FILE BEGINS 03/08/1987 ENDS 24/12/1987

FILE TITLE

TASK FORCE 1987–1988

FILE NUMBER PO-CH/NL/0739 PART A

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| DATE | | |

•C10/41

SECRET AND PERSONAL

Copy No. 10 of 10.

FROM: A W KUCZYS
DATE: 10 JULY 1987

DP

MR CAYLEY - IR

cc PS/Financial Secretary
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
Mr Houghton - IR

**REFORM OF CAPITAL GAINS TAX**

The Chancellor was grateful for your minute of 1 July. He has a number of initial comments.

2. First, he has asked Mr Scholar to consider the question of at what stage to bring in the Bank to advise on market effects. Second, he was surprised to find that you are no longer predicting a significant short-term yield (because of unlocking) from rebasing. He has asked Mr Scholar to pursue this with you.

3. In his postscript, Mr Isaac said the most difficult area might be people at the top of the basic rate band and just above the higher rate threshold, who could both lose from the wider income tax package <u>and</u> be pushed into the 40% tax bracket by the capital gain. The Chancellor has noted that we have not yet decided what the higher rate threshold should be.

4. You note that one major policy issue is whether the rebasing should be compulsory for all taxpayers or optional. You say logic would point to making rebasing compulsory. The Chancellor thinks this is clearly right.

5. You say that, without removal of indexation, any change on these lines would not be a simplification. The Chancellor is not sure about this. At any rate, there would be a dramatic reduction in the CGT caseload - by about a third.

6. There is a link with the income tax treatment of husband and wife here. One possibility might be to give husbands and

wives CGT thresholds in their own right, but that the threshold should be at about half its present level (we could play around with various options). Thus, married couples would, together, have about the same total of exempt gains as now; single people would have a lower threshold.

7. The Chancellor notes that more than half the cost of the proposed reform comes from rebasing for <u>companies'</u> gains. He would be grateful for a quick note exploring the possibility of rebasing for <u>individuals</u> only.

8. The Chancellor thinks we may have to be prepared for complaints that any change in CGT is retrospective, in the sense that future realisations will reflect earlier accruals. We will need to be armed with the counter-arguments. In particular, are there any helpful precedents - perhaps when CGT loopholes have been blocked up?

9. You say that full integration with income tax would greatly add to the length of legislation. By how much? The Chancellor would like a fuller note on both the costs <u>and</u> the benefits of charging capital gains to income tax.

10. You note that, where people have blocks of shares in a company some of which were acquired before and some after 1982, under the CGT rules they are deemed to dispose of the later holdings first. Is this rule immutable? Since it hinders "unlocking", there is a case for changing it. Similarly, in his postscript to your 6 July minute about minor simplifications of indexation, Mr Houghton said that the change you recommend has a drawback in that it would fix accrued indexation irremovably in the system. But if we want the full unlocking effect, we want it to be clear that we will not subsequently withdraw indexation relief. So this "disadvantage" could in fact be positively helpful presentationally.

11. Finally, it would be helpful if the work you undertook earlier, analysing who CGT payers are in relation to income tax payers, could now be taken further. If necessary, resources will have to be made available for this.

A W KUCZYS

MR 2/67

**TASK FORCE SECRET**

Copy No. 15 .of 16

FROM: A W KUCZYS

DATE: 27 July 1987

MR CAYLEY - IR

cc: PS/FST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Byatt
Mr Scholar
Mr G Smith
Miss Sinclair
Mr Cropper
Mr Battishill
Mr Isaac
Mr Houghton

**REFORM OF CAPITAL GAINS TAX**

The Chancellor was grateful for your minute of 21 July.

2. On the costs and benefits of charging capital gains to income tax, he has asked what is the US position post tax reform?

3. On the precedents for use in dealing with complaints that CGT changes are retrospective, the Chancellor would be grateful for a note on the options for avoiding retrospection: ie

(a) making the 40 per cent rate apply only to future gains; and

(b) leaving a year in which past gains are taxable at 30 per cent before moving to 40 per cent.

A W KUCZYS

TASK FORCE SECRET

Copy No. 16 of 16

FROM: A W KUCZYS

DATE: 27 July 1987

MR CAYLEY - IR

cc: PS/FST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Byatt
Mr Scholar
Mr G Smith
Miss Sinclair
Mr Cropper
Mr Battishill
Mr Isaac
Mr Houghton

**REFORM OF CAPITAL GAINS TAX**

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(a) making the 40 per cent rate apply only to future gains; and

(b) leaving a year in which past gains are taxable at 30 per cent before moving to 40 per cent.

A W KUCZYS

**TASK FORCE SECRET**

COPY NO. 11 OF 13.

FROM: A W KUCZYS

DATE: 27 July 1987

1 MISS SINCLAIR

cc 2 Sir P Middleton
3 Sir T Burns
4 Mr Cassell
5 Mr Byatt
6 Mr Scholar
7 Mr G P Smith
8 Mr Battishill - IR
9 Mr Isaac - IR

**REFORM OF CAPITAL GAINS TAX**

The Chancellor was grateful for your note of 24 July. He awaits the further report in September, looking at the costings and behavioural assumptions in more depth, with interest.

AWK

A W KUCZYS

ps3/30K

**TASK FORCE SECRET**

COPY NO. 12 OF 13.

FROM: A W KUCZYS

DATE: 27 July 1987

(1) MISS SINCLAIR

cc (2) Sir P Middleton
(3) Sir T Burns
(4) Mr Cassell
(5) Mr Byatt
(6) Mr Scholar
(7) Mr G P Smith
(8) Mr Battishill - IR
(9) Mr Isaac - IR

**REFORM OF CAPITAL GAINS TAX**

The Chancellor was grateful for your note of 24 July. He awaits the further report in September, looking at the costings and behavioural assumptions in more depth, with interest.

AWK

A W KUCZYS

ps3/30K

TASK FORCE SECRET

COPY NO. 13 OF 13.

FROM: A W KUCZYS
DATE: 27 July 1987

1 MISS SINCLAIR

cc 2 Sir P Middleton
3 Sir T Burns
4 Mr Cassell
5 Mr Byatt
6 Mr Scholar
7 Mr G P Smith
8 Mr Battishill - IR
9 Mr Isaac - IR

**REFORM OF CAPITAL GAINS TAX**

The Chancellor was grateful for your note of 24 July. He awaits the further report in September, looking at the costings and behavioural assumptions in more depth, with interest.

A W K

A W KUCZYS

**TASK FORCE SECRET**

COPY NO. 11 OF 11.

FROM: A W KUCZYS

DATE: 30 July 1987

MISS SINCLAIR

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr Byatt
Mr Scholar
Mr G P Smith
Mr Battishill - IR
Mr Isaac

**REFORM OF CAPITAL GAINS TAX**

Your note of 24 July. This is just to confirm that the Chancellor is content with your recommendation that we should not bring in the Bank until you have produced the further report in early September.

AWK

A W KUCZYS

ps3/51K

SECRET

FROM: A W KUCZYS
DATE: 30 July 1987

PS/FINANCIAL SECRETARY

cc Mr Cropper

**TAX REFORM**

The Chancellor was grateful for the Financial Secretary's minute of 28 July, which he discussed with the Financial Secretary on Tuesday evening.

A W KUCZYS

ps3/51K

SECRET

FROM: A W KUCZYS
DATE: 30 July 1987

PS/FINANCIAL SECRETARY

cc Mr Cropper

**TAX REFORM**

The Chancellor was grateful for the Financial Secretary's minute of 28 July, which he discussed with the Financial Secretary on Tuesday evening.

A W K

A W KUCZYS

TASK FORCE SECRET

Copy No. 12 9 of 12 Copies

FROM: J M G TAYLOR

DATE: 3 August 1987

MR GONZALEZ - IR

cc: FST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Byatt
Mr Scholar
Mr G Smith
Miss Sinclair
Mr Cropper
PS/IR

**REFORM OF CAPITAL GAINS TAX**

The Chancellor was grateful for your minute of 29 July. He is content that you should go ahead as soon as possible on the basis you propose.

J M G TAYLOR

TASK FORCE SECRET

Copy No. 11 .of. 11 .Copies

FROM: J M G TAYLOR
DATE: 3 August 1987

PS/FINANCIAL SECRETARY

cc: CST
PMG
EST
Mr Scholar
Mr Cropper
Mr Tyrie
Ms Rhodes
PS/IR

**ABOLITION OF EMPLOYEE'S UEL - BENEFITS-IN-KIND**

The Chancellor has seen Ms Rhodes minute of 30 July. He would be grateful for the Financial Secretary's advice in due course.

2. He has commented that this idea would have to be presented - along with other benefits-in-kind measures, notably the raising of the P11D threshold - as part of an overall benefits-in-kind package. If it were presented as part of the reform package, there would be undesirable pressure to allow tax reliefs against employee NICs.

JT

J M G TAYLOR

TASK FORCE SECRET

Copy 4 OF. 4.

FROM: J M G TAYLOR
DATE: 3 August 1987

PS/FINANCIAL SECRETARY

cc Mr Cropper

**TAX REFORM: SELF-EMPLOYED**

The Chancellor has seen the Financial Secretary's minute of 29 July. He has commented that this is a good point. He would be grateful for a note on this, examining options; perhaps you would be good enough to set this in hand.

JT

J M G TAYLOR

TASK FORCE SECRET

Copy No. 13 ...of 13

FROM: A W KUCZYS

DATE: 4 August 1987

MR SCHOLAR (o/r)

cc: PS/FST
Mr Cassell
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Isaac
Mr Houghton
Mr Mace
Mr Cayley
PS/IR

**TAX REFORM**

Please could you, and other recipients of this note, please copy all future papers on tax reform to Mr Tyrie (as well, of course, as Mr Cropper), as the Chancellor has asked him to be closely involved in this work.

AWK

A W KUCZYS

TASK FORCE SECRET

Copy No. 13 of 13

FROM: A W KUCZYS

DATE: 4 August 1987

MR MACE - IR

cc: PS/FST
Sir P Middleton
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Battishill - IR
Mr Isaac - IR
Miss Dyall - IR

**INDEPENDENT TAXATION**

We spoke about the Chancellor's request for a further refinement to independent taxation to be worked up. Independent taxation deals with <u>some</u> of the complaints about the present system. For example, it provides privacy. But, unlike transferable allowances, it retains sex discrimination, in the form of the married <u>man's</u> allowance. The Chancellor's proposal is that this should be converted into a "married person's allowance", available to either partner (but not both).

2. Your initial reaction was that this would be a major addition to independent taxation in terms of staff cost, and could seriously endanger the 1990 start date. You would let the Chancellor have a note in September.

A W K

A W KUCZYS

TASK FORCE SECRET

Copy No. 11 of 12 Copies

FROM: A C S ALLAN
DATE: 4 August 1987

MR SCHOLAR

cc: PS/FST
Sir P Middleton
Sir T Burns
Mr Cassell
Miss Sinclair
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
PS/IR

**TAX REFORM: WORK PROGRAMME**

The Chancellor was grateful for your minute of 31 July, and is content with the work programme you outlined.

ACSA

A C S ALLAN

FROM: J M G TAYLOR
DATE: 5 August 1987

PS/FINANCIAL SECRETARY

cc Sir Peter Middleton
Mr Cassell
Mr Byatt
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Battishill IR
Mr Isaac IR
Mr Painter IR
Mr Beighton IR

**TAX REFORM - REMOVING SHELTERS AND ANTI-AVOIDANCE PROVISIONS**

1. The Chancellor was most grateful for your minute of 31 July.

2. He has commented that a package comprising the Financial Secretary's suggestions in relation to redundancy payments, premiums for rent, and enterprise zones, looks possible for the 1988 Budget. He agrees that it might be worth announcing in the Budget our intention to consult on the possibility of simplifying or reducing anti-avoidance provision.

3. He does not want to do anything about farmers, gilts and corporate bonds, or the executive share option scheme. On the latter, he has noted that the proposed changes to income tax and CGT rates should greatly reduce the cost of this scheme. He also thinks that, if abolition of relief for interest is not on, the alternatives in this area are too complex to be worth pursuing.

4. The Chancellor is otherwise in agreement with the Financial Secretary's conclusions.

JT

J M G TAYLOR
Private Secretary

TASK FORCE SECRET

Copy No. 16 of 16 Copies

FROM: A W KUCZYS
DATE: 6 August 1987

MR CAYLEY - IR

cc: PS/FST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Byatt
Mr Scholar
Mr G Smith
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Battishill
Mr Isaac - IR
Mr Houghton - IR

**REFORM OF CAPITAL GAINS TAX**

The Chancellor was grateful for your further minute of 4 August.

2. He has commented that, clearly, the only possible variant - undesirable but, as US experience suggests, wearable - would simply be to announce the reform on Budget day to take effect for realisations on or after 6 April 1988. There would clearly be some significant forestalling, but the Chancellor is not aware of "market disruption" in the US, when they in effect did the same thing.

A W KUCZYS

**TASK FORCE SECRET**

Copy No. 17 of 17 Copies

FROM: J M G TAYLOR
DATE: 10 August 1987

MR CAYLEY - IR

cc: CST
FST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Byatt
Mr Scholar
Mr G Smith
Miss Sinclair
Mr Tyrie
Mr Cropper
Mr Isaac - IR
Mr Houghton - IR
PS/IR

**CGT REFORM: HUSBAND AND WIFE**

The Chancellor was grateful for your minute of 6 August. He has commented that, in the circumstances, and subject to the views of the Financial Secretary, the freeze proposed in paragraph 15 looks the most practical option.

2. He has also commented that a careful costing of the rebasing to 1982 is being conducted. He would be grateful if this could, in addition, be compared with the cost of having a higher IT and CGT rate of 35 per cent instead of 40 per cent.

JT

J M G TAYLOR

MR 12/51

TASK FORCE SECRET

Copy No. 5 .of. 5 .Copies

FROM: J M G TAYLOR

DATE: 13 August 1987

MR TYRIE o/r

cc: PS/FST
Mr Cropper o/r

**TAX REFORM: SHELTERS AND ANTI-AVOIDANCE PROVISIONS**

The Chancellor has seen your minute of 7 August. He has commented that he may be prejudiced, since he himself introduced the Executive Share Option scheme in 1984. But he retains that prejudice - quite apart from the U-turn aspect. Moreover, the present tax treatment, although lighter than its predecessor, is by no means self-evidently wrong.

JT

J M G TAYLOR

**TASK FORCE SECRET**

COPY NO. 17 OF 17 .

FROM: A C S ALLAN
DATE: 1 September 1987

MR M F CAYLEY - Inland Revenue

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Scholar
Mr G P Smith
Miss Sinclair
Mr Cropper
Mr Tyrie

Mr Battishill - IR
Mr Isaac - IR
Mr Houghton - IR
PS/IR

**CAPITAL GAINS REFORM: COMMENCEMENT ARRANGEMENTS**

The Chancellor was grateful for your minute of 26 August.

2. He awaits the further advice from the Treasury on the possible market implications of a 6 April start. He would be grateful if this could distinguish between the effect of a package containing both (a) the base date being moved forward from 6 April 1965 to 31 March 1982 and (b) the gains of individuals being charged under the new income tax rates structure, and the effect of a package containing (b) only. He would also be grateful for the views of the Financial Secretary.

3. Subject to those, his present inclination is in favour of the very much simpler option of a 6 April start.

ACSA

A C S ALLAN

Copy 14 of 14

FROM: A C S ALLAN
DATE: 3 September 1987

MR SCHOLAR

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Miss Peirson
Mr McIntyre
Miss Sinclair
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
PS/IR

**NIC REFORM**

The Chancellor would be grateful if one additional NIC option at the lower end could be considered. This would be simply to raise the lower earnings limit, without raising the thresholds for the reduced rates. He would be grateful for costings for various options for the size of the increase, and for figures on how the LEL as a proportion of average earnings has changed over time.

ACSA

A C S ALLAN

psl/18A

TASK FORCE SECRET

COPY 13 OF 13

FROM: A C S ALLAN

DATE: 4 September 1987

MR CAYLEY - Inland Revenue

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
Mr Houghton - IR
PS/IR

**CGT ON SALE OF PRINCIPAL RESIDENCE**

The Chancellor would be grateful for a note on the scope for withdrawing CGT exemption from the sale of the principal residence. In addition to all the usual consideration, he would be grateful if this could cover:

(i) the rollover option; and

(ii) the practice in the US.

2. He would imagine that removing this particular tax break would be practicable only if we were rebasing on 1982.

ACSA

A C S ALLAN

psl/14A

**TASK FORCE SECRET**

COPY 13 OF 13

FROM: A C S ALLAN

DATE: 4 September 1987

MR MACE - Inland Revenue

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
Mr Houghton - IR
Mr Cayley - IR
PS/IR

**HIGHER RATE**

The Chancellor would be grateful if the options in the tax package could be expanded to include one where the top rate was 40 per cent in 1988, and was then cut progressively to 37½ per cent in 1989 and 35 per cent in 1990. This would be announced in advance (and might, if that is possible, be legislated in advance). It would not make sense to put the CGT rate up only to put it down, and so he feels the CGT rate for those paying high rate tax would have to be set at 35 per cent straight away.

2. He would be interested in particular to see how this would interact with a NIC package where we were staging the introduction of the full NIC rate above the existing UEL.

3. He recognises that this phasing would cause some additional complexities, and so would like the option of introducing a 35 per cent rate in 1988 kept in play.

ACSA

A C S ALLAN

FROM: A C S ALLAN
DATE: 4 September 1987

PS/FINANCIAL SECRETARY

cc
Sir P Middleton
Mr Scholar
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
Miss Rhodes - IR
PS/IR

**BENEFITS IN KIND**

The Chancellor has been thinking further about the proposal to levy a charge in lieu of employees' NIC on benefits in kind, following an abolition of the UEL. On reflection, he sees very considerable difficulties in this:

(i) it would make it much harder to hold the line on the distinction between tax and NICs; and

(ii) the imposition of a substitute tax charge would lead to pressure for substitute tax reliefs, which do not run against NICs.

2. He would therefore be grateful if the Revenue could also look again at the scope for levying a more realistic charge on car benefits, as an alternative way of reducing the under-taxation of benefits in kind. This would need to be looked at in the context of the overall package, and with a view to avoiding overall losers so far as possible.

3. He recognises that avoiding overall losers would reinforce the case for raising the P11D earnings threshold; and that would also have obvious administrative benefits. But, on further reflection, he sees difficulties in a substantial increase in the P11D threshold. And it would look particularly odd to do this if the most troublesome benefits (third party entertainment, car

parking etc.) are to be exempted. He would therefore be grateful for advice from the Inland Revenue on a more radical alternative: exempting employees from tax on benefits, but instead either levying a charge on employers or simply disallowing expenditure on benefits against Corporation Tax. He recalls that this has been considered before, and was rejected partly because of the danger that it would be seen as a windfall for employees and partly because of the practical difficulties of valuing the benefit to employees. But he thinks this proposal is well worth re-examining as part of the present package.

4. If neither of these avenues seem attractive, the Chancellor feels we may have to say that for the time being the NIC loophole has to remain; if there was then a massive increase in exploitation, that would make subsequent action much more defensible.

ACSA

A C S ALLAN

MR 1/61

**TASK FORCE SECRET**

Copy No. 11 .of 11 Copies

FROM: A C S ALLAN

DATE: 8 September 1987

MR M S CAYLEY - IR

cc: PS/FST
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
PS/IR

**CAPITAL GAINS REFORM**

The Chancellor would be grateful for advice on a further option.

2. This would be to keep CGT as a separate tax, but charged at progressive rates which were equal to those for income tax - ie an exempt amount of, say, £6,600, a slice at 25 per cent, and the rest at 35 per cent or 40 per cent.

3. I should be grateful if you could provide a note on this, covering the costings, the effect on gainers and losers, and the implications for legislation.

ACSA

A C S ALLAN

Copy No 16 of 16

FROM: J M G Taylor

DATE: 14 September 1987

MR CAYLEY - INLAND REVENUE

cc Financial Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Scholar
Mr G P Smith
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Isaac - IR
Mr Houghton - IR
PS/IR

**CGT REFORM**

The Chancellor was most grateful for your minute of 10 September.

2. He agrees with Mr Isaac's suggestion that he should consider this minute alongside the further note from statisticians, and the separate note in answer to his question about a 25 per cent/35 per cent regime for capital gains tax not integrated with income tax. He will hold a meeting on this in due course, and he would be grateful if Mr Scholar could provide an annotated agenda for that meeting.

JT

J M G TAYLOR

COPY No 15 of 15

FROM: J M G Taylor

DATE: 14 September 1987

MR CAYLEY - INLAND REVENUE

cc Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Riley
Mr Cropper
Mr Tyrie
Mr Isaac - IR
Mr Houghton - IR
PS/IR

**CGT ON SALE OF PRIVATE RESIDENCE**

The Chancellor was grateful for your minute of 11 September.

2. He has noted Mr Isaac's manuscript observation that: "The question is whether this game, even for a level playing field, is worth the candle". He agrees with the implied conclusion that it is not.

J M G TAYLOR

COPY NO 3 OF 3 COPIES

FROM: J M G TAYLOR
DATE: 15 September 1987

PS/FINANCIAL SECRETARY

**THE REFORM OF CAPITAL GAINS TAX**

The Chancellor was most grateful for the Financial Secretary's minute of 15 September.

2. He has noted that the Financial Secretary is getting some information on the costings of his proposals. The Chancellor is happy to look again at a means of simplifying CGT by abolishing indexation. He has commented, however, that answers will need to be found to the objections that emerged when this was looked at before (these are set out in the earlier papers). He suggests that the Financial Secretary might also like to discuss this with Mr Houghton before he leaves this area.

JT

J M G TAYLOR

pal/8A

**TASK FORCE SECRET**

COPY NO 16 OF 16 COPIES

FROM: A C S ALLAN
DATE: 16 September 1987

MISS C E C SINCLAIR

cc PS/Financial Secretary
Sir P Middleton
Mr Cassell
Mr Monck
Mr Scholar
Mr G P Smith
Mr Michie
Miss Hay
Mr Cropper
Mr Tyrie

Mr Isaac - IR
Mr Painter - IR
PS/IR

**TAXATION OF BENEFITS IN KIND**

The Chancellor was most grateful for your minute of 15 September, proposing a radical change to taxing employers on the value of the benefits in kind which they give.

2. He feels that, given our current benefits in kind problems, which are likely to grow, this is something which should be pursued as a matter of urgency. He would be grateful for Inland Revenue views.

3. He was not sure whether we needed to approach the Australians and New Zealanders to ask all the questions in Annex B. What do the Inland Revenue think?

ACSA

A C S ALLAN

MR 12/2

TASK FORCE SECRET Copy No. 18 of 18 Copies

FROM: J M G TAYLOR

DATE: 21 September 1987

MISS SINCLAIR

cc: FST
Sir P Middleton
Mr Scholar
Mrs Lomax
Mr Ilett
Mr Cassell
Mr Riley
Mr G Smith
Miss Hay
Mr Sparkes
Mr Cropper
Mr Tyrie
Mr Call
PS/IR
Mr Cayley - IR

**CGT REFORM: MARKET IMPLICATIONS OF 6 APRIL 1988 START DATE**

The Chancellor was grateful for your minute of 18 September.

2. He would be grateful for a rough estimate of the amount of tax revenue that might be brought forward from 1988-89 to 1987-88 under option (b).

JT

J M G TAYLOR

MR 12/1

**TASK FORCE SECRET**

Copy No..7..of.7..Copies

FROM: J M G TAYLOR
DATE: 21 September 1987

PS/FINANCIAL SECRETARY

cc: Mr Houghton - IR
Mr Cayley - IR
Mr Cropper
Mr Tyrie

**REFORM OF CAPITAL GAINS TAX**

The Chancellor was grateful for your minute of 18 September.

2. He has commented that the comparison in your paragraph (iv) is not necessarily the right one since if we are retaining indexation we may not need or wish to rebase, which would turn the cost of £1050 million into a yield of £100 million.

J M G TAYLOR

**TASK FORCE SECRET**

Copy No..16..of..16..Copies

FROM: A C S ALLAN
DATE: 21 September 1987

MISS SINCLAIR

cc: PS/FST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr G P Smith
Mr C Riley
Miss Evans
Mr Cropper
Mr Tyrie
PS/IR
Mr Beighton - IR
Mr Calder - IR

**TAX REFORM: FIRST "SCORECARD" COSTINGS**

The Chancellor was most grateful for your minute of 18 September.

2. He would be grateful if the further scorecards promised in your paragraph 6 could include a check list (and wherever possible the costing) of the further options which are at present being explored.

3. In the meantime, however, he would be grateful to see as soon as possibe how Table 1 would look <u>without</u> the CGT rebasing (this is not derivable from Table 3, which does not show the year-by-year pattern).

ACSA

A C S ALLAN

TASK FORCE SECRET

COPY 11 OF 11

FROM: J M G TAYLOR
DATE: 22 September 1987

MR SCHOLAR

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Riley
Miss Sinclair
Miss Evans

**TIMING OF TAX AND COMMUNITY CHARGE CHANGES**

The Chancellor was grateful for your minute of 21 September. He looks forward to the distributional analysis of the impact of these changes.

JT

J M G TAYLOR

COPY 16 OF 16

FROM: J M G TAYLOR

DATE: 23 September 1987

MISS C EVANS

cc Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr G P Smith
Mr Riley
Miss Sinclair o.r.
Mr Scholar
Mr Cropper
Mr Tyrie
PS/IR
Mr Beighton - IR
Mr Calder - IR

**TAX REFORM: FIRST "SCORECARD" COSTINGS**

The Chancellor was most grateful for your minute of 22 September.

J M G TAYLOR

COPY NO 14 OF 14

FROM: J M G TAYLOR
DATE: 5 October 1987

PS/FINANCIAL SECRETARY

cc Sir P Middleton
Miss Peirson
Mr Scholar
Miss Sinclair
Mr Macpherson
Mr McIntyre
Mr Cropper
Mr Tyrie
Mr Battishill - IR
Mr Isaac - IR
Mr Mace - IR

**TAX REFORM: SELF EMPLOYED**

The Chancellor has seen Mr McIntyre's minute of 30 September, and the enclosed paper prepared by Mr Macpherson.

2. The Chancellor has commented that he does not think that the "current proposal", as described in Mr Macpherson's paragraph 11, is acceptable. He has also said that (Mr Macpherson's paragraph 26) it is not an objective of the tax reform package to make any significant reduction in the NIF "subsidy" to the self-employed.

3. He has noted the "alternative" proposal (paragraph 15 of Mr Macpherson's paper), under which Ministers would introduce a 6.3 per cent rate above the UPL, with tax relief on half the contributions above (as well as below) the UPL. He has commented that, at first glance, this is the very least that should be done to produce a package that is tolerable to the self-employed.

J M G TAYLOR

**TASK FORCE SECRET**

Copy No...17..of.17..Copies

FROM: J M G TAYLOR
DATE: 5 October 1987

MR MACE - IR

cc: CST
FST
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Scholar
Miss Sinclair
Mr G P Smith
Mr Cropper
Mr Tyrie
Mr Battishill
Mr Isaac
PS/IR

**TAX REFORM: INCOME TAX AND NIC**

The Chancellor was most grateful for your minute of 29 September.

2. He has noted the assumption (paragraph 6 (iv) of your minute) that there would be no income tax relief on the Class IV NIC charge above the UPL. He would be grateful for a note on the effect/cost of giving such relief.

3. He would also be grateful for two further tables. First, he would be grateful for a version of the table on page 5 in cash terms. Second, he would like a version of the table on page 8 in terms of percentage distribution.

J M G TAYLOR

FROM: J M G TAYLOR

DATE: 7 October 1987

MR SCHOLAR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Monck
Miss Peirson
Mr Riley
Miss Sinclair
Mr G P Smith
Mr Macpherson
Mr Cropper
Mr Tyrie
Mr Isaac - IR
Mr Mace - IR
PS/IR

**TAX REFORM AND NICs AT THE LOWER END**

The Chancellor was grateful for your minute of 2 October, and for Mr Macpherson's enclosed paper. He will consider this further.

2. He would be grateful if, in the meantime, he could be provided with a costing for an option on the following lines:

| | Employees % rate | | Employers % rate | |
|---|---|---|---|---|
| £ per week | now | proposed | now | proposed |
| 41-70 | 5 | 0 | 5 | 0 |
| 70-105 | 7 | 5 | 7 | 5 |
| 105-155 | 9 | 9 | 9 | 9 |
| 155-305 | 9 | 9 | 10.45 | 10.45 |

(NB: Could be a higher start than £70 p.w.)

JT

J M G TAYLOR

ps3/15T

**TASK FORCE SECRET**

COPY NO 16 OF 16 .

FROM: J M G TAYLOR

DATE: 7 October 1987

MR MACE - Inland Revenue

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Jenkins (Parly Counsel)
Mr Battishill - IR
Mr Isaac - IR
Mr Lewis - IR
PS/IR

**INDEPENDENT TAXATION: VARIANTS OF THE MARRIED MAN'S ALLOWANCE**

The Chancellor was grateful for your minute and enclosures of 28 September.

2. He is prepared to rule out all the options except for:

- the "cosmetic" option;
- the vanishing exemption based on the husband's income.

3. He would be grateful if costings for the vanishing exemption based on the husband's income could be worked up. These should be based on a higher starting point for the withdrawal of the married man's allowance (so as to avoid the 300,000 extra losers identified in your minutes) and perhaps a 4 per cent additional marginal rate.

J M G TAYLOR

FROM: J M G TAYLOR
DATE: 7 October 1987

MR CAYLEY - INLAND REVENUE

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Battishill - IR
Mr Isaac - IR
Mr Houghton - IR
PS/IR

**CAPITAL GAINS TAX**

The Chancellor has seen and was grateful for your minute of 17 September. He would be grateful if you could prepare a full costing of the option set out in your note, and set this out on a table comparing it with the other options.

J M G TAYLOR

ps3/16T

**TASK FORCE SECRET**

COPY NO 15 OF 15 .

FROM: J M G TAYLOR
DATE: 7 October 1987

PS/FINANCIAL SECRETARY

cc Sir P Middleton
Miss Peirson
Mr Scholar
Miss Sinclair
Mr Macpherson
Mr McIntyre
Mr Cropper
Mr Tyrie
Mr Battishill - IR
Mr Isaac - IR
Mr Mace - PS/IR

**TAX REFORM: SELF EMPLOYED**

My minute of 5 October set out the Chancellor's reactions to Mr McIntyre's minute of 30 September and the enclosed paper by Mr Macpherson.

2. The Chancellor has been considering further the points in these papers. He has commented that we shall need to look very carefully at the losers among the self-employed before deciding to go ahead in this area. He would like some illustrative tables and costings to be prepared. I should be grateful if Mr McIntyre could take this forward.

J M G TAYLOR

FROM: J M G Taylor

DATE: 7 October 1987

MR MACE - INLAND REVENUE

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Scholar
Miss Sinclair
Mr G P Smith
Mr Cropper
Mr Tyrie
Mr Battishill - IR
Mr Isaac - IR
PS/IR

**TAX REFORM: INCOME TAX AND NIC**

The Chancellor has been considering further your minute of 29 September. In addition to the remits recorded in my note of 5 October, he would also be grateful for

- an analysis of option A in money-of-the-day terms;
- an estimate of the cost of bringing down the small companies CT rate to 25 per cent.

J M G TAYLOR

TASK FORCE SECRET

COPY NO. 7 OF 7 .

FROM: J M G TAYLOR
DATE: 12 October 1987

PS/FINANCIAL SECRETARY

cc Mr Scholar
Mr Cropper
Mr Tyrie
Mr Cayley - IR

**CAPITAL GAINS TAX: ANOTHER OPTION**

The Chancellor has seen the Financial Secretary's minute of 6 October.

2. He does not see this three-point proposal being a runner. We have always seen the first two points as alternative options, and he does not see how the addition of the third point - even if desirable - alters this. But he realises that the Financial Secretary is very keen to abolish indexation, and he would be content for a re-assessment of this to be conducted in time for discussion, alongside the 25/35 option, at any forthcoming CGT meeting.

JT

J M G TAYLOR

COPY NO. 13 OF 13

FROM: J M G Taylor
DATE: 12 October 1987

MR CAYLEY - INLAND REVENUE

cc Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Battishill - IR
Mr Isaac - IR

**CAPITAL GAINS TAX**

The Chancellor was grateful for your minute of 9 October.

J M G TAYLOR

ps4/11H

TASK FORCE SECRET

COPY NO. 21 OF 21 .

**NOTE OF A MEETING HELD IN HM TREASURY**
**ON 12 OCTOBER 1987, AT 3.00 PM**

Present

Chancellor
Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Miss Sinclair
Mr McIntyre )
Mr Macpherson ) for discussion of NICs only
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill - IR
Mr Isaac - IR
Mr Johns - IR
Mr Mace - IR

---

**INDEPENDENT TAXATION; AND NATIONAL INSURANCE CONTRIBUTIONS**

Paper: Mr Scholar of 9 October, and papers referred to within.

**Independent taxation**

- **Allocation of married man's allowance**

1. The Chancellor agreed that the married man's allowance should go automatically to the husband, except in strictly defined circumstances where he was unable to make full use of it. He was inclined to go for the "cosmetic" scheme A in Mr Mace's 28 September submission, which would split the allowance into a single allowance and a married couple's allowance. This looked quite straightforward, and could be aborted at a late stage if necessary.

2. Mr Mace said that there were some operational complications, and it would be harder to deal with breadwinner wives. But a bigger question was whether such an allowance would prove as robust as the present married man's allowance. It would have to be defined specifically in the legislation, which would draw more attention to the fact that there were rules allocating the allowance automatically to the husband.

3. The Chancellor concluded that, on balance, the married couple's allowance was preferable to the present married man's allowance.

4. Mr Scholar pointed out that there would no doubt be a large number of amendments put down, designed to take the change further. The Chancellor said that he had no objection to public debate on the issue, but confirmed that there would be no question of changing the proposal.

- **Progressive withdrawal of the married man's allowance**

5. The Chancellor explained that he was concerned that the overall effect of the reform package would be to produce enormous benefits for married couples at the top of the income range. His aim was to reduce those benefits, and the progressive withdrawal of the married man's allowance seemed to be the only device available. Before making a final decision, he asked to see worked examples of the effect of the measure on different couples.

6. On Mr Mace's 9 October minute, the Chancellor said that he was envisaging a higher rate of 35 per cent, rather than 40 per cent. This would bring down the withdrawal rates, which was important because he did not want any rate to be above 50 per cent. The starting point for withdrawal could be raised even higher than the top of the range in Mr Mace's minute. Gains and losses should be considered in terms of the package as a whole, rather than the

effect in any one year - it was a single package, which, for operational reasons, had to be spread over a period of years. On that basis, he thought a package could be constructed with no losers. The only oddity was that the package would remove the so-called "kink", but add a "hump", though at higher incomes and affecting fewer people.

7. The Financial Secretary thought there were objections to the proposal in logic. Operating on the husband's income alone sat uneasily with the move to treating the husband and wife equally. The Chancellor pointed out that the move to independent taxation meant that it would be impossible to operate on the joint income. The Government had been forced to retain the married man's allowance, which was now an anomaly, and which he was seeking to reduce at the top end. He said that the aim was to withdraw the married couple's allowance from whichever partner was using it.

8. Mr Mace said that that meant a couple with two similar incomes totalling, say, £30,000 would do better than a one-earner couple with the same income. The Chancellor accepted this, but could see no other way of reducing the benefit to couples at the top of the income range. He asked for a range of examples, with a fairly high starting point for withdrawal, probably considerably above the higher rate threshold. The only losers he was concerned about were those with the normal range of reliefs, rather than those exploiting tax shelters.

- **Breadwinner wives**

9. The Chancellor agreed with the Financial Secretary that part of the married man's allowance should be transferable to breadwinner wives, with transitional protection for existing breadwinner wives.

\- **The elderly**

10. The Chancellor agreed that the elderly should be treated on the same basis as breadwinner wives, and that, under independent taxation, men should qualify for the age allowance on the basis of their own age, not that of their wives. It was agreed that the approach was simple in concept, and could be simplified in the presentation, though there would be some complications in practice.

\- **Capital Gains Tax exemption**

11. The Financial Secretary thought that each married couple should have only one Capital Gains Tax exemption between them for the principal private residence. This meant that cohabiting couples with two residences would be treated more favourably, but he saw nothing that could be done about this. Very few people were affected, and in order to benefit, they would actually have to sell two houses. The Chancellor noted that this would still leave an - albeit modest - tax penalty on marriage, which would attract some attention. But the only alternative was to give married couples two exemptions. He decided not to make any changes at this stage.

**Mortgage interest relief**

\- **Improvements**

12. The Chancellor thought that ending mortgage interest relief for improvements looked to be the only practical way of whittling down the relief. He thought that relief for improvements was the main vehicle for abuse.

13. Mr Johns said that up to 20 per cent of the relief given for improvements might be an abuse of the proper provisions. He said that the justification for the relief in the past had been to preserve equity between the person who bought a run-down house and the person with a new house, or between the person who wanted to extend a house and the person who bought a bigger house. The Chancellor said that some unfairnesses would have to be

accepted, but that these tended to be exaggerated. For example, the costs of purchase were so much greater than improvements, that withdrawing relief on the latter would have only a marginal effect. Also, the price of run-down houses would fall to reflect withdrawal of improvement relief.

14. The Chancellor thought a viable package could be devised, involving an increase in the mortgage interest relief ceiling, but restricting relief to house purchase. The higher ceiling would have to apply to existing loans, including those for improvements, as well as new loans.

15. Mr Tyrie thought it would be wrong to raise the ceiling for relief. He also thought that the package would be a fillip for property developers. The Chancellor asked for more work to be done on the likely effects of the proposals. There were special reasons for increasing the ceiling as part of the overall package (see paragraph 20 below)

- **Residence basis**

16. Turning to the proposed move to a residence basis, the Chancellor said that he had been attracted to the proposal in the Green Paper, but that its ramifications appeared complicated, particularly if an individual ceiling were retained alongside the ceiling for the residence. Two potential problems would be removed by abolishing relief for a dependent relative's house and a divorced spouse's house. The Chancellor said he was prepared to do this. This left the problem of married couples with two houses, who might be able to claim relief for both if there were no individual limit on relief. Clearly each partner could own a house. The question was whether they could show that they actually had separate main residences. That could be extremely difficult to determine.

17. After discussion, it was agreed that it was best to legislate that married couples were assumed to have the same residence, with a joint limit for relief, and the relief available to whichever partner could make best use of it.

18. The Chancellor said he was not clear why the Revenue were proposing a different approach for sharers. He did not see why sharers could not be allowed to split the available relief as they wished. Mr Johns explained that there were more changes of circumstances, and possibly problems of confidentiality, between sharers. Neither the Revenue nor the lenders could become embroiled in those, and it would be an administrative nightmare if an election for the split of the relief had to be made annually. But some of his worries had concerned loans for improvements, and if relief were no longer available for these, the position would be easier to handle.

19. The Chancellor asked for this issue to be reviewed. The proposal for sharers was much harsher than the existing treatment, and he did not want to be unnecessarily harsh. He recognised the potential administrative problems, and accepted that there would have to be a proviso that if there was no clear agreement among sharers, the relief would have to be split equally.

- **Mortgage interest relief ceiling**

20. The Chancellor said he started with a presumption against increasing the ceiling. But he saw two special reasons for doing so this year: to help sharers, who were treated more harshly under the proposed regime; and the embarrassing number of losers in the main package. Given the cost, he thought the increase should only be to £35,000. Confining the relief to the basic rate had to be ruled out.

21. Mr Mace said that increasing the ceiling to £35,000 reduced the potential losers from 300,000 to 220,000, and would reduce the size of the remaining losses.

22. Mr Tyrie argued against raising the ceiling. There was no pressure from the Opposition Parties. Part of the reason why reform of the private rented sector was necessary was the existing distortion caused by mortgage interest relief. And there was no pressure from the housing lobby. The Chancellor said that the problem lay with the number of losers in the package as a whole. There was no direct way of eliminating these, but this measure was reasonably well targetted.

23. Mr Scholar pointed out that some of the elements in the package would reduce the cost of mortgage interest relief, eg the reduction in the higher rates and the proposed removal of improvements relief.

24. Sir T Burns proposed an alternative of a £20,000 ceiling per person, without the residence basis, with protection for existing mortgages. The Chancellor thought this had a number of attractions, but saw problems with the reduction for single people, particularly first-time buyers. There would have to be transferability between married couples, but not between co-habiting couples. He asked Mr Johns to compare and contrast two options:

(a) the residence basis, with the ceiling at £35,000;

(b) the present regime, with a ceiling of £20,000 per person.

**National Insurance Contributions at the lower end**

Key papers: Mr Scholar's minute of 2 October; Mr Macpherson's minutes of 9 and 12 October.

25. The Chancellor said it was generally agreed that relief should be given at the bottom end of the earnings scale, and that NICs was the most suitable route. Any change should be simple. He also wished to avoid options in which there was little relationship

between contributions and benefits (given that the contributory principle was already stretched to its limit). He was attracted to raising the lower earnings limit. This was the best way of getting low earners out of the tax and contributions system. It also helped to redress the drift of the LEL down the earnings scale.

26. The Financial Secretary noted that raising the LEL removed entitlement to benefits as well as the requirement to pay contributions for those taken out of the field. They would need to rely on means tested benefits instead. The Chancellor said he envisaged taking 2 million people out of the field. Most would in fact become entitled to benefits at a later stage as their earnings increased. He noted that establishing a zero band would also benefit employers.

27. The Chancellor said that Mr Macpherson's minutes set out various options involving a zero rate band. There was little to choose between these on micro economic grounds; the aim should be for simplicity. Other constraints were that, for the employer, there must be no increase for any of the bands, and there should be no additional burden overall, compared to the present position.

28. The meeting considered the options set out in Mr Macpherson's second minute of 12 October. The Chancellor noted that, although this implied a large first step, this was less than had been the case in the past. Mr Macpherson noted that there would be around 80,000 additional losers, if this option were built into Mr Mace's option A. There would also be an effect on the actuarial basis of the NI Fund calculation; the Government Actuary would wish to recalculate this, and this would in turn affect firms calculations for the purpose of developing personal pension plans. Sir P Middleton noted that the switch to means tested benefits would also have a long term effect on DHSS running costs.

29. The Financial Secretary said he had considerable reservations about raising the LEL. This needed to be assessed in the context of the objectives of NIC reform. These included reducing the "unemployment trap", reducing the cost of labour, and relieving the tax burden. The Chancellor said the main objectives were to reduce the burden on the low paid, and the "unemployment trap". Raising the LEL particularly helped towards these objectives.

30. In further discussion, it was noted that raising the LEL had an inconclusive effect on the size of the "black economy". It was also noted that, under the reform, some single people would still pay income tax although they would no longer be liable for NICs.

31. The Chancellor noted that if the employers rates were set at the scale 0:7:9:10.45, the cost in the first full year would be reduced to around £½ billion. This option should be examined further. A fallback option with a 2 per cent lower rate band should also be considered. Other ways of juggling with the bands, at similar cost, should also be pursued. Mr Scholar undertook to take this forward. He would report back to the Chancellor in time for the opening of discussions with Mr Moore. This would be soon after the Autumn Statement.

**Further work**

32. The Chancellor noted that it was planned to hold further meetings to discuss capital gains tax, and benefits-in-kind. The more general proposal about switching taxation of benefits in kind to employers should be examined with the additional burden on businesses in mind. The Chancellor wished to hold further meetings on: the effect of the overall package on small businesses and the

self employed; on overall winners and losers; on NICs for the self employed. He also looked forward to the paper setting out the economic rationale behind the proposals.

A P HUDSON

J M G TAYLOR

13 October 1987

Circulation

Those present*
Chief Secretary
Paymaster General
Economic Secretary
PS/IR

(*Mr McIntyre and Mr Macpherson: paragraphs 25-31 only)

COPY NO. 7 OF 8 .

FROM: J M G TAYLOR
DATE: 14 October 1987

MR CROPPER

cc Financial Secretary
Mr Scholar
Mr Tyrie
Mr Call
Mr Isaac - IR

**NICs**

The Chancellor has seen your minute of 13 October.

2. He has commented that, raising the LEL apart, he agrees that we should concentrate all concessions this year on employees (your paragraph 1). A simple residence (or citizenship) qualification for the OAP (your paragraph 3(i)) is <u>not</u> on. He awaits Mr Scholar's comments on the other points.

JT

J M G TAYLOR

ps3/36T

**TASK FORCE SECRET**

COPY NO. 15 OF 15.

FROM: J M G TAYLOR
DATE: 14 October 1987

MR CAYLEY - Inland Revenue

cc Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Jenkins - Parly Counsel
Mr Battishill - IR
Mr Isaac - IR
PS/IR

**REFORM OF CAPITAL GAINS TAX**

The Chancellor has seen your minute of 12 October. He is content to keep only the "alternative" option in play, ie to retain CGT as a separate tax and charge at the rates that would apply if gains were the marginal slice of income.

J M G TAYLOR

TASK FORCE SECRET

COPY OF 25

Inland Revenue

Policy Division
Somerset House

FROM: B A MACE

DATE: 19 OCTOBER 1987

CHANCELLOR OF THE EXCHEQUER

TAX REFORM: INCOME TAX AND NIC

1. Mr Taylor's note to me of 5 October asked for

(a) a version of the table on page 5 of my submission of 29 September showing gainers and losers in cash terms (compared with 1987-88);

(b) a version of the table on page 8 of the submission in terms of percentage distribution.

These two tables are attached (Tables 1 and 2)

2. Mr Taylor's note of 7 October asked for an analysis of Option A (my submission of 29 September) in money-of-the-day terms.

3. As I explained in my previous submission an analysis in money-of-the-day terms of options involving phasing is complex and requires forecasts to be made of earnings and prices some three years from now (on which we would need advice from the Treasury).

cc Financial Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Miss Peirson
Mr Scholar
Miss Sinclair
Mr MacPherson
Mr McIntyre
Mr G P Smith
Mr Cropper
Mr Tyrie

Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Lewis
Mr Calder
Mr Mace
Mr Cayley
Mr Eason
Mr Allen
PS/IR

TASK FORCE SECRET

We would then build the resulting projections into the data for our computer model. We have not yet been able to undertake this work and we think it would be preferable not to do so until up to date economic assumptions are available from the Autumn Statement forecast and until we have incorporated data from the most recent (1985-86) Survey of Personal Incomes into our model (which we shall be doing shortly). Both these developments could significantly affect the results of any money-of-the-day analysis.

4. A money-of-the-day analysis would provide information about the effects of the reform package on receipts in different years in the form usually presented in the Scorecard and the FSBR. But a distributional analysis of gainers and losers on this basis would be more difficult to interpret because the effects of the tax reform would be compounded with economic changes. There is no obvious way in which the changes in tax burden on individuals as a result of the reform could be identified and quantified separately from the changes in the tax burden due to the general growth in incomes and prices. We should need to consider with you the sort of distributional analysis you require.

## Small companies rate of Corporation Tax

5. You also asked for an estimate of the cost of reducing the small companies rate of corporation tax to 25 per cent from financial year 1988. The figures are

| | | £m |
|---|---|---|
| 1988-89 | 1989-90 | Full year |
| negligible | 55 | 90 |

## Mortgage Interest Relief

6. Finally you may like to have an approximate indication of the effect on losers from Option A of my 29 September submission if the mortgage interest relief ceiling were reduced to £20,000 per individual but husband and wife were each given their own limit (so that they had a ceiling of £40,000 between them).

**TASK FORCE SECRET**

7. Looking at the transitional regime for Option A in 1988-89 (with 7 per cent NIC above the UEL), of the total of some 300,000 losers about one-third are married couples claiming mortgage interest relief in excess of £3000 who might be helped at least to some extent by this proposal. (Virtually all the losers paying mortgage interest in excess of £3000 are married couples). If nearly all those married couples were able to take full advantage of the increase in the ceiling (which would be worth about £280 to the basic rate taxpayer) the number of losers might be reduced by up to 100,000. But in practice the reduction in the number of losers would be considerably smaller.

B A Mace

B A MACE

TASK FORCE SECRET

TABLE 1

Option A: Percentage Distribution of Losers and Gainers by Income

Comparison with 1987-88

| Lower limit of total income £'000 | Loss (£) Over 400 | 200-400 | less than 200 | Gain £ less than 200 | 200-400 | over 400 | Tax Units (thousands) |
|---|---|---|---|---|---|---|---|
| 0 | | | 100 | | | | 10,200* |
| 10 | - | - | 1 | 57 | 42 | - | 8,300 |
| 20 | 2 | 7 | 15 | 14 | 42 | 20 | 1,900 |
| 30 | 1 | 3 | 4 | 10 | 18 | 64 | 530 |
| 40 | 1 | 1 | 2 | 3 | 5 | 88 | 390 |
| All | 1/4 | 3/4 | 2 | 72 | 20 | 5 | 21,400* |

* An additional 300,000 tax units are included in this distribution compared with the table on page 5 of the submission of 29 September. These are units taken out of tax by indexation of the personal allowances.

TASK FORCE SECRET

TABLE 2

Option A (Phased NIC)
Percentage Distribution of Losers* by Income

| Total Income (Lower limit) £000s | 1988-89 | 1989-90 | 1990-91 |
|---|---|---|---|
| | | | % |
| 10 | - | - | - |
| 15 | 2 | 4 | 9 |
| 20 | 62 | 62 | 57 |
| 25 | 30 | 27 | 24 |
| 30 | 4 | 5 | 5 |
| 35 | 1 | 1 | 2 |
| 40 | - | 1 | 1 |
| 45 | - | - | 1 |
| 50 | 1 | 1 | 1 |
| Total losers (thousands) | 305 | 427 | 568 |

*Compared with 1987-88

CLASSIFICATION: Budget Secret SECURE FAX NO: IR 1

OUTGOING SECURE FAX

FROM INLAND REVENUE (PRIVATE OFFICE)

(Fax No. 2541 7681 ) Operation (2541 6315 )

TO CH/X Department

Date 19/10/87 Time 11 00

No of pages following 4 + receipt

Copy will also be sent by post Yes ☑

No ☐

RECEIPT OF THIS TRANSMISSION MUST BE SENT

This material must be handled in accordance with the security instructions applicable to the classification.

CLASSIFICATION:

FST

Mr Scholar

TASK FORCE SECRET

Inland Revenue

Policy Division
Somerset House

FROM: B A MACE

DATE: 19 OCTOBER 1987

1. MR ISAAC Seen in draft BAM 19/10

2. CHANCELLOR OF THE EXCHEQUER

TAX REFORM: SELF-EMPLOYED NIC: IMPLEMENTATION

Self-employed NIC: Implementation

1. Paragraph 19 of Mr Macpherson's paper of 30 September mentioned our preliminary view that it would be difficult to implement the proposal to charge 9 per cent NIC without tax relief on self-employed profits above the UPL in 1988-89. We have subsequently been examining further the operational implications of the change and this note reports the outcome of that work.

Abolition of the UEL/upper profits limit

2. The present working assumption is that abolition of the UEL for employees would take effect from October 1988. This means that broadly half an employee's total earnings above the UEL in 1988-89

---

| cc | |
|---|---|
| Financial Secretary | Chairman |
| Sir P Middleton | Mr Isaac |
| Sir T Burns | Mr Painter |
| Mr Byatt | Mr Rogers |
| Mr Cassell | Mr Beighton |
| Miss Peirson | Mr Lewis |
| Mr Scholar | Mr Calder |
| Miss Sinclair | Mr Cayley |
| Mr Macpherson | Mr Eason |
| Mr McIntyre | Mr Yard |
| Mr G P Smith | PS/IR |
| Mr Cropper | |
| Mr Tyrie | |

would be charged to NIC. Because Class IV NIC is assessed on an annual basis (like income tax) the closest way of matching the change for employees would be to charge self-employed profits above the UPL assessed for 1988-89 at half the rate which would otherwise be imposed ($4^{1}/2$ per cent, for example, if the NIC rate above the UEL/UPL were 9 per cent, 3.15 per cent if the rate were 6.3 per cent). This arrangement would not produce exact parity of treatment between the employed and self-employed (for example where a business starts or finishes during 1988-89 compared with someone starting or finishing employment) but would give a reasonably close match for the majority.

## Operational Considerations

3. Abolishing the UPL for the self-employed requires significant changes to the infrastructure of the computerised Schedule D assessing (CODA) system which is at present running as a pilot in two of our Regions prior to national implementation in Spring 1988. We are currently about half-way through the pilot and although it has been reasonably successful so far we may come across further teething problems over the next few months. Even on the assumption that the pilot continues to go well there are dangers in making changes to the system at the same time as it is introduced nationally. And because of the scope of the NIC changes there are particular reasons why attempting to make them in time for implementation in 1988-89 would carry fairly severe risks.

## Computer Implications

4. Making the NIC changes in time for a 1988-89 start will add to the burden of work on our trained computer staff, who, as you know, are already very heavily stretched at present. The time for implementation of the changes will in practice be very short. In order to avoid continual disruption to the computer system we normally make programming and other software changes in batches at six monthly intervals. The next batch of changes is due to be made in April 1988 and work on them is now in progress. We think it would be too risky and disruptive to try to incorporate the changes

TASK FORCE SECRET

needed for abolition of the UPL for NIC in the batch for implementation in April. The changes would therefore have to be made as a separate item and we think that, as a result, they could not be put into place until June 1988. This has important implications for the work on the Schedule D assessing programme in tax offices (see paragraph 6 below).

5. It will take about 11-12 weeks to make the software changes needed for UPL abolition. So with a June 1988 start the work would need to begin at the latest in March 1988. There is very little that can be cut out of our present development plans to make way for this additional work and we therefore think that we would have to rely on overtime to carry out the task (for which funding would be required). (There is a contingent risk that the work would be vulnerable if an overtime ban was called by the Unions in the early part of 1988, during the negotiations on next year's pay settlement. We are considering whether it would be possible to minimise this risk by bringing some of the work forward. But the scope for this may be limited and it would, of course, mean widening the circle of those aware of the changes at a much earlier stage.)

Implications for tax offices

6. In the normal way work on the Schedule D assessing programme begins in tax offices in April each year and builds up over the succeeding months. However, as the computer changes needed for UPL abolition cannot be in place before June 1988 the start of the assessing programme in tax offices would be delayed next year, compressing the work which has to be done into the subsequent period. The delayed start would also mean a clash with the programme for introducing CODA into tax offices next year. Because the computer changes for UPL abolition would not be in place until June tax office staff would have to be trained to use the new computer system on the basis of the old NIC arrangements. But once they begin live working they would then have to familiarise themselves with the new scheme. This would be an unwelcome complication to the already difficult task of ensuring a smooth transition from the present manual Schedule D system to CODA.

**TASK FORCE SECRET**

## Conclusion

7. To sum up, attempting to implement UPL abolition in 1988-89 carries fairly severe risks, both on the computer side and for the work of local tax offices. Successful implementation would depend on everything going right. Although we could not say at this stage that a 1988-89 start has to be absolutely ruled out on operational grounds, our very strong preference would be to postpone implementation for the self-employed until 1989-90.

8. You will wish to discuss the implications of this for the reform package as a whole at your meeting on 20 October. If you find the operational risks of 1988-89 implementation for the self-employed unacceptable there are, perhaps, two possible options:

(i) To delay implementation of the UEL/UPL changes for both employees and the self-employed until April 1989. (This might in any case prove necessary if DHSS were to take the view that they cannot manage an October 1988 start for employees).

(ii) To keep the October 1988 start for employees but to postpone the start for the self-employed until April 1989. This might help with the presentation of the package to the self-employed and might be defended on the grounds that there are significant differences between NIC on self-employed profits and employment earnings (for example the annual nature and previous year basis of assessment for Class IV NIC compared with the weekly/monthly current basis for employees NIC) as well as operational constraints which justified a different approach.

B A Mace

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Inland Revenue

Policy Division
Somerset House
FROM: B A MACE
DATE: 19 OCTOBER 1987

CHANCELLOR OF THE EXCHEQUER

TAX REFORM: SELF-EMPLOYED

1. This note answers your recent requests for further information about the effects of the tax reform package on the self-employed. (Mr Taylor's minutes to me of 5 October and to Mr McIntyre of 5 and 7 October). I am also sending you separately (today) a note about the operational implications for 1988-89 of the reform package for the self-employed.

Self Employed NIC: assumptions

2. Mr Taylor's minute of 5 October to me asked about the assumption in paragraph 6(iv) of my submission of 29 September that there would be no tax relief on Class IV NIC charged on profits above the upper profits limit (UPL). As in my submission of 14 July this assumption is aimed at ensuring that the combined top income tax and NIC rate is the same (at 49 per cent under Option A) on all earnings, employed

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and self-employed. Giving tax relief on half the Class IV NIC on profits above the UPL would reduce the combined top rate on self-employed profits to 47.2 per cent. The cost of giving this additional relief in a full year would be about £85 million. Mr Taylor's note of 5 October to PS/Financial Secretary indicated that you might be interested in a package for the self-employed which restricted the NIC rate above the UPL to 6.3 per cent with tax relief on half the contributions above (as well as below) the limit. (This option was discussed in paragraph 15 of Mr Macpherson's paper attached to Mr McIntyre's note of 30 September.) A 6.3 per cent rate above the UPL with tax relief on half the contributions would imply an effective combined top marginal rate on self-employed profits of slightly over 45 per cent.

3. If the top rate of income tax were 35 per cent the effective combined top marginal rate on self-employed profits would be just under 42 1/2 per cent with a 9 per cent NIC rate above the UPL (with tax relief) and about 40.2 per cent with a 6.3 per cent rate (and tax relief). These figures compare with a combined rate of 44 per cent for employees.

Self-Employed: Distributional effects

4. Mr Taylor's note of 7 October to PS/Financial Secretary asked Mr McIntyre to provide some illustrative tables and costings for the options for reform for the self-employed. We agreed with Treasury ST Division that we would take on this task as the necessary analysis has to be obtained from our computer model based on the Survey of Personal Incomes (SPI). (We have not had time to show the results to ST before submitting this note.)

5. Our estimates are based on projections of incomes reported in the 1984-85 SPI and will therefore differ to some extent from those which are included in (or which can be inferred from) the paper by Mr Macpherson. These are based on a simplified version of the model used by the Government Actuary's Department incorporating some data from earlier SPIs. We have discussed the reasons for the variations in the figures with the Treasury and believe that our estimates are better for incomes above the tax threshold but not at the lower end of the income range.

## Option A

6. Table 1 attached shows the full year effects of imposing a full 9 per cent NIC charge (without tax relief) on self-employed profits (Schedule D Case I and II) above the UPL at 1988-89 income levels. This is effectively Option A of my submission of 29 September. Thus of the total of nearly $1^{3}/4$ million self-employed individuals whose profits are liable to NIC just over 350,000 have profits above the UPL and would pay around £480 million in additional contributions in a full year with 9 per cent NIC on those profits (out of the total of £1.88 billion payable as a result of abolishing the UEL/UPL.) The table also shows that the total cost of giving tax relief on half those additional contributions would be around £85 million in a full year (see paragraph 2 above).

7. Table 2 is similar to Table 1 but shows the effect of a 6.3 per cent charge above the UPL and the cost of giving relief on half the additional contributions. On this basis the additional contribution income is reduced to just under £340 million in a full year and the cost of giving tax relief on this sum to around £60 million. The net result is that, overall, a 6.3 per cent NIC charge above the UPL, with tax relief would yield about £120 million less in a full year than a full 9 per cent NIC charge without relief.

8. Table 3 shows details of the losers from the reform package amongst the self-employed on a number of different assumptions and compared with indexation in 1988-89. Thus of the total of just under 800,000 losers compared with indexation under Option A (paragraph 12 of my submission of 29 September) about 135,000 are self-employed. Giving tax relief on half the NIC charge above the UPL would reduce the number of losers to around 75,000. A 6.3 per cent NIC charge above the UPL (without tax relief) combined with the other components of Option A would involve about 75,000 self-employed losers. This would be reduced to 44,000 if tax relief were given.

9. Table 4 gives similar information to Table 3 but the comparison is in cash terms with 1987-88. With the full 9 per cent NIC charge

(and no tax relief) just under 100,000 of the 560,000 * cash losers are self employed. With a 6.3 per cent NIC charge and tax relief on half the extra contributions the number of self-employed losers in cash terms falls to around 24,000 in total.

10. Both Tables 3 and 4 give unrounded estimates taken directly from the computer analysis. Differences in totals between the analysis by total income and by size of loss are due to rounding and are therefore not significant.

Other options for the self-employed

11. Paragraph 14 of Mr Macpherson's paper looked at other options for reducing the burden of NIC on the self-employed namely

(i) lowering the Class II rate
(ii) increasing the LPL
(iii) cutting the Class IV rate below the UPL

All the options were designed to have the same first and second year costs, £25 million and £60 million respectively.

11. We have not looked in detail at the effect of these options on self-employed losers from the reform. But in round terms it appears that, combined with Option A (including full 9 per cent NIC charge above the UPL and no tax relief), Options (i) and (ii) might reduce the total numbers of losers by around 20,000 (compared with either indexation or 1987-88) and Option (iii) might reduce the number by about 40,000. If tax relief were given on the 9 per cent charge (or if the NIC charge above the UPL were reduced to 6.3 per cent) Options (i) and (ii) might reduce the residual losers by a further 10,000 or so and Option (iii) by around 20,000.

* Paragraph 15 of my submission of 29 September.

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TAX REFORM: SELF EMPLOYED

Table 1

9 per cent NIC above UPL (Option A)

| Total Income (lower limit) £000 | No. of self-employed* 000s | No. with profits above UPL 000s | Yield of NIC £m | Cost of tax relief £m |
|---|---|---|---|---|
| 0 | 1163 | 32 | 2 | 0.2 |
| 18 | 68 | 22 | 4 | 0.5 |
| 20 | 126 | 64 | 25 | 3 |
| 25 | 76 | 51 | 37 | 5 |
| 30 | 93 | 77 | 77 | 13 |
| 40 | 49 | 42 | 69 | 13 |
| 50 | 71 | 67 | 267 | 52 |
| Total | 1646 | 355 | 481 | 87 |

Table 2

6.3 per cent NIC above UPL

| Total Income (lower limit) £000 | No. of self-employed* 000s | No. with profits above UPL 000s | Yield of NIC £m | Cost of tax relief £m |
|---|---|---|---|---|
| 0 | 1163 | 32 | 1 | - |
| 18 | 68 | 22 | 3 | - |
| 20 | 126 | 64 | 17 | 2 |
| 25 | 76 | 51 | 26 | 3 |
| 30 | 93 | 77 | 54 | 9 |
| 40 | 49 | 42 | 48 | 10 |
| 50 | 71 | 67 | 187 | 37 |
| Total | 1646 | 355 | 336 | 61 |

* Liable to NIC

TABLE 3

## TAX REFORM: SELF EMPLOYED

## Comparison with indexation

| | Option A (9 per cent NIC) | | | | Option A (6.3 per cent NIC) | | | |
|---|---|---|---|---|---|---|---|---|
| | Without Class IV NIC relief | | With Class IV NIC relief | | Without Class IV NIC relief | | With Class IV NIC relief | |
| Total income (lower limit) £000 | No. losers (000) | Amt. loss (£m) | No. losers. (000) | Amt. loss (£m) | No. losers (000) | Amt. loss (£m) | No. losers (000) | Amt. loss (£m) |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 18 | 8 | 0.4 | 2 | 0.1 | 3 | 0.1 | 2 | 0.1 |
| 20 | 53 | 8 | 28 | 4 | 32 | 3 | 12 | 2 |
| 25 | 33 | 11 | 27 | 6 | 25 | 5 | 18 | 3 |
| 30 | 24 | 7 | 14 | 4 | 12 | 3 | 9 | 2 |
| 40 | 11 | 3 | 3 | 1 | 3 | 0.8 | 2 | 0.5 |
| 50 | 7 | 3 | 1 | 0.6 | 1 | 0.4 | 0.5 | 0.2 |
| Total * | 136 | 32 | 75 | 16 | 76 | 12 | 44 | 8 |
| Amount of loss (lower limit) £ | | | | | | | | |
| 1 | 22 | 0.6 | 14 | 0.3 | 18 | 0.4 | 11 | 0.3 |
| 50 | 20 | 1 | 13 | 0.1 | 16 | 1 | 8 | 0.6 |
| 100 | 29 | 4 | 18 | 3 | 20 | 3 | 12 | 2 |
| 200 | 23 | 6 | 13 | 3 | 14 | 4 | 6 | 2 |
| 300 | 24 | 9 | 13 | 5 | 6 | 2 | 3 | 1 |
| 500 | 17 | 12 | 5 | 3 | 4 | 2 | 3 | 2 |
| Total * | 135 | 33 | 76 | 15 | 78 | 12 | 43 | 8 |

* Totals not identicial due to rounding

TABLE 4

# TAX REFORM: SELF EMPLOYED

## Comparison with 1987-88

| Total income (lower limit) £000 | Option A (9 per cent NIC) Without Class IV NIC relief: No. losers (000) | Amt. loss (£m) | Option A (9 per cent NIC) With Class IV NIC relief: No. losers. (000) | Amt. loss (£m) | Option A (6.3 per cent NIC) Without Class IV NIC relief: No. losers (000) | Amt. loss (£m) | Option A (6.3 per cent NIC) With Class IV NIC relief: No. losers (000) | Amt. loss (£m) |
|---|---|---|---|---|---|---|---|---|
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 18 | 4 | 0.1 | 0 | 0 | 1 | - | 0 | 0 |
| 20 | 44 | 6 | 20 | 2 | 21 | 2 | 10 | 1 |
| 25 | 27 | 8 | 19 | 4 | 19 | 3 | 9 | 2 |
| 30 | 13 | 4 | 8 | 2 | 6 | 1 | 4 | 0.8 |
| 40 | 6 | 2 | 1 | 0.6 | 1 | 0.4 | 1 | 0.3 |
| 50 | 3 | 1 | 0.7 | 0.3 | 0.5 | 0.2 | 0.3 | 0.1 |
| Total * | 97 | 21 | 49 | 9 | 48 | 7 | 24 | 4 |
| **Amount of loss (lower limit) £** | | | | | | | | |
| 1 | 21 | 0.5 | 10 | 0.3 | 12 | 0.3 | 6 | 0.1 |
| 50 | 14 | 1 | 6 | 0.4 | 7 | 0.5 | 4 | 0.3 |
| 100 | 21 | 3 | 14 | 2 | 16 | 2 | 6 | 1 |
| 200 | 17 | 4 | 12 | 3 | 7 | 2 | 4 | 1 |
| 300 | 18 | 7 | 6 | 2 | 5 | 2 | 3 | 1 |
| 500 | 7 | 5 | 2 | 2 | 1 | 1 | 1 | 0.5 |
| Total * | 98 | 20 | 50 | 10 | 48 | 8 | 24 | 4 |

* Totals not identicial due to rounding

TASK FORCE SECRET

COPY OF 25

Inland Revenue

Policy Division
Somerset House

FROM: B A MACE
DATE: 19 OCTOBER 1987

CHANCELLOR OF THE EXCHEQUER

TAX REFORM: INCOME TAX AND NIC

1. Mr Taylor's note to me of 5 October asked for

(a) a version of the table on page 5 of my submission of 29 September showing gainers and losers in cash terms (compared with 1987-88);

(b) a version of the table on page 8 of the submission in terms of percentage distribution.

These two tables are attached (Tables 1 and 2)

2. Mr Taylor's note of 7 October asked for an analysis of Option A (my submission of 29 September) in money-of-the-day terms.

3. As I explained in my previous submission an analysis in money-of-the-day terms of options involving phasing is complex and requires forecasts to be made of earnings and prices some three years from now (on which we would need advice from the Treasury).

cc Financial Secretary
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Mr Tyrie

Chairman
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Mr Mace
Mr Cayley
Mr Eason
Mr Allen
PS/IR

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We would then build the resulting projections into the data for our computer model. We have not yet been able to undertake this work and we think it would be preferable not to do so until up to date economic assumptions are available from the Autumn Statement forecast and until we have incorporated data from the most recent (1985-86) Survey of Personal Incomes into our model (which we shall be doing shortly). Both these developments could significantly affect the results of any money-of-the-day analysis.

4. A money-of-the-day analysis would provide information about the effects of the reform package on receipts in different years in the form usually presented in the Scorecard and the FSBR. But a distributional analysis of gainers and losers on this basis would be more difficult to interpret because the effects of the tax reform would be compounded with economic changes. There is no obvious way in which the changes in tax burden on individuals as a result of the reform could be identified and quantified separately from the changes in the tax burden due to the general growth in incomes and prices. We should need to consider with you the sort of distributional analysis you require.

Small companies rate of Corporation Tax

5. You also asked for an estimate of the cost of reducing the small companies rate of corporation tax to 25 per cent from financial year 1988. The figures are

| | | £m |
|---|---|---|
| 1988-89 | 1989-90 | Full year |
| negligible | 55 | 90 |

Mortgage Interest Relief

6. Finally you may like to have an approximate indication of the effect on losers from Option A of my 29 September submission if the mortgage interest relief ceiling were reduced to £20,000 per individual but husband and wife were each given their own limit (so that they had a ceiling of £40,000 between them).

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7. Looking at the transitional regime for Option A in 1988-89 (with 7 per cent NIC above the UEL), of the total of some 300,000 losers about one-third are married couples claiming mortgage interest relief in excess of £3000 who might be helped at least to some extent by this proposal. (Virtually all the losers paying mortgage interest in excess of £3000 are married couples). If nearly all those married couples were able to take full advantage of the increase in the ceiling (which would be worth about £280 to the basic rate taxpayer) the number of losers might be reduced by up to 100,000. But in practice the reduction in the number of losers would be considerably smaller.

B A Mace

B A MACE

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TABLE 1

## Option A: Percentage Distribution of Losers and Gainers by Income

### Comparison with 1987-88

| Lower limit of total income £'000 | Loss (£) Over 400 | 200-400 | less than 200 | Gain £ less than 200 | 200-400 | over 400 | Tax Units (thousands) |
|---|---|---|---|---|---|---|---|
| 0 | | | 100 | | | | 10,200* |
| 10 | - | - | 1 | 57 | 42 | - | 8,300 |
| 20 | 2 | 7 | 15 | 14 | 42 | 20 | 1,900 |
| 30 | 1 | 3 | 4 | 10 | 18 | 64 | 530 |
| 40 | 1 | 1 | 2 | 3 | 5 | 88 | 390 |
| All | 1/4 | 3/4 | 2 | 72 | 20 | 5 | 21,400* |

* An additional 300,000 tax units are included in this distribution compared with the table on page 5 of the submission of 29 September. These are units taken out of tax by indexation of the personal allowances.

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TABLE 2

Option A (Phased NIC)
Percentage Distribution of Losers* by Income

| Total Income (Lower limit) £000s | 1988-89 | 1989-90 | % 1990-91 |
|---|---|---|---|
| 10 | - | - | - |
| 15 | 2 | 4 | 9 |
| 20 | 62 | 62 | 57 |
| 25 | 30 | 27 | 24 |
| 30 | 4 | 5 | 5 |
| 35 | 1 | 1 | 2 |
| 40 | - | 1 | 1 |
| 45 | - | - | 1 |
| 50 | 1 | 1 | 1 |
| Total losers (thousands) | 305 | 427 | 568 |

*Compared with 1987-88

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Mr Scholar

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Inland Revenue

Policy Division
Somerset House
FROM: B A MACE

DATE: 19 OCTOBER 1987

1. MR ISAAC Seen in draft
BAM 19/10

2. CHANCELLOR OF THE EXCHEQUER

TAX REFORM: SELF-EMPLOYED NIC: IMPLEMENTATION

Self-employed NIC: Implementation

1. Paragraph 19 of Mr Macpherson's paper of 30 September mentioned our preliminary view that it would be difficult to implement the proposal to charge 9 per cent NIC without tax relief on self-employed profits above the UPL in 1988-89. We have subsequently been examining further the operational implications of the change and this note reports the outcome of that work.

Abolition of the UEL/upper profits limit

2. The present working assumption is that abolition of the UEL for employees would take effect from October 1988. This means that broadly half an employee's total earnings above the UEL in 1988-89

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PS/IR

would be charged to NIC. Because Class IV NIC is assessed on an annual basis (like income tax) the closest way of matching the change for employees would be to charge self-employed profits above the UPL assessed for 1988-89 at half the rate which would otherwise be imposed ($4^{1/}2$ per cent, for example, if the NIC rate above the UEL/UPL were 9 per cent, 3.15 per cent if the rate were 6.3 per cent). This arrangement would not produce exact parity of treatment between the employed and self-employed (for example where a business starts or finishes during 1988-89 compared with someone starting or finishing employment) but would give a reasonably close match for the majority.

Operational Considerations

3. Abolishing the UPL for the self-employed requires significant changes to the infrastructure of the computerised Schedule D assessing (CODA) system which is at present running as a pilot in two of our Regions prior to national implementation in Spring 1988. We are currently about half-way through the pilot and although it has been reasonably successful so far we may come across further teething problems over the next few months. Even on the assumption that the pilot continues to go well there are dangers in making changes to the system at the same time as it is introduced nationally. And because of the scope of the NIC changes there are particular reasons why attempting to make them in time for implementation in 1988-89 would carry fairly severe risks.

Computer Implications

4. Making the NIC changes in time for a 1988-89 start will add to the burden of work on our trained computer staff, who, as you know, are already very heavily stretched at present. The time for implementation of the changes will in practice be very short. In order to avoid continual disruption to the computer system we normally make programming and other software changes in batches at six monthly intervals. The next batch of changes is due to be made in April 1988 and work on them is now in progress. We think it would be too risky and disruptive to try to incorporate the changes

needed for abolition of the UPL for NIC in the batch for implementation in April. The changes would therefore have to be made as a separate item and we think that, as a result, they could not be put into place until June 1988. This has important implications for the work on the Schedule D assessing programme in tax offices (see paragraph 6 below).

5. It will take about 11-12 weeks to make the software changes needed for UPL abolition. So with a June 1988 start the work would need to begin at the latest in March 1988. There is very little that can be cut out of our present development plans to make way for this additional work and we therefore think that we would have to rely on overtime to carry out the task (for which funding would be required). (There is a contingent risk that the work would be vulnerable if an overtime ban was called by the Unions in the early part of 1988, during the negotiations on next year's pay settlement. We are considering whether it would be possible to minimise this risk by bringing some of the work forward. But the scope for this may be limited and it would, of course, mean widening the circle of those aware of the changes at a much earlier stage.)

Implications for tax offices

6. In the normal way work on the Schedule D assessing programme begins in tax offices in April each year and builds up over the succeeding months. However, as the computer changes needed for UPL abolition cannot be in place before June 1988 the start of the assessing programme in tax offices would be delayed next year, compressing the work which has to be done into the subsequent period. The delayed start would also mean a clash with the programme for introducing CODA into tax offices next year. Because the computer changes for UPL abolition would not be in place until June tax office staff would have to be trained to use the new computer system on the basis of the old NIC arrangements. But once they begin live working they would then have to familiarise themselves with the new scheme. This would be an unwelcome complication to the already difficult task of ensuring a smooth transition from the present manual Schedule D system to CODA.

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## Conclusion

7. To sum up, attempting to implement UPL abolition in 1988-89 carries fairly severe risks, both on the computer side and for the work of local tax offices. Successful implementation would depend on everything going right. Although we could not say at this stage that a 1988-89 start has to be absolutely ruled out on operational grounds, our very strong preference would be to postpone implementation for the self-employed until 1989-90.

8. You will wish to discuss the implications of this for the reform package as a whole at your meeting on 20 October. If you find the operational risks of 1988-89 implementation for the self-employed unacceptable there are, perhaps, two possible options:

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Policy Division
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FROM: B A MACE

DATE: 19 OCTOBER 1987

CHANCELLOR OF THE EXCHEQUER

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TASK FORCE SECRET

and self-employed. Giving tax relief on half the Class IV NIC on profits above the UPL would reduce the combined top rate on self-employed profits to 47.2 per cent. The cost of giving this additional relief in a full year would be about £85 million. Mr Taylor's note of 5 October to PS/Financial Secretary indicated that you might be interested in a package for the self-employed which restricted the NIC rate above the UPL to 6.3 per cent with tax relief on half the contributions above (as well as below) the limit. (This option was discussed in paragraph 15 of Mr Macpherson's paper attached to Mr McIntyre's note of 30 September.) A 6.3 per cent rate above the UPL with tax relief on half the contributions would imply an effective combined top marginal rate on self-employed profits of slightly over 45 per cent.

3. If the top rate of income tax were 35 per cent the effective combined top marginal rate on self-employed profits would be just under $42^{1}/2$ per cent with a 9 per cent NIC rate above the UPL (with tax relief) and about 40.2 per cent with a 6.3 per cent rate (and tax relief). These figures compare with a combined rate of 44 per cent for employees.

Self-Employed: Distributional effects

4. Mr Taylor's note of 7 October to PS/Financial Secretary asked Mr McIntyre to provide some illustrative tables and costings for the options for reform for the self-employed. We agreed with Treasury ST Division that we would take on this task as the necessary analysis has to be obtained from our computer model based on the Survey of Personal Incomes (SPI). (We have not had time to show the results to ST before submitting this note.)

5. Our estimates are based on projections of incomes reported in the 1984-85 SPI and will therefore differ to some extent from those which are included in (or which can be inferred from) the paper by Mr Macpherson. These are based on a simplified version of the model used by the Government Actuary's Department incorporating some data from earlier SPIs. We have discussed the reasons for the variations in the figures with the Treasury and believe that our estimates are better for incomes above the tax threshold but not at the lower end of the income range.

TASK FORCE SECRET

Option A

6. Table 1 attached shows the full year effects of imposing a full 9 per cent NIC charge (without tax relief) on self-employed profits (Schedule D Case I and II) above the UPL at 1988-89 income levels. This is effectively Option A of my submission of 29 September. Thus of the total of nearly 1 3/4 million self-employed individuals whose profits are liable to NIC just over 350,000 have profits above the UPL and would pay around £480 million in additional contributions in a full year with 9 per cent NIC on those profits (out of the total of £1.88 billion payable as a result of abolishing the UEL/UPL.) The table also shows that the total cost of giving tax relief on half those additional contributions would be around £85 million in a full year (see paragraph 2 above).

7. Table 2 is similar to Table 1 but shows the effect of a 6.3 per cent charge above the UPL and the cost of giving relief on half the additional contributions. On this basis the additional contribution income is reduced to just under £340 million in a full year and the cost of giving tax relief on this sum to around £60 million. The net result is that, overall, a 6.3 per cent NIC charge above the UPL, with tax relief would yield about £120 million less in a full year than a full 9 per cent NIC charge without relief.

8. Table 3 shows details of the losers from the reform package amongst the self-employed on a number of different assumptions and compared with indexation in 1988-89. Thus of the total of just under 800,000 losers compared with indexation under Option A (paragraph 12 of my submission of 29 September) about 135,000 are self-employed. Giving tax relief on half the NIC charge above the UPL would reduce the number of losers to around 75,000. A 6.3 per cent NIC charge above the UPL (without tax relief) combined with the other components of Option A would involve about 75,000 self-employed losers. This would be reduced to 44,000 if tax relief were given.

9. Table 4 gives similar information to Table 3 but the comparison is in cash terms with 1987-88. With the full 9 per cent NIC charge

(and no tax relief) just under 100,000 of the 560,000 * cash losers are self employed. With a 6.3 per cent NIC charge and tax relief on half the extra contributions the number of self-employed losers in cash terms falls to around 24,000 in total.

10. Both Tables 3 and 4 give unrounded estimates taken directly from the computer analysis. Differences in totals betweeen the analysis by total income and by size of loss are due to rounding and are therefore not significant.

Other options for the self-employed

11. Paragraph 14 of Mr Macpherson's paper looked at other options for reducing the burden of NIC on the self-employed namely

(i) lowering the Class II rate
(ii) increasing the LPL
(iii) cutting the Class IV rate below the UPL

All the options were designed to have the same first and second year costs, £25 million and £60 million respectively.

11. We have not looked in detail at the effect of these options on self-employed losers from the reform. But in round terms it appears that, combined with Option A (including full 9 per cent NIC charge above the UPL and no tax relief), Options (i) and (ii) might reduce the total numbers of losers by around 20,000 (compared with either indexation or 1987-88) and Option (iii) might reduce the number by about 40,000. If tax relief were given on the 9 per cent charge (or if the NIC charge above the UPL were reduced to 6.3 per cent) Options (i) and (ii) might reduce the residual losers by a further 10,000 or so and Option (iii) by around 20,000.

* Paragraph 15 of my submission of 29 September.

B A Mace

B A MACE

TASK FORCE SECRET

TAX REFORM: SELF EMPLOYED

Table 1

9 per cent NIC above UPL (Option A)

| Total Income (lower limit) £000 | No. of self-employed* 000s | No. with profits above UPL 000s | Yield of NIC £m | Cost of tax relief £m |
|---|---|---|---|---|
| 0 | 1163 | 32 | 2 | 0.2 |
| 18 | 68 | 22 | 4 | 0.5 |
| 20 | 126 | 64 | 25 | 3 |
| 25 | 76 | 51 | 37 | 5 |
| 30 | 93 | 77 | 77 | 13 |
| 40 | 49 | 42 | 69 | 13 |
| 50 | 71 | 67 | 267 | 52 |
| Total | 1646 | 355 | 481 | 87 |

Table 2

6.3 per cent NIC above UPL

| Total Income (lower limit) £000 | No. of self-employed* 000s | No. with profits above UPL 000s | Yield of NIC £m | Cost of tax relief £m |
|---|---|---|---|---|
| 0 | 1163 | 32 | 1 | - |
| 18 | 68 | 22 | 3 | - |
| 20 | 126 | 64 | 17 | 2 |
| 25 | 76 | 51 | 26 | 3 |
| 30 | 93 | 77 | 54 | 9 |
| 40 | 49 | 42 | 48 | 10 |
| 50 | 71 | 67 | 187 | 37 |
| Total | 1646 | 355 | 336 | 61 |

* Liable to NIC

TABLE 3

## TAX REFORM: SELF EMPLOYED

### Comparison with indexation

| | Option A (9 per cent NIC) | | | | Option A (6.3 per cent NIC) | | | |
|---|---|---|---|---|---|---|---|---|
| | Without Class IV NIC relief | | With Class IV NIC relief | | Without Class IV NIC relief | | With Class IV NIC relief | |
| Total income (lower limit) £000 | No. losers (000) | Amt. loss (£m) | No. losers. (000) | Amt. loss (£m) | No. losers (000) | Amt. loss (£m) | No. losers (000) | Amt. loss (£m) |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 18 | 8 | 0.4 | 2 | 0.1 | 3 | 0.1 | 2 | 0.1 |
| 20 | 53 | 8 | 28 | 4 | 32 | 3 | 12 | 2 |
| 25 | 33 | 11 | 27 | 6 | 25 | 5 | 18 | 3 |
| 30 | 24 | 7 | 14 | 4 | 12 | 3 | 9 | 2 |
| 40 | 11 | 3 | 3 | 1 | 3 | 0.8 | 2 | 0.5 |
| 50 | 7 | 3 | 1 | 0.6 | 1 | 0.4 | 0.5 | 0.2 |
| Total * | 136 | 32 | 75 | 16 | 76 | 12 | 44 | 8 |
| Amount of loss (lower limit) £ | | | | | | | | |
| 1 | 22 | 0.6 | 14 | 0.3 | 18 | 0.4 | 11 | 0.3 |
| 50 | 20 | 1 | 13 | 0.1 | 16 | 1 | 8 | 0.6 |
| 100 | 29 | 4 | 18 | 3 | 20 | 3 | 12 | 2 |
| 200 | 23 | 6 | 13 | 3 | 14 | 4 | 6 | 2 |
| 300 | 24 | 9 | 13 | 5 | 6 | 2 | 3 | 1 |
| 500 | 17 | 12 | 5 | 3 | 4 | 2 | 3 | 2 |
| Total * | 135 | 33 | 76 | 15 | 78 | 12 | 43 | 8 |

* Totals not identicial due to rounding

703.TXT

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TABLE 4

## TAX REFORM: SELF EMPLOYED

### Comparison with 1987-88

| | Option A (9 per cent NIC) | | | | Option A (6.3 per cent NIC) | | | |
|---|---|---|---|---|---|---|---|---|
| | Without Class IV NIC relief | | With Class IV NIC relief | | Without Class IV NIC relief | | With Class IV NIC relief | |
| Total income (lower limit) £000 | No. losers (000) | Amt. loss (£m) | No. losers. (000) | Amt. loss (£m) | No. losers (000) | Amt. loss (£m) | No. losers (000) | Amt. loss (£m) |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 18 | 4 | 0.1 | 0 | 0 | 1 | - | 0 | 0 |
| 20 | 44 | 6 | 20 | 2 | 21 | 2 | 10 | 1 |
| 25 | 27 | 8 | 19 | 4 | 19 | 3 | 9 | 2 |
| 30 | 13 | 4 | 8 | 2 | 6 | 1 | 4 | 0.8 |
| 40 | 6 | 2 | 1 | 0.6 | 1 | 0.4 | 1 | 0.3 |
| 50 | 3 | 1 | 0.7 | 0.3 | 0.5 | 0.2 | 0.3 | 0.1 |
| Total * | 97 | 21 | 49 | 9 | 48 | 7 | 24 | 4 |
| Amount of loss (lower limit) £ | | | | | | | | |
| 1 | 21 | 0.5 | 10 | 0.3 | 12 | 0.3 | 6 | 0.1 |
| 50 | 14 | 1 | 6 | 0.4 | 7 | 0.5 | 4 | 0.3 |
| 100 | 21 | 3 | 14 | 2 | 16 | 2 | 6 | 1 |
| 200 | 17 | 4 | 12 | 3 | 7 | 2 | 4 | 1 |
| 300 | 18 | 7 | 6 | 2 | 5 | 2 | 3 | 1 |
| 500 | 7 | 5 | 2 | 2 | 1 | 1 | 1 | 0.5 |
| Total * | 98 | 20 | 50 | 10 | 48 | 8 | 24 | 4 |

* Totals not identicial due to rounding

703.TXT

ps3/66T

**TASK FORCE SECRET**

COPY NO. 8 OF 8 .

FROM: J M G TAYLOR
DATE: 19 October 1987

PS/INLAND REVENUE

cc PS/Financial Secretary
PS/Sir P Middleton
Mr Scholar
Miss Evans
Mr Isaac - IR

**TAX PROPOSALS**

**Inheritance tax**

The Chancellor has asked for a note showing the comparative incidence of IHT in the UK and other major countries on a businessman leaving property to his son. I should be most grateful if you could arrange for this to be done. The Chancellor would like two examples to be worked through. In the first example, the donor passes on a business worth £1 million, and other net assets of £100,000; in the second example, these amounts are double.

**Capital Gains Tax**

2. I passed on to you by telephone a further CGT option. Under this option, CGT would be payable on gifts at the point of transfer, and the base price for the donees' future CGT liability would be the price/value at transfer. I should be grateful for advice in due course.

**Stamp Duty**

3. You may also have seen (my minute of today to Miss Evans) that the Chancellor has suggested another starter. Under this, the £30,000 lower limit for liability of real estate to stamp duty is to be converted to a £30,000 threshold. I should be grateful for advice on this also.

J M G TAYLOR

FROM: J M G TAYLOR

DATE: 19 October 1987

MR MACPHERSON

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr A Wilson
Mr Scholar
Miss Peirson
Mr McIntyre
Mr Riley
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill - IR
Mr Isaac - IR
PS/IR

**NICs AT THE LOWER END**

The Chancellor has seen your note of 16 October, which he thought very helpful. He has commented that we are getting warmer. He would be most grateful if you could cost these further options:

(i) employees' rates: £41-130 at 5 per cent, £130-155 at 7 per cent, £155-305 at 9 per cent; employers' rates unchanged;

(ii) employees as above, but employers: £41-130 at 5 per cent, £130-155 at 7 per cent, £155-305 at 10.45 per cent;

(iii) as (i), but setting reduced rates for 18 months;

(iv) as (ii), but setting reduced rates for 18 months.

J M G TAYLOR

ps3/65T TASK FORCE SECRET

COPY NO. 22 OF 22.

FROM: J M G TAYLOR
DATE: 19 October 1987

MISS C EVANS

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Riley
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill - IR
Mr Isaac - IR
Mr Mace - IR
Mr Calder - IR
PS/IR

**TAX REFORM: 'SCORECARD' COSTINGS**

The Chancellor was most grateful for your minute and enclosure of 16 October. The Scorecard is most helpful.

2. He has one or two detailed comments:

(i) he should prefer the order of costings to show proposal No.3 before proposal No.2;

(ii) the costing for proposal No.11 should show the tax effect only;

(iii) a new proposal should be added: the £30,000 lower limit for liability of real estate to Stamp Duty to be converted to a £30,000 threshold;

(iv) amend option 2(b) to read: 37 per cent in 1988-89, 36 per cent in 1989-90 and 35 per cent in 1990-91, with capital gains added to income and taxed at income tax rates in each case.

3. You should be aware that he has also asked the Revenue for a note on a further CGT proposal which should produce a yield. Under this proposal, CGT would be payable on receipt of a gift, and the base price for future CGT would be the price/value at transfer to the donee. (I passed this on separately to PS/IR).

J M G TAYLOR

**NOTE OF A MEETING HELD AT 3.00PM ON**

**TUESDAY 20 OCTOBER IN HM TREASURY**

Present: Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Scholar
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill - IR
Mr Isaac - IR
Mr Mace - IR
Mr Cayley - IR
Mr Gonzalez - IR
Mr Calder - IR

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**TAX REFORM: DISTRIBUTION AND COSTINGS**

Papers: Mr Scholar's annotated agenda of 16 October, and related papers.

**Tax reform: "Scorecard" costings (Miss Evans' minute of 20 October)**

The Chancellor, opening the discussion, thanked officials for the comprehensive set of papers prepared for the meeting. He preferred the revised scorecard in its changed format. It produced an interesting and attractive package, of the right order of magnitude, which produced a good basis for further work. One or two elements would need adjustment: the figures for independent taxation did not take full account of proposals for the MCA, and reduced the number of losers. But should there be an offsetting phasing in the reductions in the higher rate of income tax?

6. On the proposal itself, Sir T Burns said that it might be that many of the losers would not, in fact, lose very much. If so it might not be worthwhile to introduce the complexity of the phasing arrangement simply to convert small losses into small gains. Mr Scholar said that the offsetting phasing of the higher rate might excite unfavourable attention from basic rate taxpayers who would see their national insurance contribution rate rising each year uncushioned by any reduction in income tax. The Chancellor invited Mr Mace to prepare a table showing the size of the losses on the phasing option.

7. The Chancellor noted that there were now two main choices on mortgage interest relief. First (proposal 10), the relief should be restricted to the residence basis from 1988 and the ceiling raised to £35,000. Second (proposal 10a), the relief would continue on the present basis, with a £20,000 ceiling for singles and a £40,000 ceiling for couples. Proposal 10 hit single people who wished to share; proposal 10a hit single people on their own. The effects on single people, and especially on the disadvantaged in this category (eg. widows) would need to be considered carefully. He noted that the package as a whole hit single people. Mr Cassell noted that proposal 10 had already been canvassed and had received a favourable reception. The Chancellor said that, for this reason, there should be a disposition towards proposal 10, though the issue would need to be examined further. The Revenue said that further papers on these proposals would be coming forward shortly (they would, inter alia, give an estimate of the proportion of new mortgages going to single people).

8. It was noted that exempting forestry from tax (proposal number 11) would give rise to additional revenue (around £5 million per year). Further work was under way on the proposal to abolish

tax relief on new covenants between individuals (proposal number 12).

9. On taxing employers instead of employees on benefits in kind (proposal number 13), Mr Isaac said the Revenue saw some scope for a tax which focussed on a limited number of high yielding benefits. A note was on its way to the Chancellor.

10. The Chancellor said something must be done about inheritance tax. He was not attracted by a relief to businesses; the relief should be general in nature. The proposal to consolidate at a rate of 40 per cent (proposal number 14) would assist businessmen, and also took people out of the tax net altogether.

11. The Chancellor said that converting the £30,000 lower limit on stamp duty into a threshold seemed the most optional proposal in the package. If it were necessary to drop a proposal in order to reduce the revenue cost of the package as a whole, this proposal should fall.

**Tax reform: self employed**

12. The Chancellor commended Mr Mace's paper of 19 October. He was increasingly convinced that fixing a NIC rate above the Upper Earnings Limit for the self employed of 9 per cent would be damaging to the package as a whole, and would stretch the contributory principle too far. He would prefer simply to abolish the UPL. The self employed would then have a lower top rate of tax/NIC combined than employees, but this was a "necessary evil" to secure acceptance of the package. A proposal on these lines would maintain the integrity of the NIC system, and appeared also to help losers (Mr Mace undertook to provide further figures on this).

13. Mr Isaac suggested that the Chancellor would want to look horizontally at the position of the self employed vis a vis employees. A proposal along these lines would put pressure on high

earning employees to "become" self employed. Mr Scholar suggested that, by analogy with the NIC proposals for employees at the bottom end, some assistance might need to be given to the lower paid self employed. Lowering the class 2 rate seemed the least complicated option. The Chancellor agreed this option should be pursued.

14. The Financial Secretary noted that the self employed would still complain if the UPL were merely abolished, without further adjustment. The Chancellor said further consideration should be given to allowing tax relief on half the contributions on profits above the UPL, although he was unenthusiastic about this aspect. There should also be further examination of the package in the context of the proposed changes to employees' contributions.

15. Mr Isaac noted that the only safe option for implementing changes to NICs for the self employed was April 1989. The Chancellor strongly preferred October 1988. He invited Mr Isaac to look further at the possibilities, and provide advice.

**NICs at the lower end**

16. The Chancellor said he would like to keep in play Option C (Mr Macpherson's minute of 16 October) and Option F (Mr Macpherson's minute of 20 October). Further analysis of these options should be carried out. Mr Calder said Option C would be included in the gainers and losers analysis (because of its effect on the "contracted out").

**Economic rationale**

17. In a brief discussion, the Chancellor suggested a number of amendments to the paper and invited those present to give further comments in writing to Mr Scholar. Sir P Middleton said further work on the paper was envisaged.

Circulation

Those present
Mr McIntyre )
Mr Macpherson ) paragraphs 12-16 only

J M G TAYLOR

21 October 1987

**TASK FORCE SECRET**

Copy No. 14 of 14 Copies

FROM: J M G TAYLOR

DATE: 22 October 1987

MR CAYLEY - IR

cc: PS/FST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Cropper

Mr Battishill
Mr Isaac
Mr Houghton
PS/IR

**CAPITAL GAINS TAX**

The Chancellor would be grateful for a further option to be considered. This option is intended to allow for as much indexation back to 1965 as possible, but to avoid the problems caused by share-pooling. The option has two parts. First, there would be rebasing to 1982 for all capital gains on shares. Second, there would be full indexation back to 1965 for capital gains on land (and, if possible, on all other items apart from shares).

2. The Chancellor would be grateful for advice on this option (including costings) in time for the forthcoming meeting on capital gains issues.

J M G TAYLOR

COPY NO 18 OF 18

FROM: J M G TAYLOR
DATE: 26 October 1987

PS/FINANCIAL SECRETARY

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middlton
Sir T Burns
Mr Cassell
Mr Monck
Mr Byatt
Mr Scholar
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Driscoll - IR
PS/IR

**FINANCE BILL 1988: ENTERPRISE ZONES (STARTER NO.208)**

The Chancellor has seen Mr Painter's submission of 20 October, and Mr Driscoll's separate note of 21 October. He would be grateful for the Financial Secretary's advice.

JT

J M G TAYLOR

TASK FORCE SECRET

COPY NO 14 OF 14

FROM: J M G TAYLOR

DATE: 26 October 1987

PS/FINANCIAL SECRETARY

cc Sir P Middleton
Mr Cassell
Mr Byatt
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Jenkins
Mr Battishill - IR
Mr Isaac - IR
Mr Beighton - IR
PS/IR

**TAX REFORM: REMOVING SHELTERS: STARTER 454**

The Chancellor has seen Mr Beighton's minute of 23 October. He takes it that restricting the tax relief for foreign entertainment (mentioned at the end of Mr Beighton's cover note) is firmly in hand as a starter for 1988.

JT

J M G TAYLOR

ps3/13T

**TASK FORCE SECRET**

COPY NO. 12 OF 12.

FROM: J M G TAYLOR

DATE: 2 November 1987

MR SCHOLAR

cc Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Riley
Miss Sinclair
Mr G P Smith
Mr Cropper
Mr Tyrie

**TAX REFORM: MERVYN KING**

The Chancellor was most grateful for your minute of 28 October.

2. He is interested in the Robinson option. He would be grateful if you could include it in the short note on options for corporate income taxation which you are putting to him. He would also like to know the full extent of the gains to simplicity and administration to which you refer, including how much would arise in advance of independent taxation.

J M G TAYLOR

ps3/12T



COPY NO. 17 OF 17.

FROM: J M G TAYLOR
DATE: 2 November 1987

MISS C EVANS

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir T Burns
Mr Byatt
Mr Cassell
Mr A Wilson
Mr Riley
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Call
PS/IR

**TASK FORCE TIMETABLE: MEETINGS**

The Chancellor was grateful for sight of your minute of 30 October to Sir P Middleton, which he thinks is very helpful and useful.

2. He is afraid that we shall need to have the benefits in kind meeting on the morning of this Friday, 6 November. This office will be in touch with precise arrangements.

JT

J M G TAYLOR

**TASK FORCE SECRET**

COPY NO. 11 OF 11 .

FROM: A C S ALLAN
DATE: 2 November 1987

MR SCHOLAR

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr McIntyre
Mr Macpherson
PS/IR
Mr Isaac - IR

**SELF-EMPLOYED NICs**

The Chancellor would be grateful for information on the following additional option to deal with the issue of self-employed NICs. This would be to abolish the 50 per cent deductibility of NICs against income tax, and to use the resulting yield to cut (or eliminate) Class II contributions. He would be particularly interested in an analysis of the distributional effects of this.

ACSA

A C S ALLAN

TASK FORCE SECRET

COPY NO 11 OF 11

FROM: A C S ALLAN

DATE: 2 November 1987

MR MACE - INLAND REVENUE

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Cropper
PS/IR
Mr Isaac - IR

**TAX PACKAGE**

The Chancellor would be grateful for information about the costs and distributional consequences of the following options:

(i) Bringing the basic rate down to 24p instead of 25p.

(ii) Cutting employees NICs to 8 per cent, starting at the point where the existing 9 per cent rate starts.

(iii) Raising thresholds by amounts which would cost the same as either (i) or (ii) above - ie two different options.

2. He would be grateful in particular for a comparison of how these various options affect the basic rate losers under the existing package.

ACSA

A C S ALLAN

COPY NO. 21 OF 21 .

FROM: J M G TAYLOR
DATE: 4 November 1987

MR SCHOLAR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr A Wilson
Mrs Lomax
Mr Riley
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill - IR
Mr Isaac - IR
PS/IR

**THE RATIONALE AND EFFECTS OF TAX REFORM PROPOSALS**

The Chancellor has been reflecting further on the Task Force paper (submitted with your minute of 16 October) on which he asked Mr Riley to produce a brief follow-up note on two of the Annex B possibilities.

2. The Chancellor would be grateful if you would include in this a short note on another Annex B-type possibility - a flat rate withholding tax on investment income, on the lines suggested by Mervyn King, but at 35 per cent. The Chancellor has asked what administrative advantages there would be in this, both before and after independent taxation.

J M G TAYLOR

**TASK FORCE SECRET**

COPY NO. 20 OF 21 .

FROM: J M G TAYLOR

DATE: 4 November 1987

MR SCHOLAR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr A Wilson
Mrs Lomax
Mr Riley
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill - IR
Mr Isaac - IR
PS/IR

**THE RATIONALE AND EFFECTS OF TAX REFORM PROPOSALS**

The Chancellor has been reflecting further on the Task Force paper (submitted with your minute of 16 October) on which he asked Mr Riley to produce a brief follow-up note on two of the Annex B possibilities.

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JT

J M G TAYLOR

COPY NO 15 OF 15 COPIES

FROM: J M G TAYLOR
DATE: 9 November 1987

PS/FINANCIAL SECRETARY

cc Sir P Middleton
Mr Cassell
Mr Byatt
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Jenkins
Mr Battishill - IR
Mr Isaac - IR
Mr Beighton - IR
PS/IR

**TAX REFORM: REMOVING SHELTERS: STARTER 454**

The Chancellor has seen your minute of 27 October.

2. He is content to go along with the Financial Secretary's strong view that the benefits of taking action, in terms of simplification, are very minor and would be outweighed by the potential disadvantages.

J M G TAYLOR

TASK FORCE SECRET

COPY NO 7 OF 7 COPIES

FROM: J M G TAYLOR
DATE: 9 November 1987

MR MONCK

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Scholar

**STARTER 208: ENTERPRISE ZONES**

The Chancellor was grateful for your minute of 30 October.

2. He agrees that a Greenock Enterprise Zone might be worth considering, and that if it turns out to be a useful component of a package announced for the Budget, Mr Rifkind should announce it without any reference to tax changes. He has asked the Financial Secretary to reconsider whether, if Greenock is given old Enterprise Zone status, it is worth taking any action on Enterprise Zones at all.

J M G TAYLOR

RJ4.55

TASK FORCE SECRET

COPY NO 16 OF 16 COPIES

FROM: J M G TAYLOR

DATE: 9 November 1987

MR MCINTYRE

cc Chief Secretary
Financial Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Scholar
Miss Peirson
Mr Gibson
Mr Macpherson
Mr Cropper
Mr Tyrie
Mr Call
Mr Mace - IR

**NATIONAL INSURANCE CONTRIBUTIONS, CONTRIBUTORY PRINCIPLE AND NIF SURPLUS**

The Chancellor was grateful for your minute of 6 November, and for the two papers enclosed.

2. He agrees that the most promising way of reducing the surplus may be to increase the NHS allocation, and that we should consider whether to use the opportunity of next year's Social Security Bill to give ourselves more room for manoeuvre on this front.

3. He has commented that SERPS entitlement is difficult. There is obviously a case for changing the rules so that it depends on total NICs paid, and not just on those between the LEL and UEL (the latter having to be notionally retained just for the purpose). On the other hand, keeping SERPS entitlement rules as they are, while employee NICs are no longer bound by the UEL, would presumably encourage contracting-out by those on high earnings. He would be most grateful for a note on this point.

J M G TAYLOR

ps3/23T — **TASK FORCE SECRET**

COPY NO. 3 OF 3 .

FROM: J M G TAYLOR

DATE: 10 November 1987

PS/FINANCIAL SECRETARY

**CGT: DEFERRED CHARGES AND REBASING**

The Chancellor has seen Mr Cayley's submission of 29 October. He would be grateful for the Financial Secretary's views.

JT

J M G TAYLOR

**TASK FORCE SECRET**

COPY NO. 19 OF 19.

FROM: J M G TAYLOR
DATE: 10 November 1987

MR M F CAYLEY - Inland Revenue

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Jenkins (Parly Counsel)
Mr Battishill - IR
Mr Isaac - IR
PS/IR

**REFORM OF CGT:**
**ABOLISHING TAX DEFERRAL ON GIFTS**

The Chancellor has seen your submission of 3 November. He has commented that your impression that the relief is increasingly used as a tax planning device is correct, and important.

J M G TAYLOR

**TASK FORCE SECRET**

COPY NO. 19 OF 19 .

FROM: J M G TAYLOR
DATE: 10 November 1987

MR CAYLEY - Inland Revenue

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Scholar
Mr G P Smith
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Battishill - IR
Mr Isaac - IR
PS/IR

**CAPITAL GAINS REFORM**

The Chancellor was grateful for your submission of 9 November.

2. He has commented that it is slightly surprising to see that a scheme which is less generous to land than that originally proposed, and the same for shares, should cost an extra £175 million. What would be the yield effect if the indexation election were abolished? And, incidentally, was the original rebasing proposal costed on the basis of indexation election retained or abolished? What would be the difference in cost?

3. I should be most grateful for advice.

J M G TAYLOR

**NOTE OF A MEETING HELD IN THE CHANCELLOR'S ROOM, HM TREASURY AT 10.15AM ON FRIDAY 6 NOVEMBER 1987**

Present: Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Kemp
Mr Scholar
Miss Sinclair
Mr Michie
Mr Cropper
Mr Tyrie

Mr Battishill - IR
Mr Isaac - IR
Mr Lewis - IR
Mr Prescott - IR
Miss Rhodes - IR

---

**TAXATION OF BENEFITS IN KIND**

Papers: Employer based tax - Mr Scholar's minute of 28 October, Mr Isaac's minute of 20 October, and previous papers. Taxation of car benefits - Financial Secretary's minute of 30 October, Mr Lewis' minute of 22 October and previous papers.

**Employer based tax**

The Chancellor thanked the Financial Secretary and Revenue and Treasury officials for their preparatory work. His objective was to level the jungle which at present surrounded the taxation of benefits in kind. He was not interested in replacing one jungle with another; if that were the only result of reform, he would prefer not to go ahead. One way through might be to take a specific number of benefits and place the burden of taxation on the employer, as Mr Isaac had suggested. Cash benefits could remain covered by the P11D system, and other benefits exempted altogether.

2. Mr Isaac doubted whether this would be workable. If tax were confined to the main benefits, and many of the remainder exempted, those remaining benefits would be exploited.

3. The Chancellor suggested that an alternative route might be to deal with those benefits not covered by the new employer based tax by raising the P11D threshold. His objective was not to reach some equitable ideal. It was, instead, to simplify the present system; to minimise the difficulties of administration; to lessen the political sensitivity of making future changes in this area; and to reduce the proportion of payment in this form (ie. to encourage employers to "cash out").

4. Sir Peter Middleton noted that, unless a change of this sort were made, benefits in kind would be encouraged by abolishing the employees UEL. The more expensive benefits had spread throughout the system, and there was a good case for cutting back on them. He doubted whether the use of alternative benefits would be encouraged by their exemption from tax: there were limits to the demand for these. The remainder of benefits could, however, be covered by action on the P11D threshold.

5. The Chancellor said that a consultative document should not be issued. There would be ample time for representations between legislation in 1988 and the proposed implementation date. He would prefer to avoid difficulties by being cautious with the proposals themselves.

6. The Chancellor noted the importance of avoiding too high a compliance burden on employers. The Revenue had suggested a possible two-tier approach: if this were pursued, there should be

no threshold for benefits on which employers paid tax and a high threshold for employees, by raising the P11D threshold, say, to £20,000. Mr Scholar suggested that an alternative possibility might be to define the threshold in terms of benefits received, not income. The Revenue thought this might encourage payments in benefit form, and hence give rise to a revenue cost. The Chancellor asked that this possibility be considered further.

7. The Chancellor invited views on an approach which dealt with benefits in kind in three categories. First, there would be an employer based tax for widespread benefits (and any other which could be dealt with without difficulty in this category). Second, exemption of minor benefits in kind, eg. car parking. Third, for those benefits which could neither be covered by an employer based tax nor could sensibly be wholly excluded, the existing system but with a much higher P11D threshold.

8. The Chief Secretary agreed that the possibility of an employer based tax for the main benefits should be examined. But the small businesses' perception of a change of this sort should not be under estimated. They would be very hostile. He agreed that there was a strong argument for exemption of the minor benefits, provided that there was no scope for abuse. He agreed entirely with the proposal to raise the P11D threshold for the remainder. In summary, the Chancellor's approach should be examined, but without a full commitment at this stage to go ahead on that basis.

9. The Paymaster General noted that encouraging employers to pay in cash rather than benefits was patently fairer. This was an important political point. He agreed with the Chancellor's general approach, although he noted that raising the P11D threshold encouraged paying in benefits up to that level. But he also agreed with the Chief Secretary that there could be a substantial perception problem with a change of this sort.

10. The Financial Secretary noted that the proposals needed to be considered in the context of Lord Young's initiative for reducing burdens on business. A number of the proposals here could be shown to point in the right direction. He supported the Chancellor's proposal, provided that the employer based tax were done in a sufficiently rough and ready way that the burden of compliance was kept to a minimum.

11. The Chancellor, summing up this part of the discussion, said this three part approach was agreed. On the other points in Mr Isaac's paper, he proposed to start from the presumption that payments would be made within the year (although not necessary monthly). The system would start in 1990-91. A study team should go to Australia; and further work should be done on the position of the self-employed.

12. The Chancellor said that he favoured non-deductibility for corporation tax purposes. This would, inter alia, avoid discrimination between the public and private sectors. Moreover, if the employer based tax were made deductible, it would need to be set at a high rate, giving rise to presentational problems.

13. Mr Isaac said that deductibility would ensure symmetry between cash payments and benefits in kind. Businesses would complain about non-deductibility of this tax in contrast to other charges.

14. In discussion, it was noted that the presentational difficulties of non-deductibility needed to be set against the presentational difficulties of fixing a high rate. It was noted that there were advantages in deterring employers from paying in kind; to the extent that the tax regime for these benefits appeared harsh employers were at liberty to transfer into payments in cash.

15. After further discussion, it was agreed to plan on the basis of non-deductibility. The rate should be set at 45 per cent. It

was noted that the presentational effects of this on basic rate taxpayers vis a vis higher rate taxpayers will need to be considered carefully.

16. The Chancellor invited officials to take forward work on an employer based tax on the basis of the decisions reached.

**Taxing car benefits**

17. The Chancellor invited the Financial Secretary, in association with the Paymaster General, to consider again the taxation of car benefits in the light of the decisions made. He would, if necessary, hold a further meeting at a later date.

J M G TAYLOR
10 November 1987

Circulation

Those present
Economic Secretary

**NOTE OF A MEETING HELD IN THE CHANCELLOR'S ROOM, HM TREASURY AT 10.15AM ON FRIDAY 6 NOVEMBER 1987**

Present: Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Kemp
Mr Scholar
Miss Sinclair
Mr Michie
Mr Cropper
Mr Tyrie

Mr Battishill - IR
Mr Isaac - IR
Mr Lewis - IR
Mr Prescott - IR
Miss Rhodes - IR

---

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The Chancellor thanked the Financial Secretary and Revenue and Treasury officials for their preparatory work. His objective was to level the jungle which at present surrounded the taxation of benefits in kind. He was not interested in replacing one jungle with another; if that were the only result of reform, he would prefer not to go ahead. One way through might be to take a specific number of benefits and place the burden of taxation on the employer, as Mr Isaac had suggested. Cash benefits could remain covered by the P11D system, and other benefits exempted altogether.

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6. The Chancellor noted the importance of avoiding too high a compliance burden on employers. The Revenue had suggested a possible two-tier approach: if this were pursued, there should be

no threshold for benefits on which employers paid tax and a high threshold for employees, by raising the P11D threshold, say, to £20,000. Mr Scholar suggested that an alternative possibility might be to define the threshold in terms of benefits received, not income. The Revenue thought this might encourage payments in benefit form, and hence give rise to a revenue cost. The Chancellor asked that this possibility be considered further.

7. The Chancellor invited views on an approach which dealt with benefits in kind in three categories. First, there would be an employer based tax for widespread benefits (and any other which could be dealt with without difficulty in this category). Second, exemption of minor benefits in kind, eg. car parking. Third, for those benefits which could neither be covered by an employer based tax nor could sensibly be wholly excluded, the existing system but with a much higher P11D threshold.

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9. The Paymaster General noted that encouraging employers to pay in cash rather than benefits was patently fairer. This was an important political point. He agreed with the Chancellor's general approach, although he noted that raising the P11D threshold encouraged paying in benefits up to that level. But he also agreed with the Chief Secretary that there could be a substantial perception problem with a change of this sort.

10. The Financial Secretary noted that the proposals needed to be considered in the context of Lord Young's initiative for reducing burdens on business. A number of the proposals here could be shown to point in the right direction. He supported the Chancellor's proposal, provided that the employer based tax were done in a sufficiently rough and ready way that the burden of compliance was kept to a minimum.

11. The Chancellor, summing up this part of the discussion, said this three part approach was agreed. On the other points in Mr Isaac's paper, he proposed to start from the presumption that payments would be made within the year (although not necessary monthly). The system would start in 1990-91. A study team should go to Australia; and further work should be done on the position of the self-employed.

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15. After further discussion, it was agreed to plan on the basis of non-deductibility. The rate should be set at 45 per cent. It

was noted that the presentational effects of this on basic rate taxpayers vis a vis higher rate taxpayers will need to be considered carefully.

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**Taxing car benefits**

17. The Chancellor invited the Financial Secretary, in association with the Paymaster General, to consider again the taxation of car benefits in the light of the decisions made. He would, if necessary, hold a further meeting at a later date.

J M G TAYLOR
10 November 1987

Circulation

Those present
Economic Secretary

FROM: J M G TAYLOR
DATE: 11 November 1987

PS/FINANCIAL SECRETARY

cc: PS/Chief Secretary
Sir P Middleton
Mr Monck
Mr Scholar
Mr Cropper
Mr Painter IR
Mr McGivern IR

**STARTER 208: ENTERPRISE ZONES (EZs)**

The Chancellor has seen your minute of 10 November. He is content that starter 208 should now be dropped.

J M G TAYLOR

COPY NO 16 OF 16 COPIES

FROM: J M G TAYLOR

DATE: 18 November 1987

MR SCHOLAR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Miss Sinclair
Mr Cropper
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Mace - IR
PS/IR

**TAX REFORM 1988: OPERATIONAL IMPLICATIONS**

The Chancellor has seen Mr Mace's submission of 17 November. He would be grateful for a note of the consequences for the package of deferring UPL abolition until April 1989.

J M G TAYLOR

COPY NO 4 OF 4 COPIES

FROM: J M G TAYLOR
DATE: 23 November 1987

MR CROPPER cc Mr Tyrie

BENEFIT TAXATION

The Chancellor was most grateful for your note of 20 November.

2. He has commented that your question whether it would be necessary to keep the P11D system going is an important one. The answer is that, in his proposed scheme, where there is no catch-all EBT but only one for the big specified benefits, there would be an incentive for employers to reward employees with benefits in kind simply because they were not on the EBT list. The P11D system would therefore need to be kept for the residue. But the P11D limit could be pitched very high, so very few people would be affected and for the vast bulk of employees life would be very simple indeed.

3. He thinks that the main problem is that the transfer from employees to employers would, as you suggest, be a permanent addition to industries' costs, unless we decide to relieve business taxation in some other way, which would be expensive. On universality, he has commented that the EBT is universal, while the P11D limit would apply only to anti-avoidance.

4. The Chancellor has also seen and was grateful for Mr Tyrie's note of the same date. He has commented that increasing the threshold etc is not without its problems.

J M G TAYLOR

TASK FORCE SECRET

COPY NO 5 OF 5 COPIES

FROM: J M G TAYLOR

DATE: 23 November 1987

MR TYRIE

cc PS/Financial Secretary
Mr Cropper

**SOMETHING RADICAL/24 PENCE AND KINK LOSERS**

The Chancellor has seen your minutes of 19 and 20 November. He has commented as follows: "Many thanks for your two contradictory suggestions of 19 November and 20 November, one commending option E1 in Brian Mace's latest paper (a 24 per cent basic rate) and the other advocating a 25 per cent flat rate for all income and capital gains. While the attractions of the latter are undeniable, the disadvantages you list are, I believe, greater than you appear to imply. Moreover there is a further, and in my opinion decisive, disadvantage. Your proposed flat rate would have a constricting finality about it. You could not reintroduce the basic rate/higher rate distinction once you had abolished it. Nor, in practice, would it be justifiable to bring the flat rate (=top rate) down any further. All you could subsequently do would be to raise personal allowances. I would prefer to keep open the option of moving the basic rate down still further, with a target of 20 per cent - which is what I take to be the attraction you see in the 24 per cent proposal. This means that retention of the basic rate/higher rate distinction is important. I am, incidentally, surprised at your estimate of only £1.3 billion for the cost of the 25 per cent flat rate."

J M G TAYLOR

TASK FORCE SECRET

COPY NO 18 OF 18 COPIES

FROM: J M G TAYLOR
DATE: 23 November 1987

PS/FINANCIAL SECRETARY

cc Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Byatt
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Cassell
Miss Hay
Mr Cropper
Mr Tyrie
Mr Call
Mr Painter - IR
PS/IR

**TAX TREATMENT OF PRIVATE RENTED ACCOMMODATION**

The Chancellor has seen Mr Cassell's note and enclosure of 19 November.

2. He would be grateful if the Financial Secretary could look at this as a matter of urgency, and let him have his recommendations.

J M G TAYLOR

COPY NO 16 OF 16 COPIES

FROM: J M G TAYLOR
DATE: 23 November 1987

MR CAYLEY - INLAND REVENUE

cc PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Riley
Mr Cropper
Mr Tyrie
Mr Battishill - IR
Mr Isaac - IR
PS/IR

**CGT REFORM: PERCEPTION OF MARGINAL RATES**

The Chancellor was most grateful for your minute of 19 November. He has commented that clearly there is no real problem with disincentive effects.

J M G TAYLOR

COPY NO. 18 OF 18 .

FROM: J M G TAYLOR

DATE: 23 November 1987

MR MACE - Inland Revenue

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Battishill - IR
Mr Isaac - IR
PS/IR

**TAX RATES**

The Chancellor would be grateful if you could cost out two further packages for income/capital gains tax.

2. These are:

(a) a higher rate of 30 per cent, and a standard rate of 25 per cent;

(b) a higher rate of 30 per cent and a standard rate of 24 per cent.

3. The Chancellor would be grateful if, in your note on these, you could set out the position on gainers/losers.

JT

J M G TAYLOR

ps3/50T

TASK FORCE SECRET

COPY NO. 9 OF 9.

FROM: J M G TAYLOR
DATE: 23 November 1987

PS/FINANCIAL SECRETARY

cc Sir P Middleton
Mr Scholar
Mr Culpin
Mr Cropper
Mr Painter - IR
Mr Houghton - IR

**SECTION 482: COMPANY RESIDENCE AND MIGRATION**

The Chancellor has seen Mr Houghton's submission of 19 November to the Financial Secretary. He agrees that the avoidance of UK tax on accrued gains is now probably the more immediate factor. He has asked to what extent this would be reduced by the proposed rebasing of CGT. I should be grateful if you could take this forward.

J M G TAYLOR

ps3/57T

**TASK FORCE SECRET**

COPY NO. 9 OF 9 .

FROM: J M G TAYLOR
DATE: 25 November 1987

MR CAYLEY - Inland Revenue

cc PS/Financial Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Isaac
PS/IR

**CAPITAL GAINS TAX: ROLLOVER RELIEF**

The Chancellor was grateful for your note of 24 November.

J M G TAYLOR

ps4/54H

**TASK FORCE SECRET**

COPY NO. 3 OF 3 COPIES

FROM: A P HUDSON
DATE: 25 November 1987

**CHANCELLOR**

**MORTGAGE INTEREST RELIEF**

I have read the various recent papers on this tricky subject.

2. The approach of a personal ceiling, on the £30/60,000 basis, has a number of attractions:

(a) it is clearly consistent with independent taxation, and the community charge;

(b) no losers;

(c) it is the only option that is clearly not inconsistent with pledges made by the Prime Minister and others.

3. But it has a number of disadvantages:

(a) we need to see the cost;

(b) we also need a proper evaluation of the effect on the housing market, and hence the cost in five years' time;

(c) it would add significantly to the bias in favour of investment in housing, rather than other things, particularly equities. The couples who would benefit from the extra relief are probably already shareholders in a small way. But they are the sort of people who we need to branch out beyond the privatisation stocks, if we are to deepen share ownership;

(d) the politics are obviously for you to judge. But over much of the country, most people will be unaffected, because their mortgages are below £30,000 anyway. And the Opposition would no doubt make great play of the big gains for a few rich people, compared to the "cuts" in housing benefit and child benefit.

4. We have to do something: it would be very odd to introduce Independent Taxation without tackling this tax penalty on marriage.

5. In principle, I think the right answer is to go for the residence basis with the ceiling at £30,000.

(a) The logic is that mortgage interest relief is designed to help people buy their homes: therefore one home should get one slice of relief.

(b) It tackles the tax penalty on marriage.

(c) It reduces, rather than increases, the scope of the relief.

(d) For all but a few, the system would remain unchanged.

6. Given protection for existing loans, the only actual losers are sharers who move house, still as sharers. I suspect these are few and far between. Most of the unmarried couples that I know have married after a while, in spite of the tax penalty. And the other groups of sharers break up, typically as one or more gets married.

7. People who intend to buy as sharers are relative losers - they will get less relief than they would do under the present system. Arguably, that does not matter. In principle two sharers, whether cohabiting or not, should get the same relief as a married couple anyway.

8. The better arguments for giving higher relief to sharers apply equally to married couples.

(a) The cost of flats and houses for two people is more than for a single person. True, but not twice as much. This points to a residence basis with a ceiling of £30,000 for single people, and, say, £40,000 for couples of any kind (or larger groups).

(b) In London and the South-East, people are often forced to share because they cannot afford to buy on their own. Married couples who are in that position have to manage with £30,000 relief anyway. And, in theory, if sharers have less purchasing power, prices will adjust. But if the point has to be addressed, the answer can be the same as above.

9. In summary, I think we should go for the residence basis with a £30,000 ceiling. This should be presented in a low-key way, as a measure to tackle the tax penalty, which won widespread support in the Green Paper. If we come under pressure - before or after the Budget - the fallback should be £40,000 for couples.

**Home Improvements**

10. If we abolish relief for home improvements, we shall need to get the positive arguments lined up. The ones I can see are that it would release more money for home buyers, and/or across-the-board tax reductions; and that home improvement needs no stimulus from the Government - people are keen to do it because they have a better home, and, as the value of their home increases, the capital gain is tax-free.

11. The prevelance of abuse could also be deployed, but people will argue that this should be tackled head on - the Inland Revenue are usually keen enough to tackle abuse wherever they see it!

APH

A P HUDSON

RJ8.3

TASK FORCE SECRET

COPY NO 18 OF 18

FROM: J M G TAYLOR

DATE: 26 November 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Jenkins - OPC
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
Mr Mace - IR

**INDEPENDENT TAXATION - STAFF COSTINGS**

The Chancellor has seen Mr Isaac's and Mr Mace's notes of 23 November. He has also seen Mr Beighton's note of the same date on cutting the cost of handling claims.

2. On Mr Isaac's note, the Chancellor has commented that changes to eg. maintenance and covenants should give rise to some staff savings. On Mr Mace's note, he has commented that this would seem to strengthen the case for a straightforward flat rate withholding tax on dividends etc.

JT

J M G TAYLOR

TASK FORCE SECRET

Copy No. 22 of 22 Copies

FROM: J M G TAYLOR

DATE: 30 November 1987

MR MACPHERSON

cc: PS/CST
PS/FST
PS/PMG
PS/EST
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Scholar
Mr Culpin
Miss Peirson
Mr McIntyre
Mr Riley
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Call

Mr Isaac
Mr Mace

**NATIONAL INSURANCE CONTRIBUTIONS: FURTHER WORK**

The Chancellor was grateful for your note of 27 November.

2. He has commented that there are arguments both ways here, but - subject to the views of the Chief Secretary and other Ministers - the LPL option looks to have the edge by virtue of fewer losers, which is the key criterion. It is also arguably more logical to compensate for a Class IV disadvantage by a Class IV (rather than Class II) advantage - and, moreover, we know that the self-employed feel particularly strongly about Class IV.

JT

J M G TAYLOR

TASK FORCE SECRET

Copy No. 17 of 17 Copies

FROM: J M G TAYLOR
DATE: 30 November 1987

MR CAYLEY

cc: PS/CST
PS/FST
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Riley
Mr Cropper
Mr Tyrie

Mr Battishill
Mr Isaac
Mr Pitts

**CGT REFORM: HUSBAND AND WIFE**

The Chancellor has seen and noted your minute of 27 November.

2. He has commented that the key defensive point is that, where aggregation does result in a greater tax charge on the gains of a wife, it may well be that the married couples' overall tax bill on income and gains combined will be less due to the reductions in tax rates on income.

JC

J M G TAYLOR

TASK FORCE SECRET

Copy No. 22 of 22 Copies

FROM: J M G TAYLOR
DATE: 30 November 1987

MR MACE

cc: CST
FST
PMG
EST
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Scholar
Mr Culpn
Miss Sinclair
Mr Riley
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill
Mr Isaac
Mr Painter
PS/IR

**TAX REFORM: INCOME TAX AND NIC**

The Chancellor was grateful for your note of 27 November, and Mr Cayley's annex.

2. He would be grateful if the options could be reworked to take account of the 30 per cent witholding tax part of the package. He would also be grateful if a further option, F2A, could be examined (i.e. option F2 with a £20,000 higher rate threshold).

JT

J M G TAYLOR

TASK FORCE SECRET

Copy No. 22 of 22 Copies

FROM: A C S ALLAN
DATE: 30 November 1987

MISS C EVANS

cc: CST
FST
PMG
EST
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Culpin
Miss Sinclair
Mr Riley
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill
Mr Isaac
Mr Mace
PS/IR
Mr Calder

**TAX REFORM: "SCORECARD" COSTINGS**

The Chancellor was most grateful for your minute of 27 November and the attached scorecard. He had the following comments.

2. Proposal No.16 (convert stamp duty £30,000 lower limit into a threshold) can be dropped altogether.

3. He would be grateful if the ordering of the socrecard could be changed, so that the NIC proposals (8, 9 and 10) follow the income tax proposals (1, 2 and 3).

4. The proposal to abolish tax relief for home improvement loans (paragraph 11 of the notes) should be included in the main scorecard.

5. Proposal No.9 on self-employed NICs should be amended to follow the alternative variant in paragraph 9 of the notes (ie to raise the LPL instead of reducing Class II NICs).

6. He feels the meeting to take stock of independent taxation and other income tax issues will need to be brought forward from 15 December, and we are arranging this.

ACSA

A C S ALLAN

PERSONAL AND TASK FORCE SECRET

Copy No..4..of..4..Copies

FROM: A C S Allan
DATE: 30 November 1987

MR ISAAC - IR

cc: Mr Battishill - IR

**A SINGLE RATE OF INCOME TAX**

The Chancellor was grateful for your minute of 27 November. As I explained to you on the 'phone, the Chancellor feels that there are some serious difficulties over moving to a single rate, for example because of the effect it would have on ossifying the tax system: once we had a single rate, it would be very difficult to reintroduce a basic/higher rate structure, and that would make it harder to continue to get tax rates down further.

2. However, he would be grateful to know whether you believe that most of the prizes you referred to in your paragraph 2 could be secured with unification for the vast majority of tax payers: ie with a higher rate threshold of, say, £50,000, a flat rate witholding tax (ie for all) on dividends etc, and a flat rate CGT (ie as now). If so, he would be happy to have urgent work done on this, with the near universal IT rate (and universal witholding tax rate) at 25 per cent, the higher rate at 40 per cent, and the flat CGT rate (as now) at 30 per cent.

ACSA

A C S ALLAN

**TASK FORCE SECRET**

COPY NO. 3 OF 3 .

FROM: J WILLIAMS
DATE: 2 December 1987

MR A G TYRIE

**MORTGAGE INTEREST RELIEF**

The Chancellor has seen and was grateful for your minute of 30 November.

Julian Williams

J WILLIAMS

RJ8.12

TASK FORCE SECRET

COPY NO 17 OF 17

FROM: J M G TAYLOR
DATE: 3 December 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Ms Sinclair
Mr Riley
Mr Cropper
Mr Tyrie
Mr Painter - IR
Mr Houghton - IR
Mr Fawcett - IR
PS/IR

**SECTION 482: COMPANY RESIDENCE AND MIGRATION**

The Chancellor was grateful for your note of 23 November, and is content with the Financial Secretary's proposals.

J M G TAYLOR

ps3/66T

**TASK FORCE SECRET**

COPY NO. 22 OF 22.

FROM: J M G TAYLOR

DATE: 3 December 1987

MR McINTYRE

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Scholar
Mr Culpin
Miss Peirson
Mr Riley
Miss Sinclair
Mr Macpherson
Mr Cropper
Mr Tyrie
Mr Call
Mr Isaac - IR
Mr Mace - IR

**NATIONAL INSURANCE CONTRIBUTIONS: SELF-EMPLOYED**

The Chancellor has seen your minute of 1 December. He awaits the views of the Chief Secretary. He has commented, however, that the merger of Classes II and IV is some way off: we must do what is best in the context of the 1988 package.

J M G TAYLOR

ps2/35M TASK FORCE SECRET

COPY NO. 12 OF 12 .

FROM: MISS M P WALLACE
DATE: 4 December 1987

MR ILETT

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Scholar*
Mr Culpin*
Mrs Lomax
Mr Cropper

PS/IR*
Mr Isaac - IR*

*with copies of Mr Ilett's submission of 20 Nov.

**CONTROL OF BORROWING ORDER: REMAINING PROBLEMS**

The Chancellor has seen your submission of 20 November. Before taking a view on all this, he would be grateful if you could consider whether the changes envisaged in the Budget render otiose the proposal to invite the Revenue to investigate possible tax changes to discourage foreign sovereign deep discounted issues. If this were the case, the COBO regime need only remain in place for local government, and the draft letter to the Governor would need to reflect this.

2. The Chancellor would be grateful if you would route your advice on this via the Economic Secretary.

MPW

MOIRA WALLACE

CONFIDENTIAL

**FROM: N J ILETT**
**DATE: 20 November 1987**

**ECONOMIC SECRETARY**

c c Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Hawtin
Mrs Lomax
Mr Peretz
Mr R I G Allen
Miss O'Mara (MG o/a)
Mr Potter
Mr Cropper
Mr Call
Mr Tyrie

Mr Hyett T.Sol

**CONTROL OF BORROWING ORDER : REMAINING PROBLEMS**

This submission advises on the problems in relation to foreign sovereign borrowing (Mrs Ryding's minute of 27 October) and local government finance. It then considers how and when to proceed with the abolition of the equity queue and of the legislation itself.

2. Paragraphs 3 to 10 were drafted by MG and cleared with the Inland Revenue. Paragraphs 11 to 17 reflect discussion with LG and DoE officials.

**Foreign sovereign borrowers**

3. We have now looked further with Inland Revenue at the tax treatment of income from deep discount, zero coupon and index-linked bonds issued by foreign sovereign and foreign public sector borrowers. It is, broadly, as we thought (see Mr Peretz' minute of 23 October).

4. The holders of zero coupon and deep discount bonds issued by such bodies can normally arrange for the bulk of their income to be taxed as a capital gain, rather than income. If such bonds are held to maturity then the "profit" (that is the difference between the purchase price and redemption value) is taxed as income. But if sold prior to maturity then any "profit" is taxed as a capital gain, subject to the normal allowance for indexation. (The interest element of a deep discount bond is of course taxed as income.)

5. In the case of index-linked bonds issued by such borrowers the uplift on the principal is generally taxed as capital, whether or not the bond is held to maturity. There is a slight uncertainty, however, as to the tax treatment of any uplift over the above the rate of inflation. Interest on index-linked bonds is treated as income.

6. A further slight complication arises from the fact that some foreign issues are structured so that the discount accrues on a daily basis. In these cases the Inland Revenue argue that the "profit" should be treated as income whenever it arises (either at maturity or if a bond is sold prior to maturity).

7. In general, therefore, zero coupon and deep discount (and index-linked) bonds issued by foreign sovereign or public sector borrowers are likely to be attractive to UK investors, from a tax point of view.

8. While the Bank's guidance, which to some degree might be thought to be founded on COBO, has in practice prevented sterling issues of this kind, the Inland Revenue report considerable investor interest in foreign currency issues. No doubt this reflects the success of the accrued income scheme in stopping most forms of bond-washing.

9. In the circumstances there is obviously a case for considering tax legislation, whether or not the Bank of England's guidance on sterling issues is to be left in place. A change in the tax regime, however, is likely to take some time since the Inland Revenue report there is no obvious or straight-forward tax solution.

10. You might wish to invite the Inland Revenue to consider the options further.

**Local government finance**

11. This is a bit of a mess.

12. A general point first. The Treasury Solicitor and DoE lawyers agree that COBO should not be used with the purpose of limiting local authority expenditure or ensuring prudential financial management by local authorities. It could be used "to control the raising of money by local authorities to maintain a proper balance between the economic resources of the community and the demands upon them". It follows, in modern circumstances, that any reliance on COBO is likely to be unsound and should be replaced as soon as possible by something better.

13. COBO is relevant to local authority finance for two purposes, deep discounted bond issues, and revenue borrowing.

Deep discounted bonds

14. There are two reasons why we wish to prevent local authorities issuing deep discounted bonds. First, the effect of the tax regime, which implies a transfer from central to local government equivalent to the implied transfer from the UK Government to the foreign public sector discussed in the first part of this submission. The second is to stop local authorities using this technique to defer the cost of borrowing into the future.

15. The DoE could use powers under the Local Government Act 1972 to forbid the issue of deep-discounted bonds. This would have obvious advantages. However, LG and DoE officials would rather leave things as they are until they can also deal with the revenue borrowing points described below.

Revenue borrowing

16. This is more difficult. The legal position is that a General Consent under COBO, issued in 1983, allows local authorities to

borrow for revenue purposes. Given the doubt about vires, we do not think limiting this consent is an option. (A general consent is a published statement of the Treasury's permission for things to be done which the Order would otherwise prohibit. It is not a Statutory Instrument as such and is not subject to Parliamentary procedure). But local authorities apparently believe that COBO does, nevertheless, apply to revenue borrowing, and in particular that COBO prevents borrowing for revenue purposes from being rolled over indefinitely. While this view is incorrect, the DoE and LG are understandably reluctant to say anything or make any other changes to the COBO regime which might stimulate local authorities to take a more careful look at the legislation and detect this loophole in the control system.

17. LG are advising separately on the legislative options, for closing the loophole - in short, neither local authority Bill in the present session is likely to be suitable, but there may be new legislation in 1988-89 which would serve.

Conclusions on local authority borrowing

18. There are two possible ways forward;

i. Given that COBO does not actually work on the one point which cannot immediately be rectified by existing local government powers, to scrap COBO now and block the local authority loophole as soon as possible;

ii. To leave the COBO regime in place for local authorities and lift it for the equity market, either

a. by a General Consent under COBO or

b. by amending COBO itself so that it no longer applies to the equity markets.

b. could be complex to draft, may attract Parliamentary challenge, and may stimulate unwelcome research into the local authority provisions. So we prefer a.

19. DoE officials do not propose to consult their Ministers if the Treasury opts for ii. a. But i. would require Mr Ridley's agreement, which is unlikely easily to be forthcoming. LG also oppose doing anything which would weaken our position on local government controls, for obvious reasons. While, from FIM's point of view, it is untidy to leave COBO in place in these circumstances, this is not an objection of substance. Were the loophole to be exploited , however, there would be no point in maintaining COBO.

## Recommendation

20. We therefore recommend:-

i. That you invite the Revenue to look more deeply into the possibility of tax changes to discourage foreign sovereign deep discounted issues;

ii. That the Treasury issue a General Consent under COBO to abolish the queue in the equity and..... markets, leaving the regime as it stands [both for foreign sovereign borrowing and] for local government. COBO itself would then be revoked as soon as alternative mechanisms were in place. (The parent legislation could then be repealed at the next convenient opportunity, ideally in this Parliament, though for the reasons discussed in our original paper , that is more a matter of presentation than substance.)

21. In any event, the Chancellor will wish to notify his decision to get rid of the queue to the Governor. I attach a draft letter for that purpose, on the basis that the Chancellor is content with the recommendations above. The draft also assumes that the Chancellor will not be announcing the abolition of the queue earlier than his Budget statement, given the present state of the markets - an announcement now would be unlikely to do good, could attract

irrelevant but unhelpful speculation about deeper motives, and might do harm. Also, this could provide a Budget lollipop.

22. Once the Governor has been informed, and has accepted the decision, you might write to Mr Maude at the DTI, as a matter of courtesy. Again assuming Treasury Ministers are content with the detailed recommendations above, it will suffice for LG to tell the DoE at official level.

N.

N J ILETT

6/4 CONFIDENTIAL

**DRAFT LETTER**

Rt Hon Robin Leigh-Pemberton
Governor
Bank of England
Threadneedle Street
LONDON EC2R 8AH

November 1987

**CONTROL OF BORROWING ORDER (COBO)**

Thank you for your letter of 9 October, which sets out the Bank's views very clearly. I have discussed this fully with the Economic Secretary. I feel strongly that the queue and COBO are unattractive relics of earlier times which really must be swept away. I have therefore decided to abolish the queue in the equity markets. Given present market conditions, however, I have it in mind to leave my announcement until my Budget statement. But I would, of course, be happy to discuss this or any other details with you.

As you know, COBO has some residual use in local government finance. It also prevents foreign public sector borrowers from making deep-discount issues which cost us tax. I am asking the Inland Revenue to look at ways of dealing with the latter point. On the former, new local government control powers are unlikely to be available before 1988/89. So I propose to leave the Control of Borrowing Order itself as it stands for the time being, and to abolish the queue by issuing a General Consent which will apply only to the equity and corporate bond markets. My officials will be in touch with yours about the precise coverage.

When COBO no longer has even the residual functions I describe above, I will revoke it, and then look for an opportunity to repeal the parent legislation.

Nevertheless, I understand the concerns you have and that you set out in your letter, and I support the policies you are pursuing. In particular, I fully support your policy on lead management, including the reciprocity test.

In my view, it should be possible for the Bank to continue to operate these policies in much the same way as at present, relying on the customary authority of the Bank, with of course my full support for the exercise of that authority. The statutory backing of COBO is at best limited and uncertain, and is therefore unreliable. And I would hope, also, that you would be able to use your customary authority to prevent foreign public sector issuers exploiting any tax loopholes.

NIGEL LAWSON

mjd 1/20A

TASK FORCE SECRET

COPY NO. 14 OF 14

FROM: A C S ALLAN

DATE: 7 December 1987

MR ISAAC

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Riley
Mr Mitchie
Mr Cropper

Mr Battishill - IR
PS/IR

**FRINGE BENEFITS TAX**

The Chancellor was grateful for your minute of 4 December, and the various attachments, which he wants to discuss at the meeting on Thursday.

2. He would be grateful for a short note on the consequences for Inland Revenue manpower.

ACSA

A C S ALLAN

ps3/69T

**TASK FORCE SECRET**

COPY NO. 13 OF 13.

FROM: J M G TAYLOR

DATE: 8 December 1987

MR SCHOLAR

cc Financial Secretary
Sir P Middleton
Mr Culpin
Mr Riley
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill - IR
Mr Isaac - IR
PS/IR

**RATIONALE OF TAX REFORM PROPOSALS**

The Chancellor has seen PS/Financial Secretary's minute to you of 7 December.

2. He agrees with the Financial Secretary that there should be much more discussion of independent taxation; that there should be a fuller discussion of the kink; and that there should be a section on the self-employed and possibly also on the employed/ self-employed interface and the personal tax/company tax interface.

3. He is doubtful if we should concede that there will be a further dent in the contributory principle.

4. He has commented, further, that whether it is right to say that the package does not score well against the objective of simplification depends largely on whether we have a withholding tax or not - but even if not, we need to stress those places where we are simplifying. He has also commented that, clearly, the overall tax burden as a proportion of GDP will not fall; but that this cuts both ways.

JT

J M T TAYLOR

COPY NO 9 OF 9

FROM: J M G TAYLOR

DATE: 8 December 1987

MR CULPIN

cc Sir P Middleton
Sir T Burns
Mr Scholar
Miss Sinclair
Mr Riley
Mr Scotter

**TAX BURDEN**

The Chancellor was grateful for your minute of 7 December, covering Mr Scotter's minute of the same date.

2. He would be grateful for comparable figures for 1989-90 and 1990-91 on the basis of the current package and last year's MTFS.

J M G TAYLOR

TASK FORCE SECRET

COPY NO. 21 OF 21 .

FROM: J M G TAYLOR
DATE: 14 December 1987

PS/CHIEF SECRETARY

cc PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt

Mr Scholar
Mr Culpin
Miss Peirson
Mr McIntyre
Mr Riley
Miss Sinclair
Mr MacPherson
Mr Cropper
Mr Tyrie
Mr Call
Mr Isaac - IR
Mr Mace - IR

**NATIONAL INSURANCE CONTRIBUTIONS: SELF-EMPLOYED**

The Chancellor has seen the Chief Secretary's minute of 7 December, and the Financial Secretary's note of the same date.

2. The Chancellor agrees with the Chief Secretary's view that we should reimburse the £170 million raised from the self-employed by the package through an increase in the lower profits limit. He has commented that this means that the only question we need to review and decide at Chevening is whether it is right to abolish tax relief on Class IV contributions.

J M G TAYLOR

COPY NO 11 OF 11

FROM: J M G TAYLOR
DATE: 14 December 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Scholar
Mr Culpin
Mr Cropper
Mr Tyrie
Mr Call

**SECTION 482: COMPANY RESIDENCE AND MIGRATION**

The Chancellor has seen Mr Tyrie's minute of 9 December.

2. He has commented that, as far as timing is concerned, the likelihood that an announcement might influence the Court's decision depends on the state of the case. If it is very much in the balance, the point has great force. But if it is a foregone conclusion that we shall lose the case, it has little force.

J M G TAYLOR

FROM: J M G TAYLOR
DATE: 16 December 1987

MR SCHOLAR

cc Mr Culpin

**ACTION POINTS**

I thought it might be helpful if I summarized the action points (other than that on the community charge) arising from yesterdays meeting. These are:

a. to review back papers on VAT on newspapers and magazines (action: Mr Scholar/Mr Culpin);

b. to chase Customs for advice on the European judgement about VAT rates (action: this office);

c. to review the past papers, and in particular the apparent technical difficulties, about taxing the income of pension funds (action: Mr Scholar/Mr Culpin);

d. to check 1985 statements about the deductability of Class IV NICs (action: Mr Scholar/Mr Culpin);

e. to chase the Revenue for their note on the effects of retaining the UEL and having either a 40% or 45% higher rate (action: this office).

J M G TAYLOR

COPY NO 7 OF 7

FROM: J M G TAYLOR
17 December 1987

MR TYRIE

cc PS/Chief Secretary
PS/Financial Secretary
Mr Cropper
Mr Call

**WITHHOLDING TAX ON INVESTMENT INCOME**

The Chancellor has seen your minute of 16 December.

2. His decision stands: withholding tax is off the menu for 1988, and will not, therefore, be considered afresh at Chevening.

J M G TAYLOR

psl/50A

**TASK FORCE SECRET**

COPY NO. 1 OF 14.

FROM: A C S ALLAN
DATE: 17 December 1987

MR McINTYRE

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Miss Peirson
Miss Sinclair
Mr Cropper
PS/IR
Mr Isaac - IR
Mr Mace - IR

**BILATERAL WITH MR MOORE**

The Chancellor reported to me the following points from his bilateral with Mr Moore.

**APA**

2. Mr Moore was cautious about making any commitments on this until he had seen the report by officials. He understood that there were considerable problems with scrapping the APA and increasing one parent benefits, and wanted to consider whether there were any other alternatives.

**NICs**

3. The Chancellor explained that he definitely wanted to make changes at the bottom end, and he thought there should be very discreet consultations between Treasury, Revenue and DHSS officials on these. Mr Moore said he wanted to consider further which officials in DHSS should be involved. The Chancellor said he was also thinking about the abolition of the UEL, but until he confirmed that this was a definite plan, he would not wish DHSS officials to be consulted.

4. Mr Moore said he had no problems with the lower-end package, but was not at all keen on abolishing the UEL. He thought this

would cause considerable problems for the contributory principle, which he had ideas for beefing up in other ways, by bringing extra benefits in etc. If the Chancellor did decide to go ahead, he would be grateful for a paper by Treasury officials for his personal use making the case for the change, and answering the points which would inevitably be made by DHSS officials.

5. He accepted the need for a fast-track bill and was content for the Treasury supplement to be abolished.

**Child benefit**

6. Mr Moore felt very strongly that tax options should be covered in the review. The Chancellor eventually agreed that the review could cover the taxation of child benefit, but not the re-introduction of child tax allowances.

7. The Chancellor made one point to Mr Mooore on which he would be grateful for help on the figuring from the Inland Revenue. Some of those who favour child tax allowances argue that ever since the time of Pitt there has been help via the tax system for children. But until very recently the vast majority of people did not pay income tax and so did not benefit in any way from child tax allowances. Could the Revenue provide figures on the lines that up till, say, 1940, X per cent of people did not pay income tax.

**NHS internal market**

8. The Chancellor and Mr Moore agreed to return to this topic in January.

ACSA

A C S ALLAN

psl/56A

**TASK FORCE SECRET**

COPY NO. 8 of 8 .

FROM: A C S ALLAN

DATE: 21 December 1987

MR McINTYRE

cc PS/Chief Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr MacPherson

**NICs AT THE LOWER END**

The Chancellor had another brief word with Mr Fowler. Mr Fowler suggested that if the Chancellor was seriously contemplating abolishing the UEL, he should consider abolishing the LEL as well. That would make for further simplification. And no one with earnings above the LEL would be affected.

2. The Chancellor expressed some doubts about this proposal, pointing out that it would mean that very poor people paid more. But he would be grateful for a note on this, by Thursday, 7 January, please.

A C S ALLAN

TASK FORCE SECRET

COPY 15 OF 15

FROM: J M G TAYLOR

DATE: 24 December 1987

MR ISAAC - IR

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Miss Peirson
Miss Sinclair
Mr Riley
Mr Cropper
Mr Tyrie

Mr Battishill - IR
PS/IR

**BILATERAL WITH MR MOORE, TASK FORCE/DHSS INTERFACE: CHILD TAX ALLOWANCES**

The Chancellor has seen your minute of 18 December.

2. He has commented that it is of course essential that over-riding priority is given to Budget and Finance bill work, and that any work on the taxation of child benefits must not be allowed to interfere with this. However, when the time comes to do this work in the context of child benefit, it should not take too long, given the work that has already been done in the recent past on the taxation of child benefit.

3. He is grateful for the interesting historical information, and for the Written Answer.

J M G TAYLOR

TASK FORCE SECRET COPY 5 OF 5.

FROM: J M C TAYLOR
DATE: 24 December 1987

MR SCHOLAR

cc Mr Culpin
Mr Mace - IR

**LOSERS**

The Chancellor was most grateful for your minute of 18 December.

2. He has commented that your proposal is most ingenious, and certainly needs to be included in the discussion at Chevening. But he would not want further work on this option to get in the way of other Task Force work.

J M G TAYLOR

mjd 2/52Jn

TASK FORCE SECRET

COPY 3 OF 3

FROM: J M G TAYLOR

DATE: 24 December 1987

MR SCHOLAR

**COMMUNITY CHARGE**

The Chancellor has seen and was grateful for your minute of 18 December.

2. He has commented that the answer to the points in your paragraph 3 is that the 'surtax rate', would have to be set nationally (with the same RPI safeguard) like the NNDR. It would also clearly have to come in gently above the threshold, to avoid a steep discontinuity and incentive to stay below the threshold. He accepts that there will be the 'distortions' you referred to in paragraph 5; but these are in the system now, and do not lead to all that much difficulty. Finally, the 'old lady on her own in a big house' (your paragraph 5) would almost certainly pay less in CC and 'surtax rate' than she does now.

J M G TAYLOR

TASK FORCE SECRET

COPY 23 OF 23

FROM: J M G TAYLOR

DATE: 24 December

MR RILEY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Scholar
Mr Culpin
Miss Sinclair
Ms Munro

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
Mr Johns - IR
Mr O'Connor - IR
Mr Weeden - IR
Mr I Stewart - IR
PS/IR

**MORTGAGE INTEREST RELIEF AND HOUSE PRICES**

The Chancellor was most grateful for your minute of 17 December.

JT

J M G TAYLOR

mjd 2/50Jn

TASK FORCE SECRET

COPY 4 OF 4

FROM: J M G TAYLOR

DATE: 24 December 1987

MR TYRIE

cc PS/Financial Secretary

**A FRINGE BENEFITS TAX**

The Chancellor has seen and noted your minute of 11 December.

J M G TAYLOR