

PO/CH/NL/744
Part. A

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Part. A

FRINGE BENEFITS TAX
(FBT)



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

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr Odling-Smee
Mr Scholar
Mr Sedgwick
Mr Riley

PRIME MINISTER

1987 BUDGET: MTFS

In my minute of 5 March, I set out my tax proposals and said I would let you have a further note on the PSBR and monetary targets for 1987-88.

Public Sector Borrowing

The latest estimates of the February PSBR show that cumulative borrowing in the first eleven months of the year was only £0.1 billion. Borrowing in March is always large, and there will be some special factors pushing it up further this year; these include the £680 million payment to Rover. The forecast I propose to publish for the out-turn for 1986-87 is £4 billion, though considerable uncertainties remain, particularly over likely borrowing by local authorities and public corporations.

That means the PSBR has now reached what I judge to be the appropriate level for the medium term: 1 per cent of GDP. I therefore propose to set the PSBR for 1987-88 at that level. Thanks to the strength of tax revenues, I can do that at the same time as implementing the £2.6 billion tax package we have agreed. Indeed, the resulting published PSBR of £3.9 billion will be underpinned by deliberately cautious estimates of revenue, including an assumption of a \$15 oil price.

For the remaining years of the MTFS period, I plan to show the PSBR remaining at 1 per cent of GDP. It is a major achievement to have reached this level well before we had earlier thought possible - a level recorded on only two previous occasions since the War.

CH → PM
27/3/87



Monetary Targets

As I mentioned when we spoke yesterday, for 1987-88 I intend to set a target for M0 but not for £M3. As you know, we have had increasing difficulties in interpreting changes in broad money; £M3 has for several years been erratic and shown a tendency to grow more rapidly than money GDP. This year, it has once again grown well above its target range. I do not think that dropping the £M3 target will cause any surprise at all: indeed, the markets would be surprised if it were not dropped. And as the Governor's Loughborough Lecture indicated, there is no point in switching to any other broad money target: all broad aggregates are in much the same boat.

The velocity of M0 has been much more stable, and M0 has remained within its target range of 2 to 6 per cent during 1986-87. For 1987-88, the illustrative range we set in last year's FSBR was also 2 to 6 per cent, and I see no reason to change that now. For the future years of the MTFIS I shall also be publishing the same illustrative ranges as in last year's FSBR.

The dropping of a broad money target does not mean that the whole weight of monetary policy is thrown on to M0, though that has a very important role to play. I shall continue to assess monetary conditions in the light of all the available indicators, including in particular the exchange rate. And I will make it clear that, although I am not setting a formal target for £M3, I shall continue to take broad money into account in assessing monetary conditions.

This approach has been fully discussed with the Bank who support these recommendations.

These proposals will give us a solid financial framework for the medium term. I would be glad to know if you are content with them.

N.L.

12/3/87

A handwritten signature in dark ink, appearing to be 'N.L.', located at the bottom right of the page.



App. pl m.

FROM: FINANCIAL SECRETARY
DATE: 22 December 1987

CHANCELLOR

Thanks. This seems to be very much done with a view to the cash (mostly @ X) but I don't know how happy to do X, but unless the FST has shown a mtg with public will be the next step.

- cc Chief Secretary
- Paymaster General
- Economic Secretary
- Sir P Middleton
- Mr Scholar
- Miss Sinclair
- Mr Michie
- Mr Cropper
- Mr Tyrie
- Mr Isaac
- Mr Lewis
- Mr Prescott
- Miss Rhodes
- PS/IR

FST
To
CH.
22 DEC

FRINGE BENEFITS TAX: COVERAGE

I have been looking at the detailed issues on coverage which are discussed in Mr Prescott's minute of 15 December and Miss Sinclair's of 18 December. I have to say that these are not minor matters and will be acutely sensitive. The arguments for exclusion or inclusion of each benefit are finely balanced and I do not think that there are any conclusive answers. Politics must weigh heavily.

2. I believe that there are two particularly awkward areas:

- (i) Canteens, Luncheon Vouchers (LVs) and Directors' Lunches;
- (ii) Existing ESC Exemptions.

On both of these areas there is a choice between taking the radical and controversial route and removing the exemptions or simply carrying over the existing exemptions into the new world without any attempt to justify them. The argument for taking the

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non-radical route is that the aim for 1988 would be to get the FBT on the statute book. In later years one could look at the various exemptions and decide which ones were admissable. I think that even the non-radical route would be controversial and it would, as the Revenue have pointed out, mean that we could not argue in 1988 that the FBT made it possible to tax benefits which could not be taxed without disproportionate hassle in the individual's hands.

3. My presumption has been, in looking at these issues, that you will tend to favour the more radical approach.

Canteens, LVs and Directors' Lunches

4. These three exemptions hang together, and if one is removed I think they all must be. In particular, at present directors' lunches are only exempt from tax if lunches are provided for the staff generally on or off the premises or if the rest of the staff are given LVs up to the value of 15p per day and no more. (The Revenue think that in practice in some cases the exemption has also been given even where LVs were for more than 15p per day).

5. It is clear that the main LV exemption is a real anomaly and there are I think strong arguments for removing it in a tax reforming Budget. Logically, an alternative might be to raise the LV exempt limit to a level reasonable in relation to the subsidy for canteen meals for directors and others on the premises - but that would be expensive. Nor I think could we defend giving exemption for an unlimited subsidy in directors' lunches but taxing lunches for the rest of the workforce, where the value exceeds 15p.

6. We will, if we bring "meals" into tax, face the criticism that we are discouraging a widespread and "much-loved" benefit. Our main defence will have to be that employees will not have to pay the tax and will not suffer. I cannot pretend that the taxing of LVs and canteens will be easy and we will doubtless

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get threats of canteen closures. But if we highlight the case of directors' lunches, argue the need for consistency, point to the difficulties with the alternative options, and stick to the line that employees will not, in general, suffer, I think that we probably can get this through Committee.

Existing ESCs

7. The second cluster of particularly awkward issues is described in Mr Prescott's paragraph 12. These are the various minor but very tricky exemptions covered at present by ESCs. These are not "real world" issues for significant numbers of people; they are very much at the margin of the tax system. Nevertheless bringing these benefits into the FBT would cause a wholly disproportionate amount of fuss.

8. Again, the logical choice would seem to lie between taxing all these benefits (which would mean that the Finance Bill would not need to mention them specifically although we would need to announce our intention to remove the ESCs when the Bill was published) or retaining all the existing exemptions - either as revised ESCs or as statutory exemptions (which would require specific legislation and would be the most defensible approach given that ESCs ought in principle to be put on a statutory footing when the opportunity arises).

9. Whether we continue to exempt or not I have no doubt that we cannot avoid a debate on these matters in Committee. We would be attacked if we removed all the exemptions, but if we kept them all we would have to defend a very ragged line. On close examination of this miscellaneous batch of exemptions it is obvious that there is no rhyme or reason behind the existing situation.

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X 10. I believe that if we sought to leave the exemptions as they are we would quickly run into trouble with our own backbenchers on miners' coal. In some cases this is now a pure cash benefit and I think there will be great pressure to bring it into the FBT. I would therefore suggest that we pre-empt this pressure and remove this particular exemption.

11. For the sake of consistency I would argue that we should also bring in clergymen's and agricultural labourers' concessions (For clergymen, payments made towards their heating and lighting costs are exempt from tax, whilst for agricultural labourers the exemption covers board and lodging where tied accommodation is not available). In each case of course, we would need to emphasise that the individuals concerned would not pay the tax and should not lose from the change. I do not think that any of the other exemptions could be removed. The exemption for late night taxis, for instance, has just been introduced. Similarly, the ESCs on training were published only recently. The removals concession we intend to review after the Budget. For the moment, I think that has to stay, though we might, at least, have to say that this is being reviewed.

12. I am conscious that I am now picking and choosing between these exemptions. Logic suggests that the two most defensible lines would be to tax all these benefits or none. But to tax all these would not be politically possible in my view, and to tax none I think would be almost as difficult. We are left with my suggested compromise though obviously different people might have different views.

Other Issues: Coverage

13. That leaves a group of marginally less tricky issues for decision:

- (i) **Round Sum Allowances and Loans Written Off:** I agree with officials that these should continue to be liable to PAYE and NIC and not brought within the FBT;

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- (ii) **Shares Acquired at Undervalue or Disposed of at Overvalue:** I agree with officials that these should be included in the FBT;
- (iii) **Third Party Entertainment and Gifts up to £100:** as you will recall we announced this exemption only a few months ago and, although I have reconsidered it in the context of the new tax, I believe it still should stand. There would be much controversy if it were now removed and it would be seen as a significant extension of the tax system into businesses. It would be easier (though still not easy) to tax under the FBT, but is it really a benefit in kind when a third party provides entertainment for an employee? I would have thought that the entertainment will in general be provided to build up business contacts not as an alternative (tax-driven) form of remuneration;
- (iv) **Entertainment and Gifts provided by the Employer:** I agree that this should be disallowable and subject to FBT;
- (v) **Sports facilities:** my own preference would be to continue to exempt the provision of sports facilities on own premises. There would be a major row if we sought to tax this but I really do not see how we could do otherwise if we are going to tax canteens (and workplace nurseries). I therefore think this has to be brought into tax;
- (vi) **Car Parking:** I think we should exempt parking on own premises. It is simply not worth the political hassle to tax all free car parking. I think we would just look very silly if we tried.

Other Issues: Valuation

14. On the various valuation issues discussed in Mr Prescott's minute I would make the following recommendations:

- (i) **Car Scales/Thresholds:** I think that our ultimate objective should be to go for the 100% charge, to retain the half rate rule for high business mileage, and to drop the 1½ rate rule when we get the scale charges up to the right proportion of the standing charges. For the next few years, however, we will be continuing with our usual 10% p.a. increases in the scale charges and so I think both the ½ rate and the 1½ rate rules will have to stay. I am content to drop the separate scale charges for rotary engine and electric powered cars etc;
- (ii) **Car Fuel Scale:** I think we should relax the present "all or nothing rule";
- (iii) **Cheap Loans:** I agree that we should drop the de minimis limit of £200. I also think we should bring into tax cheap loans attracting interest relief. There may be criticism, but this can be presented as a simplification, as the provision of an incentive to cash out the benefit and as a response to the impact of cheap loans in the South East particularly on house prices.

CONCLUSION

15. After two fairly exhaustive meetings with officials I recognise that my conclusions are not immune from attack. All this is very awkward and illustrates both the inherent difficulties of the tax and the sorts of criticisms we will get. I would welcome the opportunity to have a word with you about it.

NL.

NORMAN LAMONT



Ch

You also wanted to
discuss London
Vouchers whether or
not we introduce FBT

AA

PBM/BR



Ch.

FBT

Mr Lewis's minute (immediately behind) covered the Renenne's 3 most recent pps. I have split these up on the folder.

2. The folder has 2 main sections

(i) Cars

Key pps - Mr Lewis's note of 28/1
- Mr Monck's note of 28/1

(ii) FBT coverage

Key pps - FST's 2 notes; PMG's note;
- Mr Prescott's notes of 28/1
and his earlier note of 15/12

3. I suggest you take the car question first. If it runs, there will be no need to consider the rest (the "accommodation" ppr. has some points relevant to non-FBT, but these can be left to next year if you wish).

1 Jonathan
 2. BF in Benefits & Kind meeting.
 28/1
 Always says -
 how - how - how -
 why - how - why -



Ch/ You might like to see this. Mr Moore reminded the FST about it the other day and FST's office are trying to establish if the original copy ever arrived, and if DTSS and IR ever got in touch.*

Also behind:

- note of Mr Moore's meeting with Royal College presidents
- letter from Earl of Carrick to Mr Moore

mpw 18/1

* advice now behind

Ch

Do you want to ask Revenue
for a list of awkward cases on
non-car benefits they are likely to bring
to Ministers over the next 12
months, now there will be no FBT?
(+ LVs).

AA

Chanelle



Inland Revenue

Policy Division
Somerset House

PM

We must now press ahead with the drafting of FBT as quickly as possible. In that context it would be helpful to have decisions on

FROM: M PRESCOTT
DATE: 15 DECEMBER 1987

- 1. MR LEWIS *He points Mr Prescott wishes as soon as possible,*
- 2. FINANCIAL SECRETARY *(we shall, inevitably, need to come back to you on other points which arise during the course of drafting; and we shall, of course, look out for any further simplifications which may be possible.)*

FRINGE BENEFITS TAX: COVERAGE

1. It was decided provisionally at the Chancellor's meeting on 10 December to proceed with FBT, and that we should go for a comprehensive scheme covering virtually all benefits and expenses payments. A number of more detailed points now need to be decided, concerning certain benefits to be excluded from FBT and/or exempted from tax altogether, and possible simplification of some of the valuation rules.

2. We set out below what might serve as an annotated agenda for a meeting to go over these points. Much of the ground has been covered already in earlier papers, particularly Miss Rhodes' note on Exemptions and mine on Coverage, both dated 4 December - and the references below are to the relevant sections of those papers.

PRESCOTT
TO
FST
15 DEC

- cc PS/Chancellor
- PS/Chief Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Mr Scholar
- Mr Culpin
- Ms Sinclair
- Mr Michie
- Mr Cropper
- Mr Tyrie
- Mr Jenkins (OPC)

- Mr Isaac
- Mr Beighton
- Mr Lewis
- Mr Prescott
- Miss Rhodes
- Mr Easton
- Mr Northend
- Mr Hodgson
- Mr I Stewart
- Mr Geraghty
- PS/IR

TAXABLE BENEFITS EXCLUDED FROM FBT

3. Is it agreed, as we recommend, that round sum expense allowances and the benefit of loans released or written off should be excluded from FBT and continue as at present to be liable to PAYE and NIC? (See paragraphs 6-8 of Note On Coverage). These two benefits are virtually indistinguishable from cash remuneration and, because they are already liable to PAYE and NIC, there seems no reason to alter things.

Benefit of shares acquired at undervalue/disposed of at overvalue

4. We suggested previously - paragraph 31 of Note on Coverage - that these two benefits might continue to be taxed outside FBT, in the hands of the employee, because of the difficulty in some cases for employers in having to determine the value of the shares in question. On reflection, however, we are not sure that the difficulties for employers would be any greater here than they would be in the case of eg certain expenses payments where the employer will in future be responsible for interpreting the Schedule E expenses deduction rules in determining whether and to what extent the employee would otherwise have been entitled to an offsetting expenses deduction for the expenditure in question. And in some cases - ie where the shares are quoted - valuation should normally be very straightforward anyway. (There would still be some difficulty for employers, eg where the shares were unquoted, and there might then be pressure for some sort of clearance facility concerning valuations).

5. For these reasons, therefore, and in the interest of "tidiness", we now think that these benefit should be included in FBT along with the rest. Do you agree?

EXEMPTIONS/EXTENSION OF THE CHARGE

6. The main question here concerns the various benefits that are - or are to be - exempted from tax altogether, whether or

not under FBT. Linked to this, however, and arising from the Chancellor's meeting, the question also arises whether certain benefits which at present are not taxed should be in future by including them in FBT.

7. With an FBT that applied to all benefits there would in principle be no real need for a long list of exemptions. Nor would benefits be excluded simply because they were already being successfully taxed under the existing system. At present, however, a number of benefits effectively escape tax because it is virtually impossible to quantify them on an individual basis. These include

- canteens (for which there is a statutory exemption)
- business entertainment and gifts provided by third parties
- sports facilities
- car parking

8. Though some valuation difficulties would remain (see paragraph 7 below), quantifying the above benefits on an aggregate basis should normally be much less difficult and on the face of it, therefore, all of these exemptions could be dropped with an FBT. In considering whether or not these exemptions should be retained or removed, the following points arise;

- there is an awkwardness concerning third party entertainment and gifts up to £100, the exemption for which was announced as recently as 25 September. The question is whether this exemption should now carry over to FBT or whether, precisely because we are now talking about an employer rather than employee-based tax, the exemption should - at least for the future - now be dropped.

- as regards entertainment and gifts provided by the employer himself these would continue to be disallowable for CT as at present. In addition, the employer would pay FBT on the cost of providing these benefits. Is that agreed?

9. Similarly, it is for consideration what should happen to the other three benefits listed in paragraph 7 - canteens, sport facilities, car parking. Should the present effective exemption continue or should these benefits be brought into FBT. Points arising include

- it will often be very difficult for employers to "cash out" on-site benefits such as canteen facilities, so FBT would represent an unavoidable extra cost for them. Similarly, while benefits such as sport facilities are strictly taxable already, but are not being taxed, FBT charged on them would again represent an extra cost for employers and one that might be difficult to avoid (eg short of selling off existing sport facilities etc). And while the quantification would be easier on an aggregate basis, it would still be less than straightforward, so adding to employers' complaints about compliance.
- is it agreed that if any exemptions are to be provided here, they should be confined to benefits provided on the employer's premises and available to the staff generally?
- would the taxable amounts be the whole of the cost to the employer, including imputed rent and/or an appropriate proportion of other relevant fixed costs, or would it be the variable costs only?

10. There is also a link across between canteens and the ESC on luncheon vouchers. As Miss Rhodes' note explains, the only tidy solution would be to tax both canteen subsidies and LVs.

11. Paragraphs 8-11 of Miss Rhodes' note dealt with various other exemptions - those given by extra-statutory concession. (Suggestion schemes and long service awards were inadvertently omitted from the list in paragraph 8). Again the question is what is to happen to these exemptions; which if any are to be retained and which if any of the benefits are to be brought into FBT?

12. Here, too, it should in principle be much easier to tax all of these benefits under an employer-based system, because the need to quantify them on an individual basis is removed, and on that basis there would be no obvious reason for retaining the present exemptions under an FBT. On the other hand, removing these exemptions would obviously be difficult and would no doubt be criticised

- if the concession for late night taxis was removed there would be the same awkwardness as for the exemption for third party entertainment; this concession too was only recently announced on 25 September.
- training and home to work travel for severely disabled employees could be seen as an incentive to do something the Government wishes to encourage (train staff, employ disabled people) and there might well be pressures to retain them for that reason. The training concessions, in particular, are complementary to the new training relief introduced last year. (We assume that the statutory exemptions for training would be carried over into FBT - is this agreed?)
- travel costs where public transport is disrupted caters for unusual situations where an employer incurs additional costs to get his staff to work. Taxing these might be criticised as being unnecessarily churlish.

- removing the clergymen's and agricultural labourers' concessions would no doubt result in hardship pleas from the Churches and farming community respectively. Also, the clergymen's concession is simply a minor extension of an existing statutory exemption which we assume Ministers will want to carry over to FBT
- the removals and additional housing costs allowances (which you had asked us to review after the Budget) involve large amounts.

13. Insofar as any of these concessions remain they should, wherever possible, be brought into legislation as part of FBT. In some cases (eg training) quite extensive legislation would be required which may not be practicable within the short timescale. But, subject to that, do you agree that we should aim to put surviving ESCs on to a statutory footing?

14. The remaining concession in this area is miners' free coal. On the face of it, introduction of FBT would be a good opportunity to withdraw this concession which is difficult to justify, bearing in mind also that miners now get cash and not coal anyway, and that the concession is often criticised by other taxpayers. But there is a problem. Because this is now a cash benefit the question arises whether, if it was to be taxed, it should like eg round sum allowances be made taxable on the employee (ie liable to PAYE and NIC) rather than being brought into FBT. But that would obviously recreate the very difficulty FBT is designed to remove.

VALUATION RULES

15. In the main paper on coverage we examined (in the Annex) for each category of benefit and expenses payments precisely what additional tasks would be placed on the employer under an FBT in order for him to be able to operate a current valuation rule relevant to that benefit etc and thereby to assess the net taxable amount of the benefit or expenses payments. The paper

also showed what changes to the present valuation rule would be needed to avoid that extra task.

16. The paper concluded that, looked at objectively, the extra task involved here might reasonably be regarded as not imposing a significantly additional or intolerable burden on employers. However, employers themselves would be likely to see things very differently and the question is, therefore, whether the present valuation rule for certain of the main benefits might be simplified so as to help employers in this regard. The difficulty, of course, is that simplification may involve a degree of rough justice which actually works to the employer's disadvantage - ie by increasing the amount on which FBT is payable.

17. The benefits concerned here are cars and car fuel, cheap loans and provided accommodation and we consider these separately below.

Car benefits

18. Paragraphs 11-16 of the Note on Coverage refers. Also relevant are Miss Rhodes' paper of 22 October on car benefits and your note of 30 October to the Chancellor with your provisional conclusions.

19. The car benefit scale charges vary depending on the size or value of the car, and its age. No change is proposed here - the employer already has to collect and record this information and so a switch to FBT would not involve any additional task for him. In addition, however, the charge is halved where business mileage is more than 18,000 miles, and increased by half if business mileage is less than 2,500 miles or if the car is a second (or subsequent) car made available concurrently. These rules would give employers an extra task (albeit quite a small one) in collecting information from employees about business mileage/second cars, and the question is whether these rules should be retained or dropped.

20. About 15% of directors and higher paid employees with a company car get the half-rate scale charge because they do high business mileage; at the other end, about 5% have a second car or do less than 2,500 business miles and so are liable to one and a half times the scale charge. As regards the half-rate scale charge for high business mileage you have already in the earlier papers noted a trade-off here between retention of this rule and a decision whether to base the measure of the car benefit on 50% or 100% of standing charges. While - all else being equal - you saw a case for a 100% charge, you were reluctant to consider this without some let-out for heavy business users.

21. Points for consideration;

- (a) is it agreed that we should either retain both the $\frac{1}{2}$ rate and $1\frac{1}{2}$ rate rules or drop both rather than seeking to retain one but not the other? It would be perverse to drop the $1\frac{1}{2}$ rate rule while retaining the $\frac{1}{2}$ rate rule, especially for so long as the scale charges remain so low. Conversely, employers would no doubt regard it as inequitable to them if the half rate rule was dropped while the $1\frac{1}{2}$ rate rule was retained.
- (b) in the long term, would it be better to go for 100% of standing charges and retain the half rate rule for high business mileage, or for 50% standing charges and drop the present rules. [This is largely a matter of judgment. An important consideration here, however, would be to avoid unnecessarily opening up a second front of controversy with employers, bearing in mind that the introduction of FBT itself would be likely to be controversial. For those employers of the 85% of employees who do not do high business mileage, the balance of advantage - in terms of impact on their FBT bill - would lie in the lower proportion of standing charges and the dropping of

the half rate rule. For those employers whose employees do a lot of business mileage, the reverse would be true - and in the past, this group certainly have been very vocal in making their demands known.]

22. One other possibility worth considering would be to drop the separate scale charge for cars that do not have a regular cc engine (eg rotary engine and electric powered cars), as suggested in paragraph 33 of Miss Rhodes's earlier paper on car benefits. There are virtually no such company cars in existence and abolition would not in practice, therefore, lead to any real administrative saving. But it would give employers one less thing to worry about and so at least presentationally would make the car (and car fuel) scales look that bit simpler.

Car fuel scale (paragraphs 17-18 Note on Coverage)

23. Is it agreed that we should take this opportunity to relax the present "all or nothing" rule under which there is no scale charge only if the employee makes good the cost of all fuel used privately, in favour of a rule under which the scale charge would be reduced to the extent that he made good the cost? (This would be in line with the car scale arrangements and might be simpler for employers - but would mean that for someone getting £1,000 of fuel and paying the scale charge of say £500 there would be no FBT charge in respect of the £500 net benefit).

Cheap loans (paragraphs 19-21 of Note on Coverage)

24. At present there is no charge if the benefit of the loan (the difference between the "official rate" and the actual rate of interest) is £200 or less; if it exceeds £200 the whole of the benefit is charged. This limit could perhaps now be dropped, the main arguments being

- (a) this is the only benefit for which there is a statutory de minimis limit, and so it is a bit of an oddity anyway. In principle all benefits should be taxed; its existence has encouraged the widespread use of, for example, season ticket loans in recent years
- (b) it could be presented as a simplification in that employers would not have to work out for each employee whether the benefit was below the limit; though on the other hand this would mean higher FBT for many employers than otherwise
- (c) one of the benefits claimed for an FBT is that it would make it more cost effective to tax small benefits, because this can be done on an aggregate basis; it might seem inconsistent with this to retain this kind of de minimis limit.

25. There is at present a further exemption to the extent that the loan is such that the interest on it is (or would be) wholly eligible for eg mortgage interest relief. You queried this and the possibility of making the benefit of cheap loans subject to tax irrespective of purpose, but were I think persuaded that under the present system such a move would be contentious and wrong in principle. With FBT these considerations still apply - though the use to which the employee puts the loan is getting a little remote. The main new points are that continuing the exemption would allow the full employers' and employees' NIC advantage to apply to cheap/interest free loans. Removal of this exemption would also help simplify the rules for employers.

Provided accommodation

26. As noted in the paper on coverage (paragraphs 23-24) we shall with the phasing out of domestic rates need a new

valuation rule for this benefit anyway, and we are working on this. We shall, of course, keep an eye on the need to keep things as simple as possible for employers. We shall submit a separate note on this shortly.

Other benefits, and expenses payments

27. No other changes to existing valuation rules for the remaining benefits, or to the basis on which any profit element in expenses payments is determined, are proposed at this stage. As indicated in the note on Coverage, however, the aim would be to assist employers in a number of ways, in particular by

- (a) incorporation into FBT of the present "dispensations" facility so that any expenses payments covered by a dispensation would not be taxable under FBT
- (b) publication of technical rulings and guidance on problem areas, to help employers determine whether or not an expenses deduction in respect of the benefit or expenses payments in question would otherwise have been allowable to the employee
- (c) the specification of prescribed amounts for eg motor mileage allowance that would be regarded as allowable and, therefore, not taxable.

M Prescott

M PRESCOTT

CONFIDENTIAL

BF to JT in 4/1
(for ministerial act when have seen Ch. Comptrols in FST ppt)

FROM: MISS C E C SINCLAIR

DATE: 18 December 1987

FINANCIAL SECRETARY

- cc PPS
- PS/CST
- PS/PMG
- PS/EST
- Mr Scholar
- Mr Calpin
- Mr Michie
- Mr Cropper
- Mr Tyrie
- Mr J Isaac IR
- Mr P Lewis IR
- Mr M Prescott IR
- PS/IR

I do not agree with the proposed amendments on page 2. If we are to have an FST, an important argument for it is not to include us. This would mean benefits would be effective as enjoyed by those below the P11D limit, but on the basis that a ~~benefit~~ benefit should also apply to benefits which it is not practicable to tax.

FRINGE BENEFITS TAX: COVERAGE

Mr Prescott's submission of 15 December provides an annotated agenda on the coverage of the proposed fringe benefits tax: and on the valuation rules. This note suggests some broad principles on which the approach to coverage and valuation might be based.

Coverage

2. One approach would be based on making it as easy as possible to get this tax accepted. That would point to maintaining all, or nearly all, of the present exemptions. The argument would be that we are simply switching to a more effective way of taxing those benefits we tax now: we were not seeking to tax things we do not tax now.

3. At present there are three broad reasons for exempting benefits in kind from tax:

- (i) The tax is too difficult to value and collect on an individual basis (third party entertainment, canteens).

as it would be done when follows that, because a tax should accept the FST.

SINCLAIR
TO
FST
18 DEC

CONFIDENTIAL

(ii) On an individual basis, it looks piffling (late night taxis, car parking).

(iii) The benefit is regarded as desirable (training, home to work travel for severely disabled employees).

4. (iii) would continue to be a valid reason for exemptions under an FBT, but (i) and (ii) could lose much of their force under an FBT.

5. If the approach in paragraph 2 were adopted, however, we think you could argue that the cost to employers of late night taxis, canteens, car parking facilities etc should continue to be exempt because we were not seeking to change the base of the tax.

6. The most difficult exemptions to maintain on this basis would be those applying to special groups eg clergymen, agricultural labourers and miners. There are good arguments for taxing such benefits in the hands of employers under an FBT (the Chancellor favoured this in the case of miners' coal). But if your overriding objective is to get the tax accepted, these exemptions should be extended to employers. We would not favour trying to tax them on an individual basis even where the benefit has in practice been converted into cash and looks very similiar to a round sum expense allowance. That would be likely to create a major fuss.

7. Third party entertainment and gifts, however, are a special case. The recently announced exemption was designed to get away from the hassle of trying to tax these in the hands of the individual. There is no question of this under an FBT: individuals will not pay tax on such benefits. Mr Prescott asks in paragraph 8 of his note whether you would want to give the employers an exemption instead. Here we do think there is a case for an exception to the approach suggested above. Taxing the cost to employers of third party entertainment and gifts would not affect individuals and would thus not reverse the exemption for individuals announced on 25 September.

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8. The "minimal change" approach is one way of answering the questions about exemption raised in Mr Prescott's note. But I recognise that it is not fully in tune with the Chancellor's thinking at his last meeting, where he suggested that we switch to an FBT was an opportunity for limiting the present exemptions.

9. A much more radical approach would be to drop all, or most of the present exemptions. This could be justified on the basis that the old difficulties about valuation on an individual basis were much reduced under an FBT. There are strong arguments of principle for this approach, but it is likely to maximise the difficulty of getting the FBT accepted.

Valuation

10. Here we suggest that the general approach should balance simplicity for the employer against the risk that any change to the present valuation rules will stir up an unnecessary fuss.

11. On this basis there seems much to be said for maintaining the present rules about business mileage. As Mr Prescott points out in paragraph 19, it would not be particularly onerous for employers to collect information from employees about business mileage. They would surely know if they were providing a second car concurrently! Any change in the rules eg a 50 per cent standing charge with no distinction between high mileage and low mileage users would be likely to stir up trouble. You could consider falling back on this if the employers made a disproportionate fuss about the need to collect information about business mileage use from employees.

12. We agree that it looks sensible to drop the separate scale charge for rotary engine and electric powered cars.

13. It is not clear that relaxing the present "all or nothing" rule for fuel would make valuation easier for employers, as opposed to reducing their FBT bill. If it would not simplify matters

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for employers, it would seem better to leave the rule as it is.

14. On cheap loans, we agree that the £200 de minimis limit could be dropped under an FBT since it looks simpler for employers not to have to operate it. For the same reason, we would also argue for dropping the present exemption for cheap loans for house purchase below the MIR ceiling. But this second point could be contentious. If so, you could fall back on the general approach in paragraph 2, and allow the exemption to continue


CAROLYN SINCLAIR

FRINGE BENEFIT TAX: COVERAGE

1. At the Chancellor's meeting on 6 November, it was agreed to proceed on the basis that FBT would apply - without a threshold - for certain widespread benefits and any others which could be dealt with without difficulty in this category, and that various other benefits which could not be dealt with in this way, or exempted altogether, would continue to be taxed under the existing employee-based system. This note reviews the possible coverage of FBT in more detail.

2. We consider two possible approaches:

- Common to both approaches is that FBT would cover certain main (widespread) benefits, such as cars, fuel and private medical insurance which between them account for about 80% (by value) of all benefits and expenses payments, and for which Section 189 claims are either not admissible, or relatively rare; and would not cover round sum expense allowances, which would continue to be taxed under PAYE. The question at issue is the middle category (described in our earlier notes) of benefits and expenses payments, for which employees often, but by no means always, can make valid expenses claims.
- One approach (discussed in our earlier papers) would be for a narrowly based FBT covering only the few predominant benefits, and leaving aside the more arguable benefits and expenses. The rationale here would be to limit employers' new responsibilities under the FBT to those benefits which we can confidently say they could tax on a self-assessment basis, without taking on any significant new administrative burden. The disadvantage, of course, is that employers would have to operate two systems side by side.

FBT
COVERAGE
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The other approach would be to extend the FBT to virtually all benefits and expenses (other than round sum expense allowances). The disadvantage here is that this would involve the employer in collecting information from employees, of a kind that he does not now collect, and taking responsibility for some quite complex marginal decisions - of a kind which in the past employers have strongly resisted. The Revenue could help by issuing further information and guidance, but there is a risk that employers would see this as contrary to the deregulation thrust and perhaps unworkable. As against that, there would be the big prize of a universal benefits system with no residual system remaining for Pl1Ds.

PRESENT POSITION

3. On a preliminary point, it is important to note that the taxability or otherwise of benefits under present legislation does not hinge solely on whether the individual concerned is or is not a director or a "higher paid" employee with earnings above the "Pl1D" threshold. Rather, the position is as follows

- (a) Certain benefits - see items 1-7 of the annex attached - are assessable on all employees and office holders, regardless of the level of earnings. They are taxable either under normal income tax rules (eg payments in kind generally; meeting an employee's pecuniary liability such as paying his gas bill, etc), or under special provisions (eg the FA 1975 vouchers legislation, and the special provisions in FA 1977 for valuing and taxing the benefit of living accommodation provided to an employee by his employer). A return of these benefits has to be made by the employer for all employees - for directors and "higher paid"

employees on the form P11D, and for other employees on the form P9D. Of course, virtually all fringe benefits are "payments in kind" and so technically would be taxable under normal rules of Schedule E. The problem, however, is that over the years the Courts have determined that the measure of the benefit for this purpose is generally its cash - ie second hand - value which will usually be much less than its true worth, or than the cost to the employer of providing it. Indeed, for some benefits - eg the company car - there would on this basis be no liability at all, because the asset continues to belong to the employer and so could not be turned into cash by the employee.

- (b) For most benefits, therefore, special valuation rules apply, but only where the benefit is received by a director or a higher paid employee. Broadly, the effect of these rules is to provide that the measure of the benefit is the cost to the employer of providing it (less any contribution from the employee or any expenses deduction to which he would otherwise be entitled), or - as in the case of company cars or cheap loans - to measure the benefit by reference to a predetermined scale or formula.
- (c) Expenses payments containing a "profit" element (ie where the payment is for more than the actual expense incurred, or is for expenditure that would not otherwise be eligible for an expenses deduction). All such expenses payments are taxable, whether or not the individual is a director or "higher paid" employee. But the routing is different. For directors and higher paid employees all expenses payments have to be returned on the P11D (ie even if there is no profit element) and the employee or director is then taxed on that amount less any allowable expenses deduction. For other

employees, the employer has to return expenses payments - on the form P9D - only if they contain a "profit" element (ie in these cases, the employer already has to determine for himself whether and to what extent the employee would be entitled to an offsetting expenses deduction, just as he would if expenses payments were included in FBT).

4. It will be seen from this that because some benefits (ie those at (a) above) and all expenses payments with a profit element are assessable on all employees and directors, it does not follow that everything which was not included in FBT could be treated as taxable only if the individual concerned was a director or a "higher paid" employee. That would be tantamount to creating a new exemption for those particular benefits and for expenses payments in cases where the individual concerned was not a director or a higher paid employee. There would be no obvious justification for this. The result would be even odder and more difficult to justify if the P11D threshold itself was also being increased.

5. It also follows from this that even if the P11D threshold was raised there would still be need for a return - on the form P9D - for those employees who had fallen out of the "P11D" population as a result of raising the threshold, but who nevertheless continued to receive expenses payments and any other benefits not covered by FBT. Though the number of employees involved here is probably quite small, it is important to note that for the employers concerned there would be no offsetting administrative savings from the switch to an FBT.

"CASH LIKE" BENEFITS

6. As noted, round sum allowances (ie sums paid to or put at an employee's disposal to cover expenses etc, but for which he does not have to account to his employer) would be excluded from FBT. These are really no different from an employee's

other normal remuneration, like wages and salary, and are treated accordingly with tax deducted at source under PAYE. They are also already liable to NIC.

7. There are certain other cash-like benefits whose allocation as between FBT and IT would need to take account of

- the level at which the rate for FBT was set. A general consideration when setting the rate will be to try - so far as is possible with a single rate - to ensure tax (including NIC) neutrality between payment in cash and in kind - if the rate was set too low that might (particularly for directors and higher paid employees) encourage a shift at the margin from cash to benefits. However, while for some benefits there might be a check on this - because even at the margin there will be a limit on the extent to which employees are prepared to forgo remuneration in cash for a less liquid form of remuneration in kind - this would not apply to certain benefits that are more cash-like in nature anyway;
- whether NIC at present applies to the benefit in question. If it does not, we would still get a higher overall charge than at present from including the benefit in FBT with a rate of 45% even though that rate may not achieve complete neutrality for top rate income tax payers.

8. The benefits concerned are

- Loans released or written off (see item 11 of annex attached). Arguably this is also more like "cash" remuneration anyway and so should continue to be chargeable to the employee - especially as it would also already be liable to NIC. What is clear, however, is that if the FBT rate was set at a level

significantly below the top rate of personal tax (allowing also for NIC) inclusion of this item in FBT would open up opportunities for abuse - in this case by the simple device of converting salary or a part of it to loans that were subsequently written off. (Strictly, this consideration would apply to round sum allowances as well).

- Payment of a director's tax deductible under PAYE without deducting it from his remuneration. This benefit would not be liable to NIC under existing rules. That would point to inclusion in FBT - though a possible alternative in this case might be to amend the rules to make the benefit NIC-able
- Profit element in expenses payments. Here too NIC does not normally apply, and that again would point to inclusion in FBT. There are, however, other considerations here which we return to in paragraphs 32 etc below.

ANALYSIS BY INDIVIDUAL BENEFIT OF EXTRA TASKS FOR EMPLOYER

9. Introduction of an FBT would almost certainly be controversial and arouse strong opposition from employers. It would obviously be all the more contentious if it resulted overall in significant additional administrative burdens for employers in actually operating the tax - or if, whatever the reality, it was perceived by employers to have that result. This would also conflict with the Government's wider objectives concerning deregulation and reducing burdens on business. Clearly, therefore, in choosing between the two approaches mentioned at paragraph 2 above it is necessary to look carefully at each category of benefit in order to determine precisely what additional tasks and administrative burdens would be placed on employers. We consider this below.

10. The annex shows for each category of benefit precisely what additional tasks, including extra record keeping and information gathering, would be placed on the employer under an FBT in order for him to be able to operate the valuation rule relevant to that benefit and thereby to assess the net taxable amount of the benefit. (Generally speaking, for all benefits and expenses payments the amount that is taxable will also be reduced to the extent that the employee contributes towards the cost, and the employer will need to take this into account as well. But that is something which employers need to do anyway under the existing employee-based system, and so this would not represent an extra burden for employers arising from a shift to an employer-based system.) The annex also shows - in the fourth column - what changes, eg to the valuation rules etc, would have to be made if the employer was to be relieved of that extra task.

Car benefits (item 8)

11. This is of course the most important benefit - of the estimated 1.8m directors and higher paid employees who will receive one or more benefits in 1987/88, 1.2m have a company car, and the tax on this benefit alone accounts for 46% of the total yield on benefits and expenses payments received by directors and higher paid employees. Moreover, unlike some other benefits (see paragraphs 25 to 29 below) the possible complication for the employer of an offsetting expenses deduction does not arise here because the car scale charge is measuring the taxable value of the private use element of the car for which, by definition, no expenses deduction would be allowable.

12. However, under the present car scales the charge is halved where business mileage is more than 18,000 miles, and increased by half if business mileage is less than 2,500 miles, or if the car is a second (or subsequent) car made available concurrently. Under an FBT, therefore, there would be an additional administrative task for employers in having

to collect information from the employee about business mileage, and about whether the car was a second one, because in neither case does the employer himself need this information at present.

13. On the face of it, the tasks involved here would not seem to be all that great and many employers would probably for their own purposes collect information about business mileage anyway. Indeed, in many cases employers already return this information on the P11D, even though this is not mandatory. On the other hand, it was precisely this kind of job which employers said would be an unacceptable additional burden for them under the 1981 proposals, which had to be withdrawn, for applying PAYE directly to car benefits.

14. The only way to relieve employers of this extra task would be to change the rules so that there was a single scale charge irrespective of the amount of business mileage or of whether there was a second car. (The charge also varies with age and size of car, but employers need to collect this information under the present system anyway, so FBT would not impose an extra burden in this respect).

15. As regards the half rate charge for high business mileage, the Financial Secretary has noted a trade-off here between retention of this rule, and a decision whether to base the measure of the car benefit on 50% or 100% of standing charges. This would point to dropping the half rate rule if we opted for 50% of standing charges. In that event, this particular additional task for employers would be removed. It has to be recognised, however, that employers may see things very differently - for some of them, ie those with employees who are required to do high business mileage (about 15% of directors and higher paid employees with company cars), withdrawal of this rule might save a little on compliance but it would also mean a higher FBT bill than if the rule was retained, and they may well regard this as the more important consideration.

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16. As regards the "one and a half" rule for second cars and those with very low business use there might be a case for dropping these, though in both cases this links to the wider question whether and to what extent these scale charges generally are to be pitched at a more realistic level. The point here is that if the scale charges were raised to more realistic levels, reflecting the true value of the benefit of a company car available for private use, there would no longer be any obvious justification for having a differential charge for second cars or for low business use (if anything, on the law of diminishing marginal returns, the value of a second car will usually be less than the value of the first). Clearly, however, it would be perverse to drop the "1½ rate" rule for low business mileage/second cars if the scale charges were not being increased to more realistic levels.

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Car fuel benefit (item 9)

17. The only extra task for employers resulting from an FBT would be the need to collect information about annual business mileage in order to determine whether the reduced (again, half rate) scale charge for high business mileage applied. Here, too, the extra task would not - looked at objectively - appear to be an onerous one especially as many employers may collect this information anyway, and for employers affected there would be direct reduction in the amount of FBT payable. Again, however, employers themselves may see things differently.

18. There is one other change to the car fuel scale possibly worth making. At present, there is no charge if the employee makes good the cost of all fuel used privately. But if he makes good part of the cost, the full scale charge still applies - ie it is not reduced proportionately. The reason for this "all or nothing" rule is to simplify administration for us - but it does, clearly, involve an element of rough justice (albeit that could be avoided by the employee in repaying the whole cost). This rule might be changed so as to

reduce the taxable amount of the benefit by whatever contribution is received from the employee. Again, for those employers affected the result would be a lower FBT bill than otherwise.

Cheap loans (item 10)

19. At present, the employer simply has to provide information about the amount of such loans outstanding, and the rate of interest charged; the Inspector then determines the taxable value of the benefit by reference to the "official rate" and to the purposes of the loan (ie whether it is such that the employee would otherwise have been entitled to interest relief on it). There is also a £200 de minimis limit. Under an FBT, the employer would have to perform this task, for which he would need information about the level of the "official rate" during the period in question, and about the purpose for which the loan was applied.

20. Though these would be additional tasks for the employer they do not - objectively speaking - look particularly difficult or onerous. In most cases it would simply be a question of following the prescribed rule for computing the benefit, and Tax Offices would be in a position to give employers the information they needed about the "official rate". That said, of course, employers may again see things differently and, as we know from eg MIR, there are bound to be some more difficult cases at the margin where the rules are less easy to operate.

21. The legislation at present provides two alternative methods for calculating the benefit - one based on a simple averaging method and another based on a more precise - but thereby more complicated - calculation. There is provision for either the employee or the Inspector to elect for the second method and we would see no reason not to allow employers under an FBT the same right to choose.

Provided accommodation (item 6)

22. As noted, this is one of the benefits that is taxable on all recipients, not just directors and "higher paid" employees. Broadly, the measure of the benefit is the gross rateable value (as a proxy for annual value) of the accommodation, or the rent actually paid by the employer, less any rent paid by the employee and any expenses deduction to which he would otherwise be entitled. But there are certain exemptions, and there is an additional charge (with a separate set of rules) for more expensive accommodation.

23. The operation of the main charge at present in practice relies on the existence and maintenance of domestic valuation lists. With the abolition of domestic rates, and the introduction of Community Charge, this will no longer apply and it has therefore become necessary anyway - ie with or without introduction of an FBT - to devise new rules for valuing this benefit. The aim will also be to simplify matters by amalgamating the additional charge for expensive accommodation with the main charge; the former charge was necessary only because the main charge was based on gross rateable values which, because they have not been reviewed since 1970, no longer provide a true measure of annual values.

24. Work is in hand on this, including a review of the present exemptions, and we shall report separately in due course. The aim will, however, be to devise a fairly simple and flexible rule, perhaps on the basis of a formula applying the "official rate" to capital values. Provided the rules can be kept fairly simple, we see no reason for not including provided accommodation in FBT; there would obviously be some additional administrative tasks for the employer, but there is no reason to believe that these would be excessive.

Benefits for which an expenses deduction may be due

25. For a number of categories of benefit one extra task for the employer would be that arising from the need to assess whether and to what extent, had the expenditure on the benefit been incurred by the employee, an expenses deduction under normal income tax rules would otherwise have been allowable. (See items 2, 4, 5, 6, 7, 18 and 19). Employers are not concerned with this at present - they simply return to the Revenue the amount of the benefit provided, and the Inspector then sorts out with the employee how much of the benefit is assessable having regard to any entitlement the employee may have to an offsetting expenses deduction. Under a wide ranging FBT, however, it would be for the employer to determine whether and to what extent an expenses deduction would otherwise have been allowable.

26. In practice, the number of benefits against which an expenses deduction might otherwise be allowable may not be large. Nevertheless, for some benefits the question of an offsetting expenses deduction would arise - eg living accommodation that is provided by the employer and that has to be used partly as the employee's office, or more generally where an employer's asset other than a car is placed at an employee's disposal and is used by the latter partly for business and partly for private purposes. In these cases, therefore, there would be an extra task for the employer - compared with what happens at present - in having to determine whether and to what extent such an expenses deduction was due.

27. One possibility to help reduce the extra burden for employers in these cases might be to introduce an "all or nothing" rule under which expenses claims would be ignored except where an amount equal to the whole of the value of the benefit in question would be allowable as an expenses deduction - ie where, in effect, there was no net benefit at all. With such a rule, the employer would at least be saved having to determine the taxable amount in cases where the

benefit related partly to a business and partly to a private use - unless the benefit related wholly for business purposes, the whole of it would be taxable.

28. However, while this approach might offer some administrative saving for employers it would be unlikely to be all that great - in practice it may be no more burdensome for the employer to collect the necessary information and assess the benefit in cases involving a partial business use than it would in those involving a wholly business use. More fundamentally, it is the employer who would pay the FBT and it would, therefore, be very much in his interests that all allowable expenses deductions should be able to be brought into account - including those in "partial" cases - because that would contribute directly to reducing the amount of tax he had to pay. In short, though there would be some extra administrative burden for employers in having to determine whether and to what extent there would otherwise have been an allowable deduction, they would be likely to want this because it would help directly to reduce the size of their FBT bill.

29. Clearly, however, it would be desirable to help employers by giving them as much guidance as possible on the circumstances in which a deduction may be allowable - especially as this is not something with which they have needed to concern themselves hitherto. The Australians and New Zealanders do this - partly because their income tax systems already rely to a greater extent than ours on self-assessment - and we could do the same. Specifically, there are already many technical rulings, eg in detailed instructions for Tax Offices on problem areas, that could probably be published in suitable form.

Other benefits

30. The analysis in the annex relating to the remaining benefits suggests that in most cases (see items 12, 16, and

Some work to be done

17) there would either be no extra burden on employers as a result of shifting to FBT, or that any such additional burden would not be great.

31. One possible exception is shares acquired at undervalue (item 13) and disposal of shares at overvalue (item 15) where, in both cases, the employer would need to know the market value of the shares in order to determine what was the taxable amount of the benefit. In the case of shares in a quoted company, this would be straightforward but for shares in an unquoted company (particularly in the case of a small minority holding) the problem of valuation could be much more difficult. And, in these cases it would be for the Revenue anyway to determine what was the market value. We think, therefore, that it probably would be better to leave these two items outside FBT. Another reason for this is that they are dealing with what are not strictly benefits in kind, but filling certain technical gaps not already covered by the main Schedule E provisions that would come into play for taxing the shares acquired or disposed of by employees in that capacity at under and over value respectively.

EXPENSES PAYMENTS

32. Unlike benefits, there would with expenses payments be many instances where, if FBT applied, the employer was required to determine whether and to what extent the employee would otherwise have been entitled to an offsetting expenses deduction. On the face of it, therefore, extending FBT to expenses payments would add significantly to the administrative burdens on employers.

33. Nevertheless, there are a number of ways in which the difficulties for employers might be reduced if FBT was extended to include expenses payments. These include

- incorporation into FBT of the present "dispensation" facility. Thus, all expenses payments covered by a dispensation would not be taxable under FBT
- publication of technical rulings and guidance on problem areas, to help employers determine in various circumstances (particularly concerning travel and accommodation) whether or not an expenses deduction would be allowable under normal income tax rules
- specification of prescribed statutory amounts for particular kinds of expenses payment which would be regarded as allowable, and therefore not taxable. Amounts in excess of the prescribed rate would be chargeable to FBT unless covered by an offsetting Section 189 deduction. One obvious example would be motor mileage allowances where only payments in excess of prescribed rates, eg broadly equivalent to those payable in the Civil Service, would be treated as taxable. Another is scale rate subsistence allowances, though the scales here would be more complicated depending on the extent to which they took account of factors such as regional differences in the cost of hotel accommodation, levels of employee seniority, etc.

✓ 34. It may still be felt, however, that expenses payments would be too troublesome for employers to handle in an FBT and so should be excluded. Another consideration is that expenses payments which include a profit element are in practice little different from round sum allowances, in that both are really more like cash remuneration such as wages and salaries than like benefits in kind, and that if round sum allowances are to continue to be chargeable to income tax expenses payments should be as well. The question then, however, is whether it would be possible to cut down in some other way on the number of forms P11D (or P9Ds if the P11D threshold was raised for

those benefits covered by the special rules that were not included in FBT) that would still be needed in respect of expenses payments.

35. Most expenses payments relate to travelling and subsistence and in many cases instead of reimbursing the actual expenditure incurred the employer pays a fixed scale rate - eg a motor mileage allowance of, say, 20p per mile for use of the employee's car, or a daily subsistence allowance of £x to cover hotels, meals, etc. One possible approach might be to introduce prescribed statutory rates in respect of these scale rate payments, which employers could pay free of tax, but with a requirement that any payments above these prescribed rates should then be taxed under PAYE (and possibly subject to NIC as well) in the same way as round sum allowances. However, while it might be possible to have a rigid rule of this kind for business mileage payments (and even here there would be difficulties), it would be much more difficult in the case of subsistence allowances where there are many more variables that can affect the appropriate level of reimbursement and there would undoubtedly be greater pressure to allow claims for actual expenditure if these exceeded the prescribed rate. But if such claims were still to be allowed we could then end up having to repay tax in cases where actuals exceeded the scale rate - this would obviously not be administratively efficient for us. A second, more modest possibility, therefore, would be to have the same prescribed amounts which could be paid tax-free, with a requirement on the employer to return only any amounts in excess of this on which - allowing for any expenses deduction - the employee would be charged to income tax as at present.

APPRAISAL

36. There would bound to be some additional burdens for employers in switching from an employee to an employer-based tax. This is the inevitable result of switching to a system

in which the employer is made responsible for assessing the net taxable amount, rather than simply having to return the gross amount provided and leaving it to someone else to assess the net benefit. The question is whether those extra burdens would in practice be significant or excessive, and to what extent they could be minimised.

37. The above analysis suggests that, with certain modifications, it would be possible to extend FBT to all benefits without imposing what might objectively be regarded as significant additional burdens on employers. (Of course, some benefits might be rather more troublesome than others - either because the valuation rule is more complicated, or because the employer would have to determine whether and to what extent an offsetting expenses deduction would otherwise have been allowable. But these are the differences of degree and the analysis reveals no obvious dividing line between "difficult" and "easy" benefits in this respect).

38. There would also, the wider the coverage, be bigger offsetting administrative savings for employers themselves. These would include

- the virtual end for employers concerned of the much disliked form P11D - up to 1.8 million
- simpler codes and fewer code changes for employers to handle in the 1.8 million or so cases involving benefits that are taxed through PAYE codings
- some administrative benefit from not having to disaggregate the figures to the individual taxpayer level in all cases.

39. On this basis, therefore, all the main benefits would be included, viz

Car and car fuel benefits.

Private medical insurance (in terms of the present legislation this is not separately identified, and is simply a particular example of the general class of residual benefit covered in Sections 61 and 63 FA 1976 - see item 19).

Cheap loans.

Scholarships.

Meeting of an employee's pecuniary liability (eg paying his private gas or electricity bill).

Benefit of any asset given free or at undervalue.

Private use of assets other than cars and living accommodation. remuneration.

40. On the other hand, because of the problems over valuation, benefits in respect of shares acquired at undervalue or disposed of at overvalue would probably be best left outside FBT. Similarly, the cash-like benefits such as round sum allowances and loans waived or written off would continue to be taxed under IT.

41. There is also the question of the individual valuation rules. As noted, there would have to be some simplification to the rules for provided accommodation, but changes here are needed anyway. It would also be for consideration whether to simplify certain of the car scale charge rules, and to modify the rules for the fuel benefits. The other benefit for which there is a special valuation rule is cheap loans and, while there would obviously be an extra task for the employer in having to compute the measure of this benefit, the rules themselves would in most cases be simple to operate and the computations relatively easy.

42. Expenses payments (ie other than scale rate payments) are obviously much more problematic. There is no doubt that the additional burdens for employers here would be greater, both in collecting information about expenses claims and, possibly more difficult, in determining whether and to what extent an expenses deduction would otherwise have been allowable.

However, these difficulties did not deter the Australians from extending their scheme to expenses payments. Moreover (as noted at paragraph 2(a) above) this is something which employers have to do already for expenses payments to "lower paid" employees. And, there would be a number of practical steps that could be taken to help employers, either by removing some expenses payments from FBT altogether (dispensations) or by publication of guidance, technical rulings, etc in areas of potential difficulties.

43. Against all of this, however, it cannot be emphasised too strongly that employers themselves would almost certainly see things very differently indeed. On the assumption that they would be hostile to the very idea of FBT, they could be expected also to play up the administrative burdens - real or imagined.

44. We have tried in the above analysis to make an objective assessment of whether the additional burdens on employers would be significant, but an indication of what they themselves would regard as significant can be gleaned from the 1981 experience. Those proposals were, in fact, extremely modest. The proposal was simply to require employers who provided a company car for private use to deduct tax under PAYE in respect of the benefit by reference to the predetermined car scale charge. It was accepted, however, that because the chargeable amount could vary depending on factors such as the amount of business use, whether the car was a second car, whether the car was acquired, given up or changed part way through the year, etc, the employer would be required to apply PAYE only in respect of the "standard" scale charge for the car (taking account merely of engine size or original market value of the car, and age). Despite all this, however, employers' organisations maintained that the proposed scheme would involve an increase in employers' administrative burdens such that the extra cost to them would far outweigh any saving to the Revenue. The CBI and the ABCC, in particular, also objected in principle to the employer being

given the role of assessor, even though this was to be done by reference to the standard car scale charges. As a result, of course, the proposals had to be withdrawn and the legislation repealed.

45. In short, if the 1981 experience is anything to go by employers would even regard as unacceptable the administrative burdens associated with an FBT that applied only to car benefits, and even if the scales were further simplified on the lines discussed at paragraphs 11 to 16 above. On this basis, they would obviously regard those benefits for which the valuation rule is less straightforward or for which an expenses deduction may be due as even more troublesome and unacceptable; and they would probably regard extension of FBT to include expenses payments as simply beyond the pale.

46. All this would point towards keeping the coverage of FBT as narrow as possible, to the main benefits which - by and large - are also those which would be easiest for employers to handle.

47. The two main benefits for inclusion would, of course, be cars and car fuel which together account for about 70% of the total yield from taxable benefits and expenses payments received by directors and higher paid employees. Private medical insurance - which accounts for about a further 11% of the total yield - would also be included, and would not cause difficulties for employers because an expenses deduction for this benefit would almost never be due. It should be noted, however, that this benefit is not at present separately identified in the legislation but is simply one example of a general category of benefit - covered by Section 61 FA 1976 - other examples of which might, in certain circumstances, be eligible for an expenses deduction. So, if FBT was to be extended to private medical insurance, but not to other items in this category, we would need to bring in a specific definition for this purpose. That itself would not be difficult. What would be more awkward, however, is that we should thereby have FBT applying to this particular benefit,

but the existing employee-based system - with different rules - applying to what might otherwise be an almost identical benefit - eg private health or education insurance provided by the employer, or other essentially similar benefits.

48. Though the administrative savings for us - and employers - from having fewer PLLDs would obviously be less the narrower the coverage of FBT, there would still be a significant reduction if the scheme applied only to these three main benefits. We estimate that in 1987/88 about 870,000 (48%) of the 1.8 million PLLDs returned for directors and higher paid employees relate to those individuals who received one or more of these three benefits and no others.

(1) BENEFITS ASSESSABLE ON ALL EMPLOYEES AND OFFICE-HOLDERS

CONFIDENTIAL

BENEFIT	VALUATION RULE	EXTRA TASKS FOR/INFORMATION NEEDED BY EMPLOYER UNDER EBT	CHANGE NEEDED TO AVOID EXTRA TASK	COMMENT
1. PAYMENTS IN KIND (S.131 ICTA 1970)	Realisable value (ie what the employee could get if he sold it as soon as it came into his possession) <u>LESS</u> anything paid by the employee	'Secondhand' value of what he gives	Substitute 'cost' for secondhand value in all cases.	Under an EBT the treatment of these benefits would be the same as that which at present applies to payments in kind to higher paid employees - see item 16.
2. PECUNIARY LIABILITY (S.181 ICTA 1970)	Amount paid by employer in discharging debt owed by employee <u>LESS</u> any amounts deductible under S.189	Employee's expenses claim.	Ignore expenses claim unless expense <u>wholly</u> business.	Result would be slightly less generous treatment in respect of benefits provided to "lower paid" employees.
3. CASH VOUCHERS (S.37 F(No2)A 1975)	Amount for which the voucher can be exchanged.	NONE (cash vouchers are already within PAYE)	None required.	Result would be less generous treatment than at present, and, administrative saving to employer likely to be small; may be no more difficult to collect information in cases involving partial rather than whole business use.
4. NON-CASH VOUCHERS (S.36 F(No2)A 1975)	Expense incurred by the provider in connection with - the provision of the voucher and - the money, goods or services for which it can be exchanged. <u>LESS</u> any amounts deductible under S.189.	Employee's expenses claim	Ignore expenses claims unless expenditure <u>wholly</u> deductible S.189	

BENEFIT	VALUATION RULE	EXTRA TASKS FOR/INFORMATION NEEDED BY EMPLOYER UNDER EBT	CHANGE NEEDED TO AVOID EXTRA TASK	COMMENT
5. CREDIT TOKENS (S.36A F(No2)A 1975)	Expense incurred by the provider in connection with the provision of money, goods or services obtained with the credit token <u>LESS</u> any amounts deductible under S.189.	Employee's expenses claim	Ignore expenses claims unless expenditure <u>wholly</u> deductible S.189	" "
6. LIVING ACCOMMODATION (1) (S.33 FA 1977)	Greater of - annual value* of accommodation <u>OR</u> - rent paid by employer <u>LESS</u> rent paid by employee <u>LESS</u> any amounts deductible under S.189 (* for properties in the UK "annual value" is taken to be the same as GRV, although there is a concession for properties in Scotland where the amount taken is $\frac{100}{270}$ x 1985 valuation).	1. Employee's expenses claim (if any) 2. Whether employee meets conditions for exemption under S.33(4) FA 1977, ie (a) accommodation provided for the proper performance of duties <u>OR</u> (b) provided for better performance of duties <u>and</u> provision is customary <u>OR</u> (c) provided as part of special security arrangements	1. Ignore expenses claims unless accommodation used wholly for business. 2. Repeal exemptions in S.33(4)(a) and (b) [Exemption for (c) not practicable]. <u>OR</u> have exemptions only for certain specifically defined groups of employees.	These rules (see also item 7) need major recasting anyway with advent of Community Charge. Some simplification also desirable, even without EBT.

BENEFIT	VALUATION RULE	EXTRA TASKS FOR/INFORMATION NEEDED BY EMPLOYER UNDER EBT	CHANGE NEEDED TO AVOID EXTRA TASK	COMMENT
7. LIVING ACCOMMODATION (Expensive Houses) (2) (3.33A FA 1977)	<p>[Total cost of accommodation plus improvements or alterations (in some circumstances market value is substituted for cost)]</p> <p><u>LESS</u> £75,000</p> <p><u>MULTIPLIED BY</u> the "official rate" of interest]</p> <p><u>LESS</u> rent paid by employee (to the extent not already deducted under (i) above)</p> <p><u>LESS</u> any amounts deductible under S.189</p>	<ol style="list-style-type: none"> 1. Market value of accommodation (where substituted for cost) 2. 'Official rate' of interest 3. Employee's expenses claim 4. Whether employee qualifies for exemption under S.34(4) FA 1977 	<ol style="list-style-type: none"> 1. Base charge on 'cost' in all cases 2. Set fixed interest rate in advance - break link with 'official rate' 3. Ignore expenses claims unless accommodation used wholly for business. 4. Repeal exemptions under s.33(4)(a) and (b) <p><u>OR</u></p> <p>have exemption only for specifically defined groups.</p>	<p>" "</p> <p>Because of technical defect in legislation, this supplementary charge rule does not always apply in way intended. New regime will therefore involve some tightening up anyway.</p>

(2) BENEFITS ASSESSABLE ON DIRECTORS AND HIGHER PAID EMPLOYEES ONLY

BENEFIT	VALUATION RULE	EXTRA TASKS FOR/INFORMATION NEEDED BY EMPLOYER UNDER EBT	CHANGE NEEDED TO AVOID EXTRA TASK	COMMENT
8. CAR AVAILABLE FOR PRIVATE USE	Scale charge based on age and type of car	1. Annual business mileage 2. Whether car is a 'second car' (the 2 (or more) cars do not have to be from the same employer) and, in order to identify the "second" car, which of them is used to the lesser extent for business mileage.	Have a single scale charge for each car irrespective of mileage, or whether it is a 'second car'.	Effect of rule change would be less generous treatment for cases involving high business mileage, but more generous treatment for cases involving low business mileage on second cars.
(Ss64, 65 and Sch 7 FA 1976)	<u>BUT</u> - scale charge <u>halved</u> if business mileage > 18000 miles - scale charge <u>increased</u> by half if (a) business mileage < 2500 miles or (b) car is a second (or subsequent) car made available concurrently			
	<u>AND</u> no charge at all arises if it is a 'pool car' - S.65 FA 1976			
	<u>NOTE</u> If employee makes payments as a condition of the car being made available for his private use, the amounts are deductible from the scale charge, until it is reduced to NIL.			

BENEFIT	VALUATION RULE	EXTRA TASKS FOR/INFORMATION NEEDED BY EMPLOYER UNDER EBT	CHANGE NEEDED TO AVOID EXTRA TASK	COMMENT
<p>9. CAR FUEL (ie fuel provided for a car to which a car scale charge applies). (S.64A FA 1976).</p>	<p>Scale charge based on type of car</p> <p><u>BUT</u></p> <p>Scale charge is <u>halved</u> if business mileage > 18,000 miles in year of assessment</p> <p><u>AND</u></p> <p>no charge at all if car is a 'pool car'.</p> <p><u>NOTE.</u> There is no charge if</p> <p>(a) the employee makes good the cost of <u>all</u> fuel used privately (if he makes good part of the cost, the full scale charge still applies);</p> <p>(b) if fuel is provided for business use only.</p>	<p>Annual business mileage.</p>	<p>Have a single scale charge irrespective of mileage.</p>	<p>Result would be less generous treatment than at present where there is high business mileage.</p> <p>Arguably a case anyway for modifying the "all or nothing" contributions rule to one under which scale charge would be reduced to the extent of any contribution by the employee.</p>

BENEFIT	VALUATION RULE	EXTRA TASKS FOR/INFORMATION NEEDED BY EMPLOYER UNDER EBT	CHANGE NEEDED TO AVOID EXTRA TASK	COMMENT
<p>10. BENEFICIAL LOANS OBTAINED BY REASON OF THE EMPLOYMENT</p> <p>(S.66 and Sch 8 FA 1976)</p>	<p>Amount chargeable is</p> <ul style="list-style-type: none"> - interest at the 'official rate' on the amount outstanding <p>LESS</p> <ul style="list-style-type: none"> - the interest actually paid. <p><u>BUT</u></p> <p>There is no liability where</p> <ul style="list-style-type: none"> - the amount chargeable is £200 or less <p>OR</p> <ul style="list-style-type: none"> - the loan is such that the interest on it is (or would be) wholly eligible for relief under the interest relief provisions (there are special rules for interest which is partly eligible for relief). 	<ol style="list-style-type: none"> 1. The official rate of interest in force over the period of the loan. 2. The purpose for which the loan (or loans) was applied. <p>(NOTE - If one loan was for a qualifying purpose, and one was not, the aggregation provisions in Para 55(3) Sch 8 can trigger the "partly eligible for relief" provisions in Para 10).</p> <ol style="list-style-type: none"> 3. Does benefit exceed £200 per employee? 	<ol style="list-style-type: none"> 1. No obvious solution. 2. Make the beneficial loans subject to tax irrespective of purpose 3. Remove £200 de minimis limit. 4. Repeal the provision for allowing credit for interest paid late - interest should be available for credit only when paid. 	<ul style="list-style-type: none"> - Contentious - and wrong in principle except, perhaps, to the extent that the employee may still be left with an NIC advantage. - may ease compliance, but also increases FBT. - Result would be less generous treatment than at present. But this change probably necessary anyway, in order to avoid subsequent adjustments to employer's EBT liability.
	<p><u>NOTE</u> 1. Where liability arises there are 2 possible methods of calculation</p> <ul style="list-style-type: none"> - the normal 'averaging method' - the alternative precise method. <p>2. There are provisions for taking account of interest paid late.</p>			

BENEFIT	VALUATION RULE	EXTRA TASKS FOR/INFORMATION NEEDED BY EMPLOYER UNDER EBT	CHANGE NEEDED TO AVOID EXTRA TASK	COMMENT
11. WRITING OFF A LOAN OBTAINED BY REASON OF THE EMPLOYMENT [APPLIES IRRESPECTIVE OF WHETHER LOAN 'CHEAP' OR INTEREST FREE]	Amount assessable is the amount written off.	None	None required.	
(S.66(3) FA 1976)				
12. SCHCLARSHIPS (Ss.61 & 62A FA 1976)	Expense incurred in providing the "scholarship" (as defined) for a member of the employee's family or household.	1. In cases where the employer does not directly provide the scholarship, he would need to know the amounts paid out.	1. Tax the employer on the amount he pays into the scholarship fund.	
	<u>NOTE</u> - There is no charge if (inter alia)	2. What % of payments out of the fund relates to "relevant scholarships".	2. Repeal the 25% "relevant scholarship exemption.	
	i. the scholarship is provided from a trust fund and			
	ii. not more than 25% of payments from the fund relates to relevant scholarships (broadly, scholarships obtained by reason of the parent's employment).			

BENEFIT	VALUATION RULE	EXTRA TASKS FOR/INFORMATION NEEDED BY EMPLOYER UNDER EBT	CHANGE NEEDED TO AVOID EXTRA TASK	COMMENT
13. SHARES ACQUIRED AT UNDERVALUE IN PURSUANCE OF A RIGHT OR OPPORTUNITY AVAILABLE BY REASON OF THE EMPLOYMENT (S.67(1)-(3) FA 1976)	<ol style="list-style-type: none"> 1. <u>Ascertain</u> the market value of fully paid up shares of the class acquired. 2. <u>Deduct</u> any amount paid for the shares by the employee. 3. <u>Deduct</u> any amount chargeable to tax under S.181 ICTA 1970. 4. Treat the result as a 'loan' on which a benefit is chargeable under the rules relating to beneficial loans 	<ol style="list-style-type: none"> 1. The market value of fully paid up shares of class acquired. 2. The 'official rate' of interest in force over the period of the notional loan. 	None required.	Probably best to leave items 13-15 outside EBT. They mainly fill certain narrow gaps not already covered by the main Schedule E provisions (Sections 181 and 186 ICTA.
14. RELEASE FROM OBLIGATION TO PAY FOR THE SHARES* (S.67(6) FA 1976)	If the shares were partly paid, and the obligation to pay the balance is released, the amount released is taxable in the same way as the writing off of a loan.	None.	None required.	
15. DISPOSAL AT OVER-VALUE OF SHARES ACQUIRED IN PURSUANCE OF A RIGHT OR OPPORTUNITY AVAILABLE BY REASON OF THE EMPLOYMENT* (S.67(7) FA 1976)	<p>Amount chargeable is the difference between</p> <ul style="list-style-type: none"> - the consideration received and - the market value of the shares at the time of the disposal. 	<ol style="list-style-type: none"> 1. The consideration received by the employee (or former employee). 2. The market value of the shares at the time of disposal. 		(* These two provisions apply even if the individual has ceased to be a director or higher paid employee].

BENEFIT	VALUATION RULE	EXTRA TASKS FOR/INFORMATION NEEDED BY EMPLOYER UNDER EBT	CHANGE NEEDED TO AVOID EXTRA TASK	COMMENT
<p>16. ASSETS TRANSFERRED TO EMPLOYEE (Ss.61, 63(2) & 63(3) FA 1976)</p> <p>(ie including "payments in kind")</p>	<p>The cost of the asset</p> <p><u>LESS</u></p> <p>anything paid by the employee.</p> <p><u>BUT</u></p> <p>Where the asset has been used or depreciated between acquisition by the employer and transferred to the employee, market value is substituted for cost.</p>	None	None required.	
<p>17. TRANSFER OF ASSETS FORMERLY USED TO PROVIDE BENEFITS (Ss.61, 63(3) & 63(3A) FA 1976)</p>	<p>The market value of the asset at the time when it was first applied as a benefit</p> <p><u>LESS</u></p> <p>any amounts charged as benefits from the use of the asset</p> <p><u>LESS</u></p> <p>anything paid by the employee for the transfer of the asset.</p>	<p>Market value of the asset at the time of transfer.</p> <p>Any benefits assessed on employers in respect of the use of the asset. (The employers will at present have this information - see item 18 - but will not need to marry it up when returning information item 17-type benefits).</p>	Repeal 'market value' rule.	Result would be less generous treatment than at present.

BENEFIT	VALUATION RULE	EXTRA TASKS FOR/INFORMATION NEEDED BY EMPLOYER UNDER EBT	CHANGE NEEDED TO AVOID EXTRA TASK	COMMENT
18. EMPLOYER'S ASSET PLACED AT EMPLOYEE'S DISPOSAL (Ss.61, 64(4)(5) & (6) FA 1976)	The greater of <ul style="list-style-type: none"> - the "annual value" of the use of the asset* or - any rent paid for it by the provider <p><u>PLUS</u></p> <p>any other expenses incurred in connection with the provision (apart from the cost of buying the asset)</p> <p><u>LESS</u></p> <p>anything paid by the employee for the use of the asset.</p> <p><u>LESS</u></p> <p>anything deductible under S.189.</p>	The employee's expenses claim.	Ignore any possible expenses claim, except where the asset is used wholly for business purposes.	Result would be less generous treatment than at present.
	<p>[* the "annual value of the use of the asset is</p> <ul style="list-style-type: none"> - in the case of land, the annual value determined under S.531 ICTA 1970 - in any other case, 20% of the market value of the asset at the time when it was first applied as a benefit]. 			

BENEFIT	VALUATION RULE	EXTRA TASKS FOR/INFORMATION NEEDED BY EMPLOYER UNDER EBT	CHANGE NEEDED TO AVOID EXTRA TASK	COMMENT
19. ANY BENEFIT OR FACILITY OF WHATSOEVER NATURE NOT ALREADY COVERED (INCLUDING INTER ALIA, MEDICAL INSURANCE FOR EMPLOYEES) (S.61, 63(1) & (2) FA 1976)	The expense incurred in providing the benefit <u>LESS</u> any amounts paid by the employee <u>LESS</u> anything deductible under S.189.	Employee's expenses claim.	Ignore any possible expenses claim, except where the 'benefit' is shown to be wholly deductible under S.189 (ie as with dispensations at present).	Result would be less generous treatment than at present.
(3) BENEFITS ONLY ASSESSABLE ON CERTAIN DIRECTORS				
20. PAYMENT OF TAX DEDUCTIBLE UNDER PAYE <u>WITHOUT</u> DEDUCTING IT FROM THE DIRECTOR'S REMUNERATION (S.66A FA 1976)	The amount of PAYE tax accounted for to the Revenue <u>LESS</u> any amounts made good by the director.	None.	None required.	

*In our
last discussion
of the FBT.*

BUDGET SECRET: TASK FORCE LIST

MR SCHOLAR

From: Sir G.Littler
Date: 20 January 1988

c.c. Mr Alex Allan ✓

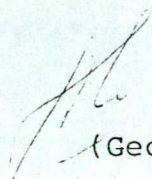
FRINGE BENEFITS

The more I look at this, the more I dislike it. I think there are two good concepts: bringing benefits into tax; and charging the tax on employers, rather than employees, as a way of making the whole idea of fringe benefits less attractive. But the form of the FBT lacks appeal; the justification for the numbers is bound to be contentious; and adding a new (and complicated) tax will in itself seem to be a reversal of strategy.

2. Moreover on cars, which are the most obvious problem, we are being driven towards an apparently high rate of charge on an abated notional value.

3. If it has not already been rejected for good reasons, could we consider as an alternative simply using 'disallowance' of costs as business expenses in the taxation of the employer. For cars, one would then need to offer allowance of business mileage claims (as we are having to contemplate on FBT anyway).

4. This would look simpler; probably be simpler; avoid a 'new tax'; and be as readily presentable as an attack on fringe benefits. The CT rates charged would be lower than we have been proposing for FBT; but we would include 100% of car costs (except for genuine mileage allowance), instead of the 50% scale we seem more likely to go for on FBT. I should like to see an estimate of the comparative ex ante revenue change.


(Geoffrey Littler)

COPY NO 1 OF 3 COPIES

FROM: M C SCHOLAR
DATE: 20 JANUARY 1988

CHANCELLOR OF THE EXCHEQUER

FRINGE BENEFITS TAX: COVERAGE

If we are to go ahead with this tax - and I continue to think we should, to plug an otherwise irreparable hole in the revenue and in order to bring about a real reform in this area - I believe we have to move one - or not more than two steps - at a time, in order to get the new tax off the ground.

2. So I am doubtful of the wisdom of combining the new principle of taxing the employer with both a steep increase in the taxation of car benefit and extensions of the tax base in a variety of different directions, however compelling the logic (and attractive the yield) for the latter. I know that you have so far favoured a wide coverage - perhaps in part as a trade-off for a lower rate, and partly because this was one of the motives for considering this tax. Could we not come to that later, once the tax is on the statute book, and keep our fire for this year on cars, broadly replicating in the new tax the coverage we have reached on the old?.

3. I really do not think the tax has a chance if, as well as taking the employers and business car lobbies, we take on the sports lobby by taxing sportsgrounds; and I am doubtful about contemplating at this stage the massive extension in the tax base, and the controversy, which taxing canteens would bring. Why can we not follow the New Zealand example and exempt any benefit provided and consumed for the generality of employees on the employers premises? This would be a great simplification and I do not think we should be driven off it just because it would exempt workplace nurseries.

Ch
(See also GJL below)

Ch
Lund with FST post - Prager's
tomorrow? yr- AA

*See the
quote to
Mr Scholar's
machine ASAP.*

4. Monday's discussion seemed to me to be pretty well balanced between the wish to cast the net as widely as possible, and to moderate that in order to get the tax accepted. I think we may get into an impasse if you do not give a further steer before the Financial Secretary's meeting on Friday (and some in the Revenue will not be sorry to see the tax foundering on an over-ambitious coverage). My vote would be for more discretion and less valour at this point.

5. Should Alex ask the Financial Secretary to consider the idea at the end of paragraph 3?

MCS

M C SCHOLAR

BUDGET SECRET: TASK FORCE LIST

COPY NO 4 OF 6 COPIES

FROM: M C SCHOLAR
DATE: 21 JANUARY 1988

SIR GEOFFREY LITTLER

cc Sir Peter Middleton
Sir Terence Burns
Mr A C S Allan —

FRINGE BENEFITS TAX

Your minute of 20 January.

2. We looked, last year, at the idea of disallowing for Corporation Tax expenditure on providing fringe benefits but exempting benefits from tax in the hands of employees: and the Chancellor yesterday asked the Revenue again to think about this.

3. As I recall it, the objections to this are:

- (i) it would give a renewed impetus to fringe benefits. For those employers who do not pay Corporation Tax it would clearly mean an unambiguous lightening of the tax burdens and even for the 27% or 35% CT-paying company the extra burden of corporate tax would be less onerous than the tax gain for higher rate employees;
- (ii) the FBT on the other hand offered the possibility of taxing benefits more widely and flexibly, and at a more neutral rate, starting with cars - and creating a clearing in the jungle of extra-statutory concessions, old Spanish customs etc at the same time.

4. Your idea suffers from some but not all of these objections. It does not suffer from 3(i). As long as benefits continue to be taxed in the hands of recipients your proposal would have no effect at all on non taxpaying employers; and should discourage the use of benefits by tax paying ones. For the latter category it would be more effective than a FBT at 45%. It would certainly be better than the present position.

*For work
FBS mty. ✓*

cl

*Lewis promises
paper by lunchtime*

AA

5. But it would not score well on 3(ii). There would be no flexibility to increase the taxation of benefits by raising the rate of tax on them; this could only be done by raising the rate of CT, which would not be a starter in this context. And it would do nothing to reduce the present problems (old Spanish customs etc) of taxing benefits in the hands of employees.

6. This has prompted me to think of a further possibility for the FBT. We decided in November to make FBT non-deductible for CT (unlike all other taxes and NICs) notwithstanding the argument that this introduced an unjustifiable disparity, as above, between the attractions of benefits v. pay in CT-paying and non-CT paying companies. The reason for this decision was to reduce the rate of FBT to a presentable level. But if, on your lines, we made the cost of providing benefit rather than the tax itself non-deductible we could reduce the FBT rate still further: the table annexed shows that, for a CT paying company any FBT rate above 31% would make benefits less attractive than pay for a higher rate taxpayer.

7. It is true that a 31% FBT would discriminate heavily against benefits for the basic rate taxpayer in the kink. But that is true to some extent with deductible benefits and a 45% FBT. A further serious disadvantage is that the incentive for non-CT paying firms to pay benefits would be a lot stronger than under the present FBT proposal. And the fact that benefit expenditure would potentially raise companies' tax liability under two separate taxes - CT and FBT - would make the package more difficult to sell.

*doesn't raise it
? merely doesn't lower it*

8. I agree with you that this tax is bound to be contentious. But I don't think it need be complicated: indeed, it should be less complicated than the present system (as the projected Revenue staff savings for the tax suggest). Monday's discussion of coverage was a set-back to most of us; but I don't think we ought to be moved by the Revenue's tactic of engulfing us with papers on canteens, sportsgrounds and clergymen's heating and lighting expenses.

MCS

M C SCHOLAR

Neutral Rates of FBT (%)

	<u>Non-kinky basic rate taxpayer</u>	<u>Kinky basic rate taxpayer</u>	<u>Higher rate taxpayer (40%)</u>
<u>A. Benefits Deductible</u>			
CT paying company (35%)	44	31	55
Non-taxying company	67	47	84
<u>B. Benefits Non-deductible</u>			
CT paying company (35%)	9	-4	20
Non-taxpaying company	67	47	84

Neutral Rates of FBT (%)

	<u>Non-kinky basic rate taxpayer</u>	<u>Kinky basic rate taxpayer</u>	<u>Higher rate taxpayer (40%)</u>
<u>A. Benefits Deductible</u>			
CT paying company (35%)	44	31	55
Non-taxying company	67	47	84
<u>B. Benefits Non-deductible</u>			
CT paying company (35%)	14	-6	31
Non-taxpaying company	67	47	84

a
To be substituted for
table in MCS \Rightarrow GJL
or FBT.

AA
(original table wrong).



FROM: FINANCIAL SECRETARY

DATE: 25 JANUARY 1988

CHANCELLOR

cc: Chief Secretary
 Paymaster General
 Economic Secretary
 Sir P Middleton
 Mr Monck
 Mr Scholar
 Mr Culpin
 Miss Sinclair
 Mr Michie
 Mr Cropper
 Mr Tyrie
 Mr Call
 Mr Isaac - IR
 Mr Lewis - IR
 Mr Prescott - IR
 PS/IR

FBT: COVERAGE

As you suggested I have been looking at ways of constructing a less controversial and less radical FBT coverage package. Perhaps my earlier note (of 22 December) can remain on the table as an attempt to "pick and choose" between which particular benefits should be exempted and which should not, if one were starting with a clean slate. I do not see much point in my attempting to produce an alternative "selective" menu. In this note I identify two broader options:

Option I: setting out - at least for the main collective benefits - a general principle that benefits will be taxable unless:

(i) they are provided on the employer's "own premises";

(ii) and they are made available on similar terms to all employees.

FST
 →
 CHEX
 25/1

BUDGET SECRET: TASK FORCE LIST

Option II: sticking as far as possible to existing practice, and enshrining this practice, however anomalous in the new legislation.

Option I

2. Although under this option the aim would be to have a clear structure into which to fit each benefit, the criteria suggested for exemptions - "own premises" and "similar terms" - are by no means as simple or as clear-cut as they might appear. "Own premises" would have to be clearly defined to include premises owned or leased by a company by not rented. Thus, if a sports ground were hired once a week it would not be exempt; if it were leased by a company for a period of years it would be exempt.

3. But leaving aside the detail of how the general principles would be applied in practice, the main implications of option I would be as follows:

- (i) **Canteens:** would be exempted if they were available for all employees and if they were on premises occupied by the company.
- (ii) **LVs:** would be taxed - the present 15p per day exemption would go.
- (iii) **Directors' lunches:** would be taxed on the grounds that they are by definition not available to all.
- (iv) **Sports facilities:** would be taxed only if they were off premises. (At present they are in theory taxable.)
- (v) **Workplace nurseries:** would be tax-free if they were on premises, (but taxed if the company used the local authority's day nursery).

BUDGET SECRET: TASK FORCE LIST

(vi) **Car parking:** again, as we had already envisaged, this would be exempt on own premises but taxable off-premises.

4. **Apart from the pressure to extend exemptions to benefits provided off premises, I think that the main areas of difficulty with this option would be:**

(a) **Taxing LVs.**

(b) **Exempting in-house workplace nurseries.**

5. **We know the arguments for and against (b).** I would be prepared to defend it and, of course, it would be widely welcomed by many people. But you may not wish to exempt. If you believe that workplace nurseries on premises should be taxed then I think option I probably falls - its main virtue being that it attempts to draw a logical dividing line between what is in and what is out.

6. **(a) is much more difficult.** Businesses without canteens, including small businesses without the space available to provide them, would doubtless point out the inequity of exempting canteens but not LVs. I have no knock-down replies. But we could argue that:

(i) The LV exemption is a relic from the past and has no place in a reformed system of lower taxes and fewer tax breaks.

(ii) The existing 15p exemption is tiny, and is frequently ignored by employers who pay more than the limit.

BUDGET SECRET: TASK FORCE LIST

(iii) The alternative to removing the exemption would be to increase the 15p limit. This would look very perverse in the context of a reform which was aiming to tax perks more effectively - LVs are virtually identical to cash and can readily be "cashed out".

(iv) Canteens are very difficult to tax since a proper valuation of the "benefit" would require apportionment of fixed costs and so on.

7. I conclude that option I has some attractions presentationally but would generate at least one major battle.

Option 2

8. The aim here would be to stick as closely as possible to existing practice and to make a virtue of this in the presentation. We would argue that the main benefit was the company car and that we would be using the FBT to launch a staged attack on that. We would also say that the coverage was not set in stone and that once the FBT had been up and running for a year or two (ie in the next Parliament) a change in coverage might be considered.

9. I can see that this might prove to be the least controversial option. It would also make it easier in the future to bring into tax some of the bigger "on premises" benefit if we decided we wanted to. But, on the other hand, it would mean that one would have to defend a fairly arbitrary system simply on the basis that that was the status quo. We would find it more difficult, I think, to defend the FBT itself if we did not use its introduction as the opportunity for some rationalisation of the current messy rules. People would justifiably argue that if the only argument for the FBT was that it made it possible to tax more effectively the company car, then it was a complicated way of meeting this objective.

BUDGET SECRET: TASK FORCE LIST

10. It is because I believe that the very FBT itself may be more difficult to implement under option II than option I that I favour the more rational approach of option I. Under the latter we can expect some awkward rows on coverage to deflect from the case for the FBT itself. Under option II, we might still get rows on coverage, but we would also find it difficult to present the FBT as a major reform of the system as a whole and a move towards a rational and less anomalous tax-base.

Non-collective benefits

11. Although I favour the option I approach for the collective benefits, I do not think that we need necessarily follow it to the letter when it comes to the more minor non-collective benefits. Equally, if we chose the status quo route there are one or two minor benefits that I think will have to be taxed even though they are currently exempt.

12. In particular I think that whether we go for option I or option II we should start to tax:

- (i) Provision for the living accommodation of "lower paid" clergymen.
- (ii) Heating and lighting bills of "lower paid" clergymen.
- (iii) Board and lodging provided for "lower paid" agricultural workers.
- (iv) Miners' free coal.

13. These are clearly just an alternative form of remuneration and we cannot possibly justify continuing to exempt them. Moreover in the case of (i)-(ii) above, the definition of "lower paid" will be lost from the legislation when the P11D system is abolished. We do not want to re-invent it just for these cases; nor do we want to extend the exemptions to all clergymen or farm-workers.

Accommodation

14. The major area not yet covered is accommodation: the Revenue will be producing a separate note on the various accommodation benefits. Here the issue is not only whether or not to tax, but also what valuation rules to use if any of them are to be taxed (given the abolition of domestic rates). My provisional view on the coverage is that whilst it would clearly be right to hit, for example, directors' flats, it would be wise to leave janitors, licensees, tied cottages etc well alone in line with existing practice.



NORMAN LAMONT

Covering

CONFIDENTIAL

Harceva

FROM: COLIN MOWL
DATE: 6 January 1988

~~MR CULPIN~~

*Markes. Ch. 9 papers.
Parkes*

cc Mr Sedgwick
Mr Ritchie
Mr Parkes

TAX BURDEN

I attach the figures you requested.

Colin Mowl

COLIN MOWL

CONFIDENTIAL

TAX BURDEN (%)Taxes and NICs as %
of money GDPNon-North Sea Taxes and NICs
as % of Non-North
sea money GDP

1963-64	28 $\frac{3}{4}$	28 $\frac{3}{4}$
1964-65	29$\frac{1}{2}$	29$\frac{1}{2}$
1965-66	31	31
1966-67	31 $\frac{3}{4}$	31 $\frac{3}{4}$
1967-68	33	33
1968-69	35	35
1969-70	36$\frac{1}{2}$	36$\frac{1}{2}$
1970-71	36 $\frac{1}{4}$	36 $\frac{1}{4}$
1971-72	34 $\frac{3}{4}$	34 $\frac{3}{4}$
1972-73	32 $\frac{1}{4}$	32 $\frac{1}{4}$
1973-74	33 $\frac{1}{4}$	33 $\frac{1}{4}$
1974-75	35$\frac{3}{4}$	35$\frac{3}{4}$
1975-76	36 $\frac{1}{4}$	36 $\frac{1}{4}$
1976-77	35 $\frac{3}{4}$	36
1977-78	34 $\frac{3}{4}$	35
1978-79	33 $\frac{3}{4}$	34
1979-80	35$\frac{1}{4}$	35$\frac{1}{4}$
1980-81	36 $\frac{1}{4}$	36
1981-82	39$\frac{1}{4}$	38$\frac{1}{2}$
1982-83	39	38 $\frac{1}{4}$
1983-84	38 $\frac{1}{2}$	37 $\frac{3}{4}$
1984-85	39	37 $\frac{3}{4}$
1985-86	38 $\frac{1}{2}$	37
1986-87	38	37 $\frac{1}{2}$
1987-88	38*	37 $\frac{3}{4}$ *

1988-89

35 $\frac{1}{2}$

(* latest view)

BUDGET SECRET: TASK FORCE LIST

COPY No SPJ/5/ 1 OF 19

FROM: PAYMASTER GENERAL

DATE: 27 January 1988

CHANCELLOR

cc Chief Secretary
 Financial Secretary
 Economic Secretary
 Sir Peter Middleton
 Mr Monck
 Mr Scholar
 Mr Culpin
 Miss Sinclair
 Mr Michie
 Mr Cropper
 Mr Tyrie
 Mr Call
 PS/Inland Revenue
 Mr Isaac - IR
 Mr Lewis - IR
 Mr Prescott - IR

FBT: COVERAGE

I have seen the Financial Secretary's minute of 25 January, which you are discussing on Friday while I am in Gateshead.

2. I had read the purpose of changing the FBT package as establishing the principle of the tax - making it non-deductible - while leaving the detail of coverage for future years. There may be a misapprehension in this, in that the threat of non-deductibility would occasion pre-emptive strikes to secure particular pledges.

3. Against this background I do not see how controversy can be avoided, and I find efforts to produce rationalisations of particular simplifications to be anomaly-ridden.

4. I am perfectly happy to defend FBT and its severer consequences, but I would be uneasy about going as far as exempting on-site canteens while discriminating against luncheon vouchers.

5. I am prepared for a small business outcry on compliance costs: I am much less enthusiastic about warding off an outcry from them on grounds of inequity.

P.B.

PETER BROOKE

 PMG
 →
 CHEX
 27/1

TAX AS
% OF GDP

CONFIDENTIAL

Mr Paul will show papers.

FROM: D I SPARKES
DATE: 6 January 1988

*CEV
7/11*

- 1. MISS EVANS
- 2. CHANCELLOR

cc Mr Culpin
Miss Sinclair
Mr Scotter

TAX CUTS AS PERCENTAGE OF GDP

You asked what the tax cuts in the 1983 and 1987 Budgets represented as percentages of GDP.

2. The following information is taken from the 1983-84 and 1987-88 FSBRS. You should note that the figures for the two years are not strictly comparable because in 1983 it was the convention to show revenue effects in the first and full years whereas we now show the effects in the first and second years. The difference is not however likely to be large.

	<u>Tax cuts, £m</u>	<u>as % of GDP</u>
<u>1983</u>		
First year from an Indexed Base	1668	0.5
Full year from an Indexed Base	2233	0.7
<u>1987</u>		
First year from an Indexed Base	2625	0.6
Second Year from an Indexed Base	2945	0.7

3. You may find it useful to know for an assessment of tax cuts in the 1988 Budget that the latest forecast of 1988-89 GDP is £451 billion.

*1
latest scenario figures
are £4.2 / £6.0,
implying 0.9% / 1.3%*

D.I.
D I SPARKES



Inland Revenue

Policy Division
Somerset House

COPY NO 1 OF 38.
FROM: P LEWIS
DATE: 28 JANUARY 1988

Chancellor

TAXATION OF FRINGE BENEFITS

1. I attach some further papers, some or all of which you may wish to discuss at your meeting on Friday afternoon.
2. The first three papers (all by Michael Prescott) are inter-linked.
 - FBT Coverage: This note follows the Financial Secretary's meeting at the end of last week, and is intended to supplement his note of 25 January by identifying the points on which decisions are needed, depending on the approach adopted.
 - Accommodation: This is the remaining area of coverage we have not so far tackled. Because of the demise of domestic rating, some change in the present rules will be needed whether or not FBT is introduced. But if FBT is dropped, the changes could be left until next year.

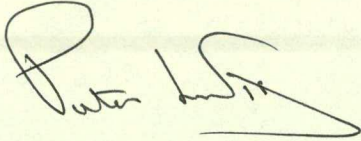
cc	Chief Secretary	Mr Battishill
	Financial Secretary	Mr Isaac
	Paymaster General	Mr Painter
	Economic Secretary	Mr Beighton
	Sir P Middleton	Mr McGivern
	Sir T Burns	Mr Lewis
	Sir G Littler	Mr Prescott
	Mr Anson	Miss Rhodes
	Sir A Wilson	Mr Mace
	Mr Byatt	Mr Hodgson
	Mr Monck	Mr Northend
	Mr Scholar	Mr R H Allen
	Mr Culpin	Mr I Stewart
	Miss Sinclair	Mr Geraghty
	Mr Sedgwick	PS/IR
	Mr Olding-Smee	
	Miss Evans	
	Mr Hudson	
	Mr Michie	
	Mr Cropper	
	Mr Tyrie	
	Mr Call	

- Valuation of goods and services: This note is not concerned with the way we should quantify the value of communally provided benefits such as canteens and sports grounds, on which we should need to give you a separate note, if you wished either to include them within the scope of FBT or alternatively disallow their "cost" in calculating taxable profits as discussed in my note of 22 January.

It is concerned with the even more general case of goods or services which are provided free or cheaply by the employer, for example through staff discount schemes. As Mr Prescott's note explains, some decisions are required for FBT because at present there are differing rules for people above and below the P11D threshold; and it is worth looking at the field generally because the present rules give varying results in differing situations and arguably often do not tax, or fully tax, quite widespread benefits amounting in aggregate to probably significant sums. But, as in the case of coverage, it would be possible to carry over into FBT broadly the present rules if you decided you did not wish to embark on a fresh look at this whole field, important though it is. (One important consideration is that we are increasingly concerned that we are now getting to the point where options must be closed down rather than opened up if there is to be a reasonable chance of getting a properly prepared and comprehensive FBT into the Finance Bill.) Going for broadly the status quo in legislation this year would not, of course, preclude you from having a further look at this important topic later on either in-house or on a consultative basis if you felt there was worthwhile work to be done but not time to do it now.

3. The remaining paper is a note I have done taking a first look at options for cars under the present system. It thus needs to be looked at alongside my note of 22 January on the abolition of the P11D threshold etc, and the work Mr Monck has in hand on the impact of car taxation changes on the motor industry.

Both pps
in first
section of
folder.



P LEWIS

1000
BUDGET SECRET - TASK FORCE LIST

COPY NO 1 OF 13

From: J ODLING-SMEE

March 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Scholar
Mr Culpin
Mr Peretz
Mr Sedgwick
Mr S Davies
Mr Mowl
Ms Evans

NOTE FOR PRIME MINISTER ON THE MTFS

Mr Culpin sent you a draft minute for the Prime Minister on the tax measures in the Budget. I attach a draft minute on the MTFS.

2. It is written as though you will send it after you make final decisions about the PSBR in 1987-88 and 1988-89 in the middle of next week. That was the time when you sent the equivalent minute last year. However, if you wanted to send it earlier, it would not be difficult to redraft paragraphs 2-3 appropriately.

Obs

J ODLING-SMEE

Draft Minute to:

PRIME MINISTER

1988 BUDGET: MTF5

Following my minute of ⁴3 March, I am writing to let you know what I plan to say about the PSBR and monetary policy in the Budget.

Public sector borrowing

at Budget time last year

2. As you know, the PSBR in 1987-88 is turning out to be much lower than I expected. In the Autumn Statement I reduced my forecast from £4 billion to £1 billion. The ^{figures} [results] since then have ^{continued that trend} been even better than expected; ^{it is now clear that} rather than a borrowing requirement, there will be net repayment of [public] debt in 1987-88 as a whole. In the eleven months to February there was a budget surplus of [...] billion. Even after excluding privatisation proceeds, there was a surplus of [...] billion, compared with a deficit of [...] billion in the same period of 1986-87.

3. The ^{level} [amount] of borrowing in ^{March} [the last month of the year] is hard to predict accurately, but it is always considerable. It is, however, likely still to leave us with a sizeable budget surplus for 1987-88 as a whole. My plan is to publish a budget surplus of about £3 billion, which is on the cautious side.

4. The Medium-Term Financial Strategy this year will cover the period up to 1991-92, and for the years 1989-90 to 1991-92 I plan to show the budget in balance - the PSBR at zero. To set the PSBR at zero in 1988-89, however, would require tax cuts of about £7 billion given the buoyancy of revenues. Tax cuts on this scale would be far too big and would run counter to the gradualist approach that we have to economic policy. The package that we have agreed, involving tax cuts costing some £4 billion in 1988-89, is forecast to leave the budget in surplus by some £3 billion. On current forecasts, I expect to have room for further tax cuts over the MTF5 period as long as we stick to our expenditure plans.

Monetary policy

5. The MTFs will say that our aim is to bring inflation and money GDP growth down over the medium term, and that this requires firm monetary policy supported by prudent fiscal policy. On monetary policy, it will say that interest rate decisions will continue to be made on a comprehensive assessment of monetary conditions. It will say, too, that the government attaches particular importance in this context to maintaining a stable exchange rate, notably the rate against the deutschemark.

6. I also intend to set a target for M0 growth in 1988-89, with illustrative ranges for later years. As last year, I do not intend to set a target for broad money although its behaviour will continue to be taken into account in the assessment of monetary conditions.

7. M0 growth over the last year has remained within the target range of 2-6 per cent set a year ago. The target range for M0 growth in 1988-89 will be 1-5 per cent, the same as the illustrative range for 1988-89 in last year's MTFs. For the future years of the MTFs I shall be publishing the same illustrative ranges as in last year's FSBR.

8. This approach has been discussed with the Bank who are content with it.

9. These proposals give a financial framework for the medium term within which we can make further progress in reducing inflation, and in cutting taxes and public spending as a share of GDP. I would be glad to know if you are content with them.

DRAFT MINUTE TO THE PRIME MINISTER

Now that we have the PSBR figures for the first 11 months of the year - the last figures we shall have before the Budget - I can let you know how I plan to present the Medium Term Financial Strategy.

have no further note on the PSBR and forecast. Re 1988 MTF's I promised in my minute of 4 March.

2. I propose to follow the format established in previous years, in which the MTF's is set out in Chapter 2 of the Financial Statement and Budget Report.

Monetary Policy

3. The MTF's will emphasise that our central objective is to bring inflation down further. This ^{of course} requires firm monetary policy ~~and~~ ^{as} ~~as~~ ^{well as} tight budgetary discipline. I therefore intend to reduce the target range for M0 in 1988-89 to 1-5% as foreshadowed in last year's MTF's. This compares with the 2-6% range in 1987-88, and actual monetary growth of around 5%.

4. For subsequent years I propose to stick to the pattern of declining monetary growth ~~each year~~ shown in last year's MTF's. The 0-4% range for the final year of the MTF's (1991-2) is ^{consistent} ~~of course~~ ~~in line~~ with our objective of achieving stable prices.

I shall make it clear
5. ~~The chapter will say~~ that day-to-day decisions on interest rates will continue to be taken on a comprehensive assessment of monetary conditions, recognising that exchange rates play a central role in both domestic monetary decisions and international policy co-ordination.

Fiscal Policy

2. 6. The PSBR for 1987-88 will ^{clearly} turn out much lower than forecast, even at the time of the Autumn Statement. We have a surplus of £x billion with one month to go. And though borrowing in the last month is always relatively heavy, we are bound to have a sizeable surplus for the year as a whole. I intend to publish a figure of £3 billion, which is ^{if anything} ~~of course~~ on the cautious side.

in the MTFs

3. *in* I propose to seize the opportunity to make a balanced budget the norm. It will fluctuate around this in particular years, but balance should be the central aspiration from now on - and this will be the figure which appears for the years 1989-90 to 1991-92. Zero is equivalent to a PSBR of 1% of GDP ~~if the value of privatisation proceeds is added back.~~ *in the absence of privatisation proceeds.*

4. *in* For next year, 1988-89, a balanced budget would mean £7 billion of tax cuts. I am sure that this ~~is too great both in market terms and in relation to our current uncertainty about the path of private sector savings.~~ *would be too much for* ~~the next year.~~ *1 billion* The £4 billion tax reducing package which we have agreed is ~~right for this year.~~ *1988-89.* It will leave us in surplus by £3 billion (the same as this year) on ~~conservative estimates about the future.~~ *deliberate* So if we succeed in containing pressures on spending, there should be further scope for tax reform and tax reduction in future years.

insert paras 5, 6 & 7 here

8. These proposals give us a sound financial framework for the medium term. I would be glad to know if you are content with them.

~~*I because of the general buoyancy of tax revenues.*~~

It also implies, incidentally, no ~~that does not allow for any reduction in the tax burden - with, taxes are as a share of GDP may be not fractionally.~~

1988 BUDGET: MTFS

In my minute of 4 March, I set out my ~~proposals~~ ^{Budget tax} proposals and said I would let you have a further note on the PSBR and monetary targets for 1988-89.

Public Sector Borrowing

2. The latest estimates of the February PSBR show that there was a Budget surplus of £[] bn in the first 11 months of the year. Borrowing in March is always considerable, but we shall clearly end up with a sizeable Budget surplus for 1987-88 as a whole. The forecast I propose to publish is a surplus of about £3 bn, which ~~is~~ ^{errs} on the cautious side.

3. This means that we have reached - and indeed overshot - our objective of a balanced Budget far earlier than had seemed possible. For 1988-89, I judge that a Budget surplus of about the same size as in 1987-88 is appropriate. This does not allow room for any cut in the total non-oil tax burden - indeed it may rise fractionally. But because of the general buoyancy of tax revenues, it does allow me to implement the £4 bn tax package we have agreed.

4. For the remaining years of the MTFS period, I plan to show the Budget in balance - ie the PSBR at zero. It is a major achievement to be in a position where we can both show a balanced budget and scope for further tax cuts - provided, of course, we stick to our expenditure plans.

5. Monetary Policy

As last year, I intend to set a target for MO growth in 1988-89, with illustrative ranges for later years, but not to set a target for broad money, though its behaviour will continue to be taken into account in assessing monetary conditions.

6. MO growth over the last year has remained within the target range of 2-6% set a year ago. For 1988-89, the illustrative range we set in last year's FSBR was 1-5%, and I propose to confirm that as the target range: it is likely that MO growth will be above this range for the early months of 1988-89, but should thereafter move back within it. For the future years of the MTFS I shall be publishing the same illustrative ranges as in last year's FSBR.

7. MO growth is, of course, only one of the indicators we use in assessing monetary conditions. I shall make it clear that interest rate decisions will continue to be made on a comprehensive assessment of monetary conditions, and that I attach particular importance in this context to maintaining a stable exchange rate.

8. This approach has been discussed with the Bank who are content with it.

9. These proposals give us a solid financial framework for the medium term. I will be glad to know if you are content with them.



Permanent Secretary
H M TREASURY

~~Alex~~

I have ^{intending}
amendments to
PEM drafts.
M.

The Chancellor might
like to see the attached
draft minute to the PM
before PEM circulates it,
for comments.

Simon 7/3

Covering
SECRET

a
Earlier papers with you



Ch

I didn't like the
Odling - Smeed draft
at all. The first
half seemed much
too wooden, the
second much too
provocative.

I attach redraft,
which follows last
year's closely.

AA



Copy No. 13 of 13

FROM: A C S ALLAN
DATE: 8 MARCH 1988

MR ODLING-SMEE

cc PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Peretz
Mr Sedgwick
Mr S Davies
Mr Mowl
Mr C Evans**NOTE FOR THE PRIME MINISTER ON THE MTFS**

The Chancellor was most grateful for your minute of [4] March. He has somewhat redrafted it, and I attach a revised version. I should be grateful for any urgent comments.

A handwritten signature in black ink, appearing to read 'ACSA' with a long horizontal stroke underneath.

A C S ALLAN

SECRET

*Please type for
signature.*

DRAFT MINUTE TO THE PRIME MINISTER

Now that we have the PSBR figures for the first 11 months of the year - the last figures we shall have before the Budget - I can let you have the further note on the 1988 MTFS I promised in my minute of 4 March.

Fiscal Policy

2. The PSBR for 1987-88 will clearly turn out much lower than forecast, even at the time of the Autumn Statement. We have a surplus of ^{over £7} ~~£3~~ billion with one month to go. And though borrowing in the last month is always relatively heavy, we are bound to have a sizeable surplus for the year as a whole. I intend to publish a figure of £3 billion, which is ~~if anything~~ on the cautious side.

3. I propose to seize the opportunity to make a balanced Budget the norm. It will fluctuate around this in particular years, but balance should be the central aspiration from now on - and this will be the figure which appears in the MTFS for the years 1989-90 to 1991-92. Zero is equivalent to a PSBR of 1% of GDP in the absence of privatisation proceeds.

4. For next year, 1988-89, a balanced Budget would mean £7 billion of tax cuts. I am sure this would be too much for one

ar. The £4 billion tax reducing package which we have agreed is, I believe, right for 1988-89. It will leave us in surplus by £3 billion (the same as this year) on deliberately conservative estimates about the future. It also implies, incidentally, no reduction in the tax burden ^{(as measured by} ~~indeed,~~ taxes etc as a share of GDP) ~~may even rise fractionally.~~ If we succeed in containing pressures on spending, there should be further scope for tax reform and tax reduction in future years.

Monetary policy

5. The MTFS will emphasise that our central objective is to bring inflation down further. This of course requires firm monetary policy as well as tight budgetary discipline. I therefore intend to reduce the target range for MO in 1988-89 to 1-5% as foreshadowed in last year's MTFS. This compares with the 2-6% range in 1987-88, and current growth of around 5%.

6. For subsequent years I propose to stick to the pattern of declining monetary growth shown in last year's MTFS. The 0-4% range for the final year of the MTFS (1991-92) is consistent with our objective of ^{moving towards} ~~achieving~~ stable prices.

JOS
Terry
Terry
7. ^{The MTFS will make} ~~I should make~~ it clear that day to day decisions on interest rates will continue to be taken on a comprehensive assessment of monetary conditions, recognising that exchange rates play a central role in both domestic monetary decisions and international policy co-ordination.



FROM: J M G TAYLOR

DATE: 9 March 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Byatt
Mr Culpin
Miss Sinclair
Mr C J Riley
Mr Cropper
Mr Tyrie

Mr Battishill - IR
Mr Isaac - IR
Mr Kuczys - IR
PS/IR

STARTER 152: PENSIONS, ACCELERATED ACCRUAL

The Chancellor has seen Mr Kuczys' minute of 7 March, and the Financial Secretary's response of 8 March.

2. The Chancellor has commented that he attaches great importance to Ministers being able to consider the response against the options to be set out in Mr Byatt's report. But this raises the problem that the options to be set out in the consultative document will not encompass all the possibilities - including possibilities that Ministers may in the end plump for. In the circumstances, the Financial Secretary may care to consider waiting until we have received Mr Byatt's paper and had a meeting on that before we say anything. Finally, if we do publish a document, he trusts that it is clear that there can be no question of going back to the status quo ante.

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

J M G TAYLOR

BUDGET SECRET - TASK FORCE LIST

COPY NO 1 OF 13

From: J ODLING-SMEE

9th March 1988

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
 Sir Peter Middleton
 Sir Terence Burns
 Mr Scholar
 Mr Culpin
 Mr Peretz
 Mr Sedgwick
 Mr S Davies
 Mr Mowl
 Ms Evans

OK
OK to draft as amended?
OK - *AA*

NOTE FOR THE PRIME MINISTER ON THE MTFS

Thank you for your draft of 8th March. My only comment is that the final sentence of paragraph 6 may suggest that we are expecting to achieve stable prices in 1991-92. As this is not the case, it would be better to end the sentence:

".... consistent with our objective of moving towards stable prices."

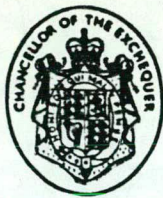
2. So that we do not overlook them, perhaps I should mention the various things which need to be checked before the note goes to the Prime Minister and after decisions are made about the PSBR this year and next:

- Paragraph 2
 The surplus for April-February 1987-88
 The PSBR for 1987-88
- Paragraph 4
 The size of tax cuts implied by a balanced budget
 The PSBR for 1988-89
 Whether the tax burden rises or not.

JOS

J ODLING-SMEE

SECRET



my

cc: PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Peretz
Mr Sedgwick
Mr Odling-Smee
Mr S Davies
Mr Mowl
Ms Evans

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

PRIME MINISTER

Now that we have the PSBR figures for the first 11 months of the year - the last figures we shall have before the Budget - I can let you have the further note on the 1988 MTFS I promised in my minute of 4 March.

Fiscal Policy

The PSBR for 1987-88 will clearly turn out much lower than forecast, even at the time of the Autumn Statement. We have a surplus of over £7 billion with one month to go. And though borrowing in the last month is always relatively heavy, we are bound to have a sizeable surplus for the year as a whole. I intend to publish a figure of £3 billion, which is on the cautious side.

I propose to seize the opportunity to make a balanced Budget the norm. It will fluctuate around this in particular years, but balance should be the central aspiration from now on - and this will be the figure which appears in the MTFS for the years 1989-90 to 1991-92. Zero is equivalent to a PSBR of 1% of GDP in the absence of privatisation proceeds.

For next year, 1988-89, a balanced Budget would mean £7 billion of tax cuts. I am sure this would be too much for one year. The £4 billion tax reducing package which we have agreed is, I believe, right for 1988-89. It will leave us in surplus by £3 billion (the same as this year) on deliberately conservative estimates about the future. It also implies, incidentally, no reduction in the tax burden (as measured by taxes etc as a share of GDP). If we succeed in containing pressures on spending, there should be further scope for tax reform and tax reduction in future years.



Monetary policy

The MTFS will emphasise that our central objective is to bring inflation down further. This of course requires firm monetary policy as well as tight budgetary discipline. I therefore intend to reduce the target range for M0 in 1988-89 to 1-5% as foreshadowed in last year's MTFS. This compares with the 2-6% range in 1987-88, and current growth of around 5%.

For subsequent years I propose to stick to the pattern of declining monetary growth shown in last year's MTFS. The 0-4% range for the final year of the MTFS (1991-92) is consistent with our objective of moving towards stable prices.

The MTFS will make it clear that day to day decisions on interest rates will continue to be taken on a comprehensive assessment of monetary conditions, recognising that exchange rates play a central role in both domestic monetary decisions and international policy co-ordination.

N.L.

N.L.

10 March 1988