum of money:

Option (1) (increasing the threshold) does most for the cheapest houses - because it does nothing for those above the new threshold.

Option (2) (reducing the rate) gives all buyers above £30,000 an equal percentage reduction, and hence a bigger cash saving to more expensive houses.

Option (3) (a £30,000 exempt slice) does less for the cheapest houses than an increase in the threshold but more than a reduction in the rate; does more for moderately cheap houses (above the possible new threshold) than any other option; and does more for expensive houses than an increase in the threshold but less than a reduction in the rate.

CONSEQUENTIAL CHANGES IN LEASE DUTY

22. If the threshold or rate of stamp duty is changed there would be a good case for changes to the parallel duty on new leases. These could be kept to a minimum of changing the £30,000 threshold and 1% rate for duty on the premium.

23. There is already a good case for revising the whole complex scale of duty on leases. We shall be reporting on our review of this later in November. But it is not a compelling issue for the 1988 Bill.

INLAND REVENUE
SOMERSET HOUSE
OCTOBER 1987

4373/42

PMP

FROM: N M DAWSON
DATE: 10 November 1987

MR ISAAC IR

cc PS/Chancellor
PS/Economic Secretary
Mr Scholar
Mr Burnhams
Mr Cropper IR
Mr Painter IR
Mr Lewis IR
Mr McGivern IR
Mr Pitts IR
Mr Houghton IR
Mr Beighton IR
Mr Stewart IR
Mr Jenkins OPC
PS/IR

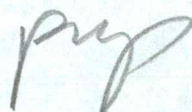
MINOR BUDGET STARTERS: MONDAY 16 NOVEMBER

1. This is to confirm that the Financial Secretary will be holding a meeting to discuss minor budget starters and the general shape of the emerging Finance Bill, on Monday 16 November at 3.00pm.

NIGEL DAWSON
Diary Secretary

From: R B SAUNDERS

Date: 10 November 1987



PCC MEMBERS

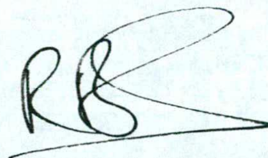
cc Mr C D Butler
Mr R I G Allen
Miss O'Mara

REPORTING OF OUTSIDE CONTACTS

Now that the Autumn Statement is out of the way, speculation about next year's Budget is bound to mount. The period between now and the introduction of Budget purdah arrangements after Christmas is therefore one in which particular care needs to be taken. The reporting arrangements in HD(87)7 accordingly assume greater importance.

2. Since the summer, reporting has got distinctly patchy. While some areas of the department have continued consciencIously to report contacts, returns from some areas have either dried up completely or are very cursory. In some cases, only the contacts of the PCC member concerned are being reported. This is not enough: we want returns which cover all the relevant divisions as well.

3. I am writing separately to the worst offenders. But could I ask you all to remind your divisions of the importance of keeping up with these procedures.



R B SAUNDERS

Private Secretary

3770/004

PWP -

FROM: P D P BARNES
DATE: 11 November 1987

MR TREVETT - C&E

cc PS/Chancellor 2
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Mitchie
Mr Cropper
Mr Jenkins - Parly Counsel

BUDGET STARTER NO.35 : AMENDMENTS TO SCHEDULE 1, VAT ACT 1983

The Economic Secretary was grateful for your submission to the Paymaster General of 2 November.

2. He is content for you to instruct Parliamentary Counsel to prepare the necessary amendments for the 1988 Finance Bill.

PB

P D P BARNES
Private Secretary

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(1) Attach [illegible] pp
(2) b/f to me 16/11 (p.m.)

Inland Revenue

Policy Division
Somerset House

The arguments are not very strong either way at the moment (the big cuts either being behind us or some way in the future). Legislation to restore the original intention would be controversial for a relatively small gain. I therefore agree with Mrs Hubbard that we might as well concede the point to the industry on both legislation and timing of assessments but keep the position under review.

FROM: MRS C B HUBBARD

DATE: 13 NOVEMBER 1987

1. MR JOHNS

2. ECONOMIC SECRETARY

13/11

OIL TAXATION: BS NO 350

PRT SAFEGUARD: DEFERRED EXPENDITURE CLAIMS

1. This note reports the results of our review, authorised in Mr Westhead's minute of 6 August 1987, of the legislation and practice relating to claims for expenditure incurred in periods where safeguard operates to reduce or cancel PRT payable. The review followed your decision, endorsed by the Chancellor, not to legislate to prevent companies benefiting from deferred expenditure claims insofar as these claims related to expenditure already incurred. The note summarises the problem and the industry representations, considers the potential costs of taking no action, and looks at the options available.

BACKGROUND

2. Safeguard relief was introduced at Report Stage of the 1975 Oil Taxation Bill, along with oil allowance, as a measure designed to remove or mitigate the new PRT charge in the case of the less profitable fields. In the words of the then Paymaster

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cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Mr Cassell
Mr Scholar
Mr Williams
Miss Sinclair
Ms Leahy
Mr Wilson

Mr Jenkins - Parliamentary Counsel

Mr Painter
Mr Pollard
Mr Beighton
Mr Johns
Mr Calder
Mr Cleave
Mr Elliss - OTO
Mr Beauchamp - OTO
Miss Hill
Mrs Hubbard
Mr Ridd
Dr Parker
Mr J Evans
PS/IR

General (Edmund Dell) it was "introduced in order to give a certain degree of additional protection to companies in the early years so as to ensure them against what they fear might happen, and that is a very considerable cut in the price of oil which might, if the tax system remained otherwise, heavily reduce their profits". This protection is afforded by giving the companies a minimum level of return on capital after PRT (but before corporation tax). In its original form safeguard was available for the whole of field life. It was introduced as an overriding relief to be given only after all other reliefs and allowances (including oil allowance) had been utilised. Given a PRT rate of 45% it was expected that the incidence of safeguard would be comparatively low, applying only to a few really marginal fields.

3. The complexion of the relief, however, was significantly changed by subsequent increases in the PRT rate. In pre-corporation tax terms the profitability of all fields declined and it became apparent that the safeguard benefit would apply to all but the most profitable fields. Consequently in 1981 it was decided to make changes to safeguard relief to restore it to its original intention of long stop protection in the early years of field life if profitability fell below reasonable expectation. Safeguard now limits the amount of PRT payable for chargeable periods up to payback and for half as many periods again. In any of these periods, if the PRT charge would otherwise reduce the return on a field before corporation tax to less than 15% of its accumulated capital expenditure, the charge is cancelled. A tapering provision ensures that the PRT charge will not be more than 80% of the amount (if any) by which the adjusted profit exceeds 15% of the cumulative expenditure. This accumulated capital expenditure (or safeguard capital base) is the total amount to date of expenditure qualifying for uplift, allowed up to the end of the chargeable period in question.

4. Safeguard applies to restrict the PRT which would otherwise be due. To establish the amount, if any, of the safeguard reduction, PRT under the safeguard rules is compared with PRT due

under the normal rules. Under the latter PRT is charged after taking account of expenditure (including uplift) which is both claimed and allowed. Where safeguard cancels PRT liability for a chargeable period it can be beneficial for companies not to claim relief for some or all field expenditure incurred before the end of that period in time for it to be allowed in the assessment on the receipts from sales of oil and gas in that period, but to save it for a claim against PRT liability in a later period where it can be used for additional relief. The later period may be a safeguard period where PRT is payable subject to the 80% taper, or a period where the safeguard limitation no longer applies. There is nothing in the present rules to prevent a company deferring its claims in the hope of achieving this result. If assessments are made for each chargeable period at the normal time (ie six monthly), it can rely on achieving its objective.

5. In the case of those few fields where this problem arose we had, until your decision not to legislate in respect of "past" expenditure, been deferring assessments for the 2H 1986 chargeable period in which there was expenditure incurred but not claimed. There was no immediate tax effect since, because of safeguard relief, the assessments would have shown no PRT liability in any event. As explained in my note of 22 June, a similar problem arises on oil allowance, and we have long had a practice of deferring assessments which has survived a challenge in litigation (High Court decision). Since the announcement of your decision not to legislate for past expenditure, however, the delayed assessments in the safeguard cases have been made and assurances given that no action will be taken to limit the companies' right to benefit in later periods from deferred claims for pre 7 August 1987 expenditure. A copy of the letter sent to the representative bodies on 7 August, announcing the review, is attached as Annex A.

6. The question now is whether action is needed - and if so whether action should be taken now or left to some later date - to counter the deferral of claims in respect of expenditure

incurred after 7 August 1987 or some later date and, if now, whether it should be by legislative or administrative means.

INDUSTRY REPRESENTATIONS

7. The main industry arguments, and our comments on them, are as follows:

Arguments of principle

(a) It is misleading to say that deferral of claims leads to "double relief". Without deferral the expenditure receives no relief at all in the safeguard exemption period, whilst deferral of claims normally ensures that the expenditure receives relief at some time. However, the expenditure as expenditure is never relieved more than once.

Comment

Industry are looking at the issue from a different viewpoint. As explained in paragraph 2 above, safeguard was introduced in 1975 as an overriding relief, to be given only after all other available reliefs and allowances have been utilised. It was never intended to replace other reliefs which could then be used at a later date.

b) There are other similar areas, eg concerning the interaction of uplift and safeguard, where the existing legislation creates anomalies and where it has not been felt necessary or desirable to change the law. Instead the Revenue have quite sensibly agreed with the industry an approach within the context of the existing legislation which does not necessarily maximise the amount of tax payable in each situation.

Comment

The anomalies referred to concern cases where it can be to a company's advantage to claim expenditure without uplift, but in such a situation the expenditure is claimed and relieved and the uplift cannot be claimed separately later on. There is no real parallel with the present issue where the claim is deferred and companies are seeking to maximise the combined effect of relief for non upliftable operating expenditure and safeguard.

(c) The present opportunity to benefit from deferred claims would not have arisen if expenditure for PRT were allowed on an "incurred" rather than a "claimed and allowed" basis. Government has in the past rejected this approach. It should not seek to change the rules of the game when occasionally matters do not work to its advantage.

Comment

The "claimed and allowed" basis was introduced to prevent companies taking early benefit from doubtful expenditure claims, or from expenditure subsequently established not to be allowable,and hence to keep the flow of revenue up, not in order to delay claims for relief or tax receipts. (It should be noted, however, that expenditure in practice most usually is relieved in the assessment for the period in which it is incurred. The company has an incentive under the payment on account rules to claim its expenditure soon after the claim period has ended and the Oil Taxation Office is able to agree the great bulk of expenditure before making the assessment for the period in which the expenditure was incurred.) Cost to the Exchequer is the reason why the Government has in the past rejected an across the board "incurred" basis, and it is the same reason why it now needs to examine claims during safeguard periods.

Arguments on grounds of equity

(d) With oil prices below $20/barrel the importance of a fully effective safeguard is highlighted. Fields currently affected by the present issue were all committed prior to 1981 when safeguard was a field life feature. None of them would be likely to incur any PRT liability at current oil prices throughout the remainder of their life if the legislation prevailing at the time of their commitment was still in place. When safeguard relief was restricted in 1981 oil prices were some $40/barrel. It seems unlikely that at that time anyone could have contemplated that the level of oil prices in the future would ever bring safeguard exemption into play.

Comment

It would only take a small increase above the current price for the two fields currently affected (North Cormorant and Maureen) to pay some PRT even if safeguard still ran for the life of the fields. But other things have changed too. The companies have benefited or stand to benefit from other tax changes since the decision to develop was taken (eg the 1983 relief for exploration and appraisal and this year's cross field allowance). And although the additional relief to be obtained by expenditure claim deferral would help mitigate the adverse effects on field economics of the recent fall in oil prices the effects would be capricious since all companies have suffered from the oil price fall but only a few are in a position to secure an additional PRT benefit by deferring expenditure claims.

Arguments on grounds of economic distortion

(e) Preventing effective relief for expenditure in safeguard encourages delays to shutdowns for essential maintenance and is not consistent with good oil field practice. The cost of production shutdowns for maintenance and

surveillance activity is significantly increased since the income deferred potentially bears tax at the full 75% rate whilst the additional maintenance expenditure incurred during the shutdown receives no effective relief.

Comment

We are sceptical of claims that preventing companies benefiting from deferred expenditure claims will actually lead to deferral of expenditure, particularly where most of the expenditure involved (as with the fields currently affected) is normal continuing operating expenditure. There may, however, be certain types of discretionary expenditure at the margin (see (f) below).

(f) Preventing effective relief for expenditure can render otherwise attractive investment opportunities uneconomic or can affect timely investment to ensure optimum reservoir management. The post-tax cost of investments is effectively increased in some cases by up to a factor of four. This can have a distortionary effect on post-tax economics. The ability to defer expenditure claims provides a broadly neutral PRT impact on investment decisions. Companies' financial incentives, particularly in relation to the timing of investments, could be influenced by the fiscal regime with the associated risks of inefficient reservoir management expenditures, lower production rates, and potential loss of ultimate recovery.

Comment

It is true that if capital expenditure is incurred during safeguard, whereas the resulting income is received after safeguard has expired or when the taper applies, there can be a distortion. The expenditure makes no difference to the amount of PRT (which is zero whatever is spent), but the income is taxed at 75% or the effect of the safeguard taper may be to tax marginal income at 80%. This can reduce the

profitability of an investment after tax considerably. If companies could defer their expenditure claims until they could be fully relieved against PRT the distortion would be greatly reduced. But this distortion does not apply to the vast bulk of development expenditure which is incurred before safeguard starts to achieve an effective reduction in PRT. Nor does it apply to operating expenditure (which constitutes the vast bulk of what companies have so far deferred). UKOOA have presented some material based on hypothetical fields in support of their contention that any counter measure could have a distortionary effect on investment decisions. Department of Energy are not, however, convinced that there is any risk of significant distortion. The type of expenditure referred to is the sort of expenditure which the companies will generally have planned and provided for and the tax issue is unlikely to affect their need or desire to press ahead with the expenditure to manage the reservoir in the most efficient manner to achieve maximum commercial recovery from the field. It cannot be ruled out that there might be certain discretionary expenditure at the margin, which it might pay them to defer, but it is very unlikely that this would be the sort of expenditure which would impact to any significant degree on ultimate field recovery.

8. It seems to us that the arguments of principle are clearly in favour of preventing companies from deferring claims for expenditure incurred in safeguard periods. It was never intended that safeguard and expenditure relief should both be separately available. The argument of equity - that deferment of claims protects fields of low profitability from the effects of the low oil price in the way that safeguard was intended until it was curtailed - carries some validity. But the benefit from deferred claims is fairly capricious in its incidence; it goes to some fields but not all. The strongest arguments for allowing deferment - the economic one - is that it reduces a distortion on incremental investment. But very little actual investment seems to be at stake at the moment.

COST OF TAKING NO ACTION

(i) Short-term cost

9. There are two producing fields (North Cormorant and Maureen) where there is some scope at present for further expenditure claim deferral within safeguard. We estimate that the cost of allowing the deferral of claims for post 7 August 1987 expenditure in respect of these fields would be low, probably less than £3m in each of the years 1988/89 and 1989/90 (but this is on top of the benefits of deferring claims for possibly as much as £100 million expenditure incurred up to 7 August 1987). It is surprising that this estimate has turned out so low given the strength of the protests made. It should be noted, however, that these costs are very sensitive to changes in the $ oil price and exchange rate assumptions. If the exchange rate remained at the current level of $1.78 throughout 1988 instead of $1.68 assumed in the Treasury Autumn forecast, the 1989/90 cost would rise by about £20 million. Also there is some uncertainty at the moment with regard to North Cormorant and the possible impact on its short term production level of the pending tie-in to its facilities of the Tern and Eider fields. If Shell and Esso are right in their estimation of the shutdown period involved, the additional cost to the Exchequer of the effect on production and the further scope for expenditure deferral as a result could be some £25m. However, Department of Energy are sceptical of claims that the field will need to be shut down for the length of period stated and have asked the companies for further information on the impact of possible legislative action to prevent deferment of claims.

(ii) Long-term cost

10. We have identified 5 fields (the Marathon representation relates to one of these) - Morecambe, Brae, North Alwyn, Ravenspurn and Tern in which the problem could well arise from 1992 onwards. The long term cost is very uncertain since it all depends on movement in the oil price, on production profiles

of the fields in question and the future MOD costs incurred in the projects over the next 10 years or so. Nevertheless, on current available data, with no change to the current fiscal regime, our estimate is that there could be some £50m a year at stake in the mid-1990s in respect of Morecambe and North Alwyn and a further £10m or so a year in the early years of the 21st century in respect of Ravenspurn and Brae. Costs might also arise in respect of other fields, such as Clyde, Tern and Miller depending on whether oil prices are higher or lower than our assumption. The industry itself recognises that there could be a substantial long term cost.

11. There is a particular problem on Morecambe because of the complex pricing formula for gas and the flexibility British Gas have in deciding production levels. Also oil allowances given in relation to the capacity charge payable where no gas is taken from the field may mean that there is scope for deferral of expenditure claims for reasons other than safeguard. This could raise the future potential cost quite considerably but it is not possible to estimate by how much since it depends on the extent to which British Gas are able to satisfy seasonal gas demand from fields other than Morecambe, so that Morecambe production is restricted accordingly. The cost depends further on the production profile in subsequent periods and how much expenditure would be incurred in periods where there is little or no production. The issue is extremely complex, involving the generosity of the oil allowance for "peak shaver" fields, and nearer the time we will in any event have to examine the position further. Action to prevent companies obtaining benefit from deferred claims for expenditure in safeguard would only go part of the way to dealing with what may be an over-generous regime for Morecambe in the mid-1990s.

OPTIONS

12. As mentioned in Mr Johns' minute to you of 3 August, there are broadly three options:

A. To legislate in 1988, on the lines earlier considered, for safeguard cases (in respect of post-7 August 1987 expenditure). At the same time it might be desirable to consider restricting the length of claim periods after first oil (see below).

B. Not to legislate in 1988, and defer assessments in both oil allowance cases and future safeguard cases.

C. Not to legislate in 1988, and to defer assessments in oil allowance cases, but not in safeguard cases.

In both Options B and C, the Revenue would need to issue a Statement of Practice on what the new practice on timing of assessments would be.

CONSIDERATIONS

Option A

13. Legislation would clearly be the most effective way to ensure that double relief is not given; deferral of assessments relies on the Revenue's ability to identify all the cases where amounts of expenditure remain unclaimed. It is only in the most extreme cases that we can readily recognise that expenditure for a period is not being claimed.

14. We considered whether a single solution could be applied to both the oil allowance and the safeguard problems. For oil allowance there is already a provision designed to cut back the scope for deferring expenditure claims (Sch 3 para 11 OTA 1975). This cuts back oil allowance if the amount obtained for a chargeable period is greater than it would have been if a timely expenditure claim had been made. It is, however, draconian - in that oil allowance is withdrawn in a period without expenditure being substituted for it in that period, though the expenditure will be taken into account in a later period and the displaced oil allowance also is available in later periods - and inadequate

- in that it only bites if the expenditure claims are deferred by more than 12 months after the end of a claim period. It seems to us better to deal with the safeguard problem by acting on the expenditure claim. Relief would be restricted where it can be shown that less effective relief would have been available if the expenditure had been claimed at the relevant time for a period where safeguard applied. This was the solution you originally agreed in the summer before the retrospection issue arose.

15. Unfortunately this cannot be used to cover the oil allowance case as well without a complicated provision to recalculate the amount of oil allowance for past periods in addition. We suggest we should continue to deal with the oil allowance problem by the "in terrorem" provision of Para 11 Sch 3, as backed by our practice of deferring assessments.

16. The legislation provides for "claim periods" for expenditure relief purposes - separate from "chargeable periods" - of 6 or 12 months duration at the option of the claimant. The 12 month claim period option was introduced for the administrative convenience of both companies and Revenue in periods prior to production from the field. For a field past payback there will typically be a six months claim period coinciding with the 6 months chargeable period for which assessments are made. Because chargeable periods for which assessments are raised are 6 month periods the ability to opt for a 12 month period when relief for expenditure is not needed can itself provide the opportunity for some limited deferral of expenditure for both safeguard and oil allowance reasons. We have seen one actual instance of this involving safeguard. It is open to us to counter the potential loss by deferring the assessment for the earlier of the 2 chargeable periods to which the 12 month claim relates. This involves making the decision on the claim in two separate stages, apportioning the expenditure between the first half year and the second half year which could give rise to difficulties. We think, therefore, that if legislation is to be introduced on the safeguard cases there would be an advantage in also legislating for six month claim periods after oil begins to flow.

17. We have considered the question whether, if we legislate only on the safeguard cases, we thereby put at risk our practice of continuing to defer assessments in oil allowance cases. We have come to the conclusion that we would not. We would be looking at a different provision of the Act, and the Courts take the view that one cannot construe earlier provisions by relation to later ones. Moreover, we can point to the existence of Para 11 of Sch 3 as evidence of Parliament's desire that the trick of deferring expenditure claims to maximise oil allowance should be defeated. Also, the Courts have upheld the Revenue's choice of timing of assessments in an oil allowance case, and although that does not in principle stop companies from seeking judicial review on the grounds that we are misusing that choice, they will probably not want to re-open the issue.

Option B

18. As described above, we feel that the practice of deferring assessments in oil allowance cases would probably not be successfully challenged under judicial review, but we could not say the same of the practice for safeguard cases. The companies would be aware that Ministers had twice declined to legislate, and although we are certain that it was not the intention of the legislation to allow a double benefit, we cannot prove so readily that it was Parliament's wish.

19. As both the principle of delaying expenditure claims and the Revenue's practice in deferring assessments have been the subject of a publicly announced review, we would, we feel, need to issue a Statement of Practice. It would not be possible for companies to challenge the validity of an assessment made at a date later than the normal time, as the Court decision established that the Revenue had a choice over the timing of assessments. The companies' only redress would be to seek judicial review on the grounds that we had exercised that choice unfairly or unlawfully. As we have carried out a consultation and invited representations on both aspects, prior to the issue of the Statement of Practice, the companies could not challenge any

deferral on grounds of procedural fairness. They would then have to rely on the argument that we had exercised our powers unlawfully, that is, in a manner not intended by Parliament when it approved the legislation, and would have to question what was Parliament's intention in the legislation. We think we would have a defence based on the sequence established in the legislation: expenditure is to be given first, then oil allowance, then safeguard. Moreover Section 9(4), which provides that an election to spread expenditure over several periods shall not have the effect of securing more safeguard relief than would otherwise have been the case, supports the view that it was not the intention that there should be a "double relief" for expenditure. Nevertheless, we would have to accept that the companies would have a stronger case in relation to safeguard than they would on oil allowance, and we could not be certain that the Revenue action would be upheld.

20. Moreover, deferral of assessments is only partially effective. For one thing, as mentioned in para 13 above, it is only where the Revenue can identify in advance that some expenditure for a period has not been claimed that they can know whether to defer an assessment. Otherwise, it is only when expenditure is eventually claimed in a later period, that one can know that an expenditure claim was deferred and by then the assessment for the period in which the expenditure was incurred will already have been raised. Also deferral of assessments in safeguard cases gives rise to more practical problems with regard to the self assessment and payment on account rules and with the deductibility of PRT for CT and the 5% provisional expenditure allowance and APRT credit. These problems are less pronounced in the oil allowance cases as the rules in Para 11 Sch 3 mean that any post-payback assessment deferral need only be for a relatively short period.

Option C

21. If you were to decide that, in the present circumstances in the oil market, it would be better to give the companies the benefit of the double relief, we would need to issue a Statement of Practice. This would announce that Ministers had decided in the light of the current conditions of the oil market not to legislate for the present; although the legislation allowed the Revenue a choice in the timing of assessments, we would not, however, exercise that choice to defer assessments in safeguard cases, but would maintain our right to defer assessments in oil allowance cases as at present.

22. This distinction could be justified both on the basis of the earlier Court decision and the existence of Para 11 of Sch 3. We could keep the position under review for later years. It should be recognised, however, that if Ministers should decide that they wanted to reverse the decision on safeguard cases in the future (as there could be significant costs in the 1990s), it would then have to be done by legislation.

23. As with Option A, we do not feel that distinguishing safeguard cases in any way undermines our practice of deferring assessments in oil allowance cases.

Conclusion

24. On grounds both of cost and of our view of the intention of the safeguard provision, there is a case for preventing the double relief, either by legislation (option A) or deferring assessments. (Option B). But, given that Option B is neither fully effective nor free from risk of challenge by judicial review, if you want to prevent the extra relief, we would recommend Option A.

25. The industry has argued that legislation or administrative action to deny the extra relief will have distorting effects on

expenditure decisions. We don't think there is a risk of fields not being developed, although we accept that there is perhaps a risk that some discretionary expenditure during safeguard periods might be deferred to later periods where the expenditure would be more effectively relieved. Department of Energy are, however, fairly relaxed about this risk, which they do not see as particularly great.

26. Nevertheless, one would have to accept that that argument, along with several other presentational points could be made by the industry, rendering Option A very controversial. They could present it as kicking certain depressed fields when they were down, and as introducing the effect of an incurred basis in the one case where it works in the Revenue's favour, which in the Keith context would seem an unbalanced approach. It would also follow shortly after this year's measures in response to the oil price fall, namely the Cross Field Allowance which, with the APRT Act, was designed to be a targeted response to help companies to adjust to the oil price fall. It would also be in a Bill in which there is likely to be not much else in the way of goodies for the oil industry, and on an issue which the industry have placed high on their shopping list of fiscal representations.

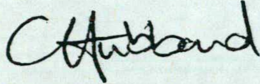
27. These latter considerations may suggest that Option C is the better course for the present. The case for legislation at a future date should be kept under review. It might be desirable to deal with the length of claim periods in the context of the Keith PRT recommendations or at any other time when the administrative machinery of PRT was reviewed. There are no significant administrative costs for either the Revenue or the industry whichever option is adopted.

Timing of an announcement

28. Whatever your decision, you will need to decide whether to announce your decision in the Budget or sooner. The companies will be pressing for an earlier clarification on the grounds that they are only covered for the expenditure up to 7 August. On

the other hand, there are obvious presentational advantages in announcing all oil taxation measures together. On balance, we think it might be preferable, if you decide not to legislate at this stage, to make an announcement now so as to remove a running source of irritation in the industry since at Budget time the presentational benefits may be lost.

29. We would of course be happy to discuss this with you. If you decide on either Option B or Option C, the next step would be to prepare draft Statements of Practice and Press Release for your approval. The detailed terms of the Statement of Practice would need careful consideration to limit the practical problems under Option B (paragraph 20 above), or to distinguish under Option C safeguard cases where the assessment is not to be deferred from the oil allowance cases where the assessment is deferred in particular situations where there are both oil allowance and safeguard effects.



MRS C B HUBBARD

ANNEX A

Britannic House, Moor Lane, London, EC2Y 9BU
Tel. No.: 01-920 8262

cc Mrs Hubbard
Mr Elliss
Mr Beauchamp
Dr Parker
Mr Evans
Float/File

Dear Michael,

PRT: EXPENDITURE CLAIMS DURING SAFEGUARD PERIOD

This letter responds to yours of 7th August 1987 and sets out UKOITC's representations in respect of the review announced in that letter.

UKOITC welcomes the decision not to apply any changes resulting from the review retrospectively, but believes that no changes are required in this area at all. In that connection we were concerned to read in your letter that even before the review is underway the issue shows signs of being pre-judged by comments to the effect that to take no action would effectively give 'double relief'.

Whilst accepting that it is possible by deferring claims to reduce the overall liability, we believe it is misleading to see this deferral as giving double relief. Without deferral the reality is that expenditure receives no relief at all in the safeguard exemption period, whilst deferral of claims would normally ensure that it receives relief at some time. However this expenditure as expenditure is never relieved more than once. The Revenue's view that it should be claimed and effectively wasted within such a safeguard period, despite the existence of a statutory 6 year time limit for making claims, would mean that it receives no relief at all.

It is of course correct that by deferring claims for expenditure a taxpayer may be able under certain circumstances to effect a reduction in his tax liability. UKOITC believes however that it is those very circumstances that safeguard is designed to relieve. They can arise through deferral of expenditure from a period where safeguard exemption operates to a later one which is either post-safeguard or one in which the safeguard taper has effect. Alternatively, but less commonly encountered, a taxpayer might wish to defer a claim for expenditure and uplift which would normally fall to be taken into account in a safeguard taper period thereby foregoing relief at 12% plus a further 12% for each additional safeguard period (or 80% if uplift is not claimed). Expenditure and uplift might be claimed later in such a case to fall into a period after safeguard has run out so that the effective relief would be higher. We believe that this second situation is likely to be more theoretical than real and that companies would normally prefer the prospect of immediate relief, albeit at a lower rate, than a higher deferred relief. There is also the aspect that expenditure agreed as qualifying for uplift in a deferred claim cannot as the law presently stands, be added retrospectively to the safeguard base.

UKOITC therefore considers that the Revenue's concerns in this area are over-stated. This issue is another example of the problems which we have discussed with the Revenue on many occasions where the interaction of uplift and safeguard produces a variety of anomalies. Mr. Elliss' letters to UKOITC of 20th January 1984 and 2nd January 1986 dealt in what we saw as a helpful and practical way within the context of the existing legislation with situations where the operation of these reliefs for different participators in the same field was causing difficulty. The Revenue ultimately agreed that the proper approach was not necessarily to maximise the amount of tax payable in each situation. In a similar area the OTO does not take the view that a taxpayer who is about to move into a period where safeguard determines his liability is under an obligation to maximise a previous period loss by claiming "excess" expenditure "on time" knowing that to do so would generate an effectively unrelieved loss carry over into the safeguard period. We note that it was not felt necessary or desirable to change the law in these areas and of course we fully agree with that approach. We find it difficult to distinguish the present issue from that and other situations of a similar kind and do not see why the approach taken should now be different to that adopted previously.

All of this would of course have been avoided by the adoption for PRT of an "incurred" rather than a "claimed and allowed" approach to expenditure. UKOITC argued for this over a number of years but now concedes that the present situation is so well established and understood and the transitional complications of moving away from it so complex, that it has to remain on the current basis. Government must accept that the present system of only allowing deductions for expenditure once claimed and allowed can defer and, notwithstanding Mr. Elliss' letters of 1984 and 1986, still deny relief to companies. The present issue is only the other side of that coin.

The present system can give rise to benefits and disadvantages in both directions. It operates against the taxpayer where claims made for expenditure are delayed during examination and are then allowed in a much later assessment without compensation for the delay through interest or otherwise. Through this delay expenditure relief may be lost where safeguard intrudes and Mr. Elliss' letters do not fully restore the position, they merely alleviate it. The Revenue resisted UKOITC contentions that expenditure ultimately allowed should be treated as having been so allowed at a specific point related to the timing of submission. It is our view therefore that a change of law or assessment practice to frustrate the taxpayer's ability to achieve an effective relief for his expenditure in this situation would be quite unreasonable.

One of the problems with the present debate about how safeguard should operate is the total silence in the legislation about the underlying intentions in regard to its working. What is certain however is that it came in at a time when oil prices had quadrupled and because of significant fears that there could subsequently be a significant reduction in those prices. It was introduced as a field life relief but from 1981 was truncated to a specific period based on field payback time. It seems unlikely that at that time anyone could have comtemplated that the level of oil prices in the future would ever bring safeguard exemption into play. The major reduction in oil prices during 1986 did just that for some existing fields and may indeed do so again for other fields in the future.

A second point relates to the 5% provisional allowance for unallowed expenditure, the effect of which for a company within safeguard when it is deducted, but out of it when that deduction is reversed, could be to erode the spirit, if not the letter, of the undertaking for the past contained in the letter of 7th August. UKOITC may want to come back on this depending on the outcome of the review for the future.

We would welcome an early opportunity to discuss this representation in further detail. Meanwhile we are copying it to Mr. Peter Lilley MP, Economic Secretary to the Treasury and Mr. Peter Morrison MP, Minister of State at the Department of Energy.

Yours sincerely,

A. E. WILLINGALE

Mr. M. Johns,
Inland Revenue,
Policy Division,
Somerset House,
London WC2R 1LB.

cc PS/Chancellor 2
PS/Paymaster General
Mr Scholar
Miss Sinclair
Mr Michie
Mr Knox - C&E
Mr Jefferson-Smith - C&E
PS/C&E

3741/011

FROM: P D P BARNES
DATE: 19 November 1987

NOTE OF A MEETING HELD IN ROOM 51/2 TREASURY CHAMBERS, PARLIAMENT STREET, AT 4.00PM ON WEDNESDAY 18 NOVEMBER

Those Present

Economic Secretary
Mr McGuigan - C&E
Mr Boardman - C&E
Sir Robin Haydon, Imperial Tobacco Limited
Angus Vine, Imperial Tobacco Limited
Mr Ron Loader, Imperial Tobacco Limited

ECONOMIC SECRETARY'S MEETING WITH IMPERIAL TOBACCO LIMITED

Imperial thanked the Economic Secretary for having agreed to see them.

2. Imperial said that since 1907 their main market had been the UK. They were now the only major UK tobacco company operating in the domestic market, since rival firms except BAT had US parents, and BAT did not market in the UK. Their plan was to develop an overseas operation, and since the mid 1970s a small part of their business had been in Europe, the US and the Middle East. Nonetheless, it was difficult to enter overseas markets where other major manufacturers were firmly entrenched, and in countries such as Italy, France, and Spain, tobacco was a state monopoly. So Imperial's major market, both for production and sales, was the UK.

3. In the UK, Imperial said that they had to operate in a market which was contracting under pressure both from the anti-smoking lobby, and from the price increases on cigarettes which had resulted from the sharp duty increases of previous years. Imperial's particular concern was competition from cheap imported cigarettes, particularly from German manufacturers with spare capacity who were selling marginally costed own-brand cigarettes into the UK market. The share of the market held by cheap imports had risen from ½ per cent in 1983 to 10 per cent in 1987. Imperial believed that there was a strong correlation between the increase in the market share of cheap cigarettes and the increase in duty, since customers' first response to increasing prices was to switch to cheaper cigarettes. The freeze on duty in the 1987 Budget had arrested the encroachment

of cheap cigarettes. Imperial estimated that double realorisation in the 1988 Budget in line with inflation would increase the market share of cheap foreign imports to 12 per cent.

4. Imperial said that they had taken measures to resist competition from cheap imports, for example by taking the opportunity of the duty freeze to rise prices by less than they usually did and by cutting prices on some of their brands to bring them closer to the price of own-brand cigarettes. But they could not profitably match own-brand imports on price. They were therefore hoping that the Government would help them resist import penetration, preferably by repeating the previous year's freeze on duty, but at least by not raising duty by more than the rate of inflation.

5. Other points made by Imperial were:-

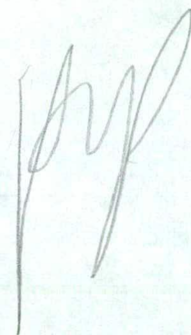
(i) Their main factories were in areas of high unemployment (Bristol, Nottingham, Ipswich, Glasgow). Because of the contracting market they had had to shut a factory in Swindon this year, in Newcastle two years ago, and in Stirling in 1983.

(ii) It was very difficult to plan ahead against an uncertain fiscal background.

6. The Economic Secretary thanked Imperial for coming and making their presentation and said he would consider, but without commitment, the points they had made. The Economic Secretary also noted Imperial's suggestion that other EC countries were operating tobacco monopolies in breach of Community rules. He said that he would be interested to see any papers Imperial were able to provide which supported this claim.

PB

P D P BARNES
Private Secretary



cc PS/Chancellor 2
PS/Financial Secretary
Sir P Middleton
Mr Cassell
Mr Moore
Mr Williams
Ms Leahy

Mr Johns - IR
Mrs Hubbard - IR
Miss Hill - IR
Mr Kuczys - IR
PS/IR

FROM: P D P BARNES
DATE: 18 November 1987

NOTE OF A MEETING HELD IN ROOM 51/2 TREASURY CHAMBERS, PARLIAMENT STREET, AT 10.45 AM ON WEDNESDAY 18 NOVEMBER 1987

Those Present

Economic Secretary
Miss Leahy
Miss Hill
Mrs Hubbard
Mr Carl J Burnett Jr, President UKOOA
Mr George Band, Chairman, UKOOA
Mr Christopher Willy, Secretary, UKOOA
Mr John Ogren, Chairman, Conoco UK
Mr Ken Taylor, ESSO

MEETING WITH UKOOA

Mr Burnett thanked the Economic Secretary for seeing UKOOA and for agreeing to discuss the proposals set out in Mr Band's letter to the Economic Secretary of 3 November.

2. Mr Burnett described UKOOA's Budget proposals as 'minor but significant'. He thought they would be minor in so far as their impact on Exchequer revenues was concerned (indeed he thought that in the long term the proposals would add to tax revenues). But he thought UKOOA's suggestions would have a significant effect on North Sea activity.

Incremental Investment Incentives

3. UKOOA said that their proposals in this area had two strands. One, on the determination of new fields, was largely a matter for the Department of the Energy. But the other strand, for the Economic Secretary to consider, was their proposal for improving the low post-tax returns on investments in existing fields which resulted from the present tax system. Mr Taylor stressed that this incentive was not the same as a Government hand-out, since the oil industry would derive a benefit only if it spent money. It was difficult to provide concrete examples of otherwise viable projects which had been prevented by the existing tax system, since the companies' engineers did not examine projects that looked as if they were going to be non-viable post-tax, because of the cost of doing so. (UKOOA

was hoping to find some other way of demonstrating the benefits of some relief for incrementals) Mr Taylor thought however that the equivalent of twenty 50 million barrel oil fields could be at stake.

Royalty

4. UKOOA said that in previous years they had urged the total abolition of royalty and this remained their unltimate aim as they thought there was little justification for paying a fixed charge. Nonetheless, they accepted that abolition would be very costly and their present suggestion of an allowance designed to help declining fields would cost £100 million a year rather than the £400 million of total abolition. They said the royalty issue is one which was very significant for their members.

Southern Basin

5. UKOOA said that they could not see why the UK discriminated against the Southern Basin and hence against gas in its fiscal regime. Finds in the Southern Basin were now often smaller than those in for example the Central Basin and the characteristically deeper reservoirs made the cost of the extraction higher. For example the technical costs of developing the South Ravensburgh fields were estimated at 50 per cent higher than those in the Bruce Fields. Mr Taylor said that very few contracts had been signed with British Gas over the last 18 months, and those presently being negotiated would depend critically not only on price but also on tax. UK gas producers had to compete against huge Norwegian fields, and UK fields dating from the late 70s already were more than half depleted, and it was unlikely that gas condensate field would to be viable under the existing tax regime. So the future of gas production on the UKCS depended critically on the tax regime in place. The gas conversion factor, which at present was worked out in terms of thermal equivalence, also, UKOOA argued, discriminated against the fair taxation of gas.

Abandonment

6. UKOOA said that the industry had now reached consensus on the fiscal aspects of abandonment. They would be putting a full paper to the Government around the New Year. UKOOA members had decided

against a cost-sharing system along Norwegian lines, and they hoped that the Government would share their preferences, as a cost-sharing system would result in additional public expenditure. Instead they were looking at a system that would reduce discrepancies between the handling of abandonment for different fields. They were considering:-

(i) Suggesting that CT carry back should be allowed for more than 1 year for continuing trades and more than 3 years on cessation of trading;

(ii) The possibility of optional trust fund with contributions attracting tax relief;

(iii) Recommending that the company that, because of joint and several liability, was obliged to bear the abandonment costs of a defaulting company should be entitled to offset those costs to the extent of the tax relief that would have been available to the defaulting company.

(iv) Removing the distortions which might arise because tax relief was given at marginal, rather than average effective rates.

7. The Economic Secretary said that he was grateful to UKOOA for having come and set out their concerns. He encouraged UKOOA to discuss their ideas in detail with officials and he understood that a meeting had already been arranged for later that week.

PB

P D P BARNES
Private Secretary