PO/CH/NL/746
Part A

PO/CH/NL/746
Part A

BUDGET DEPUTATION
TOBACCO ADVISORY
COUNCIL

25-10-89

F. S. LAW C.B.E.

9-10 GRAND UNION INDUSTRIAL ESTATE
ABBEY ROAD PARK ROYAL
LONDON NW10 7UL
01-965 7991
TELEX 8951658

The Rt. Hon. Nigel Lawson, M.P.
The Chancellor of the Exchequer
11, Downing Street
London, S.W.1

Ch/ Draft reply for you to send? Luke 20/7.

yes pls; write via FST.

18th July 1989

Dear Chancellor,

About a year ago, when you joined me for lunch together with Sir Peter Thompson, we discussed, even then, not only the EMS but particularly how we, in the NFC, could make sure that our employee-shareholders would not sell the bulk of their shares.

We had come to the conclusion that if shareholders, and particularly the new shareholding population, could be given an incentive to hold on to their shares, they would probably do so.

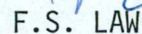
The incentive that we thought of was a reduction in the rate of Capital Gains Tax if shares were held over a period of 5 years or more.

I am writing to you again to-day with a suggestion that perhaps you might be able to give this some consideration, when preparing your next Budget proposals.

In any event, both Peter and I hope that we will be able to persuade you to lunch with us after the recess.

With best regards,

Yours sincerely,



F.S. LAW

chex.dc/j/24 **UNCLASSIFIED**

BF 26/7

FROM: MRS JULIE THORPE
DATE: 21 July 1989

BF 4/8

MR CULPIN

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

PS/IR

LETTER FROM F S LAW

... The Chancellor has received the attached letter from Mr F S Law of NFC International Holdings Ltd, about capital gains tax and the next Budget.

2. I would be grateful if you could draft a reply for the Chancellor to send, to reach this office before Friday 28 July.

Julie Thorpe.

MRS JULIE THORPE

UNCLASSIFIED

F. S. LAW C.B.E.

9-10 GRAND UNION INDUSTRIAL ESTATE
ABBEY ROAD PARK ROYAL
LONDON NW10 7UL
01-965 7991
TELEX 8951658

The Rt. Hon. Nigel Lawson, M.P.
The Chancellor of the Exchequer
11, Downing Street
London, S.W.1

18th July 1989

Dear Chancellor,

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I am writing to you again to-day with a suggestion that perhaps you might be able to give this some consideration, when preparing your next Budget proposals.

In any event, both Peter and I hope that we will be able to persuade you to lunch with us after the recess.

With best regards,

Yours sincerely,

F.S. LAW

fp.ac.rc/21

FROM: ROBERT CULPIN FP
DATE: 28 July 1989

EXTN: 4419

Julie

Do you have this letter?

CHANCELLOR

LETTER FROM F S LAW

Draft attached. You might, or might not, want to add something about his invitation to lunch.

ROBERT CULPIN

fp.ac/mac/45/F LAW

1. Jonathan - any comments?
2 Pat pl type for Chex signature.

Julie.

DRAFT LETTER TO:

F S Law CBE Esq
9-10 Grand Union Industrial Estate
Abbey Road
Park Royal
LONDON
NW10 7UL

July 1989

Many thanks for your letter of 18 July.

I am grateful to you for writing, but I am afraid I am not attracted by the idea of a lower rate of CGT on shares held over 5 years. We had a distinction between short and long-term capital gains in the 1960s. It was not a success, and Tony Barber abolished it in 1971. The Americans abolished a similar distinction in 1986. I well remember the distortion of investment decisions which this sort of discrimination used to cause, and the complexities it involved for investors and the Revenue alike. I have to say that I should need a lot of persuading before I should want to return to such a system.

NIGEL LAWSON

chex.dc/j/31

N Lawson

PP with Budget pps?

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

7 August 1989

F S Law CBE Esq
9-10 Grand Union Industrial Estate
Abbey Road
Park Royal
LONDON
NW10 7UL

Dear Mr Law

Many thanks for your letter of 18 July.

I am grateful to you for writing, but I am afraid I am not attracted by the idea of a lower rate of CGT on shares held over 5 years. We had a distinction between short and long-term capital gains in the 1960s. It was not a success, and Tony Barber abolished it in 1971. The Americans abolished a similar distinction in 1986. I well remember the distortion of investment decisions which this sort of discrimination used to cause, and the complexities it involved for investors and the Revenue alike. I have to say that I should need a lot of persuading before I should want to return to such a system.

All good wishes.

Yours

Nigel

NIGEL LAWSON

RESTRICTED.

fp.nh/ks/50

FROM: K SEDGWICK (FP)
DATE: 11 September 1989
x 5169

The arrangements outlined herein seemed to work well last year, and I endorse the proposal that they be used again in the forthcoming Budget cycle. [initials] 12/9

1. MR MICHIE [initials] 12/9
2. MR GILHOOLY
3. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir T Burns
Mr Scholar
Mr Monck
Mr Culpin
Mr O'Donnell
Mr Matthews
Miss Hay
Mr Macpherson
Mr Francis
Miss Wallis - MCU
Mrs Chaplin
Mr Tyrie
Mr Lightfoot
PS/IR
Mr D Shaw - IR
PS/C&E
Mr Parker - C&E
Mr Warr - C&E

OK: [initials]

Ch

Looks fine. We shall need to keep an eye out for those bodies who are particularly sensitive about who they see - eg. SWA, BMA & ASH - but that aside, content?

(Judith C thinks we may also want - as this year - to see the CBI separately on a "non budget" rep). [initials] 12/9

I agree

BUDGET DEPUTATIONS AND REPRESENTATIONS

This submission seeks your agreement to guidelines for the handling of deputations and representations for the coming Budget.

Budget Deputations

2. In past years the practice has been for deputations to be received automatically from bodies on a 'core list', and for other organisations to be seen only if a meeting is considered particularly worthwhile, or if the deputation is led by an MP.

3. Annex A shows the 'core list' and Annex B all the bodies who were seen by Ministers last year. You met representatives from the Institute of Directors, the Association of British Chambers of Commerce and the Backbenchers Smaller Businesses Committee, and received the CBI and TUC's Budget representations at the January NEDC. The remaining 'core list' bodies and non-'core list' bodies were seen by either the Financial Secretary or the Economic Secretary, and in one instance, the Scotch Whisky Association, by the Economic Secretary and the Paymaster General.

4. These arrangements seemed to work well and we propose to follow them again for the coming Budget, although, of course, the Paymaster General will see those bodies seen by the Economic Secretary last year. We propose also to leave the core list unchanged and to judge each request from non 'core list' bodies strictly on its merits, with the presumption that if a meting were granted, it would be with the Financial Secretary or the Paymaster General.

5. As in previous years the aim would be to see all deputations in time to allow a clear month before the Budget.

6. I attach at Annex C the standard format for briefing for meetings with Budget deputations. If you agree, this format will continue. We will make every effort to keep briefing as short as possible, seeking guidance from Private Secretaries on any supplementary briefing which may be needed.

Budget Representations

7. As in previous years, we propose that members of the public should receive an acknowledgement sent by FP. In response to letters requiring a Ministerial reply (e.g. from MPs), FP will provide a standard reply to be sent by the appropriate Minister. I attach at Annex D suggested all-purpose replies for Ministers, Private Secretaries and officials which follow those issued last year. There will, of course, always be some representations which need a non-standard response and those we will continue to provide as appropriate. But we hope that the vast majority can receive a standard reply.

8. We shall continue to report to Treasury Ministers, in the form of a short monthly summary, the subjects being raised in correspondence from members of the public either directly or through their MPs, and by the smaller organisations. Also, in conjunction with the Revenue departments, we will provide more detailed analysis of the main points made in representation from the more important organisations. The first summary will be put forward at the beginning of December.

Ministerial Representations

9. Representations from Departmental Ministers are often received too late to be given timely consideration. We suggest this year that those Ministers intending to make Budget representations are asked to do so by the 8 December. We will be putting a note forward to your Private Secretary shortly. We would be grateful, in the meantime, to know if you are content that we use the standard response, as used last year, when replying to ministerial representations (Annex D-3).

Conclusion

10. We would be grateful to know if you are content:

(a) to see the Institute of Directors, your Backbenchers Committees and the CBI and TUC at the January NEDC, and (depending on the content of their representation) the Association of British Chambers of Commerce,

(b) that all other 'core list' bodies and non 'core list' bodies will be seen by either the Financial Secretary or Paymaster General;

(c) that briefing for such meetings should be in the standard format as at Annex C;

(d) that written Budget representations should receive one of the standard acknowledgements set out in Annex D, unless it is clearly inappropriate, in which case an individual response will be drafted.

K SEDGWICK
Fiscal Policy Division

ANNEX A

CORE LIST OF REPRESENTATIVE BODIES

Confederation of British Industry
Trades Union Congress
Association of British Chambers of Commerce
Institute of Directors
Country Landowners Association
Scotch Whisky Association
Tobacco Advisory Council
Brewers Society

ANNEX B

REPRESENTATIVE BODIES SEEN BY MINISTERS IN THE RUN-UP TO THE 1989 BUDGET

BODY	MINISTER	DATE OF MEETING
Action on Smoking and Health	EST	3 February 1989
Association of British Chamber of Commerce	CHX	6 February 1989
Automobile Association (AA)	EST	7 December 1988
Brewers Society	EST	7 February 1989
British Medical Association (BMA)	EST	9 February 1989
Charities VAT and Tax Reform Group	EST	1 February 1989
Confederation of British Industry (CBI)	CHX (NEDC)	11 January 1989
Country Landowners Association	FST	8 November 1988
Gin Rectifiers and Distillers Association	EST (Lunch)	20 October 1988
Institute of Directors (IOD)	CHX	30 January 1989
Institute of Taxation	PMG (Lunch)	10 January 1989
Scotch Whisky Association	EST & PMG	6 December 1988
Society of Motor Manufacturers and Traders (SMMT)	FST	19 September 1988
Society of Conservative Accountants	FST	1 December 1988
Smaller Businesses Committee	CHX	23 January 1989
Timber Growers United Kingdom	FST	25 January 1989
Tobacco Advisory Council (TAC)	EST	6 December 1988
Trade Union Congress (TUC)	CHX (NEDC)	11 January 1989
Wider Share Ownership Council	FST	10 January 1989
The Wine and Spirit Association of Great Britain and Northern Ireland	EST	26 January 1989

ANNEX C

BUDGET DEPUTATIONS: STANDARD BRIEFING FORMAT

1. Organisation. Brief biographical details of representatives attending meeting.

2. Object of meeting (either major body seen as a matter of course or being seen for some specific reason).

3. Proposal(s) made by Organisation.

4. Background or comments where necessary.

5. Line to take.

Items 3, 4 and 5 should be repeated as necessary where a number of proposals are put forward.

ANNEX D

BUDGET REPRESENTATIONS: STANDARD ACKNOWLEDGEMENT

1. MINISTERIAL

a. Thank you for your letter of [date] enclosing correspondence from [name and address].

I can assure you that [name] representations [about subject]* will be carefully considered in the run-up to the Budget. However, I hope you will understand that it would be inappropriate for me to comment further at this stage.

[Minister's name]

---

b. Thank you for your letter of [date] enclosing correspondence for the Budget from the [name of organisation].

I can assure you that your representations [about subject]* will be carefully considered in the run-up to the Budget. However, I hope you will understand that it would be inappropriate for me to comment further at this stage.

[Minister's name]

---

2. PRIVATE SECRETARY AND OFFICIAL

The [Minister] has asked me to thank you for your letter [date].

I can assure you that your comments will be carefully considered in the run-up to the Budget. However, I hope you will understand that it would be inappropriate for me to comment further at this stage.

Thank you for taking the trouble to write.

[Name]

* optional feature

3. **CHANCELLOR'S REPLY TO MINISTERS**

Thank you for your letter of [ ], containing your suggestions for my 1990 Budget.

I have noted the points you made and I will bear them carefully in mind in the run-up to the Budget.

You will not expect me to comment further at this stage, but I do find it extremely helpful to have the comments and sugestions of my colleagues at an early stage.

[N L]

FROM: J M G TAYLOR
DATE: 13 SEPTEMBER 1989

MR K SEDGWICK - FP

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir Peter Middleton
Sir T Burns
Mr Scholar
Mr Monck
Mr Culpin
Mr O'Donnell
Mr Gilhooly
Mr Michie
Mr Matthews
Miss Hay
Mr Macpherson
Mr Francis
Miss Wallis - MCU
Mrs Chaplin
Mr Lightfoot

PS/IR
Mr D Shaw - IR

PS/C&E
Mr Parker - C&E
Mr Warr - C&E

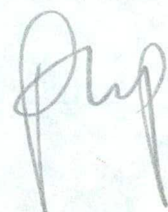
BUDGET DEPUTATIONS AND REPRESENTATIONS

The Chancellor was grateful for your note of 11 September. He is content with the proposed guidelines for the handling of deputations and representations for the coming Budget.

2. He has commented that we may - as this year - see the CBI separately on a <u>non</u> Budget representation.

J M G TAYLOR

fp.nh/rm/102



FROM: R G MICHIE (FP)
DATE: 20 SEPTEMBER 1989
x 4922

1. MR GILHOOLY
2. PAYMASTER GENERAL

cc PS/Chancellor
PS/Financial Secretary
PS/Economic Secretary
Mr Culpin
PS/Customs
Mr Wilmott)
Mr Gaw) Customs
Mr Cleaver)
Mr P Collins)

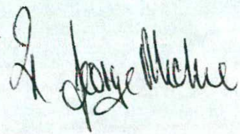
BUDGET DEPUTATION: TOBACCO ADVISORY COUNCIL

1. The Tobacco Advisory Council's (TAC) letter of 29 August asks for a meeting with the Chancellor to discuss their Budget representations and other matters concerning the Tobacco industry.

2. The Chancellor has already indicated that he would like you to meet Budget deputations from the drinks and tobacco lobbies.

3. The TAC are on the 'core list' of organisations to be seen by Ministers and we anticipate that you will wish to agree to a meeting.

4. I attach a reply.



R G MICHIE

fp.nh/rm/103

Treasury Chambers, Parliament Street, SW1P 3AG

W C Owen Esq
Chief Executive
Tobacco Advisory Council
Glen House
Stag Place
LONDON SW1E 5AG

September 1989

The Chancellor of the Exchequer has asked me to thank you for your letter of 29 August on behalf of the Tobacco Advisory Council, and to meet a delegation of your representatives. I am delighted to do so.

My preference is for the meeting to take place here in the Treasury, and I am content, as you suggest, to leave it to our secretaries to arrange a mutually convenient date. (My diary secretary, Diane Gable can be contacted on 270-5118).

I await your submission on tobacco taxation (together with a note of the other subjects which you would like to discuss) with interest, and look forward to meeting you shortly.

EARL OF CAITHNESS

TOBACCO
Advisory Council

Glen House, Stag Place, London SW1E 5AG. Telephone: 01-828 2041/2803. Telex: 8953754 TOBCOM. Facsimile: 630 9638.

From W. C. Owen
Chief Executive

29 August 1989

PAYMASTER GENERAL
REC. -7 SEP 1989
MR CLEAVER C&E
FOR ADVICE MR JEFFERSON-SMITH
MR WILMOTT
MR GAW
PMG

The Rt. Hon. Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

Dear Chancellor,

I intend to send to you shortly the tobacco industry's submission on tobacco taxation covering the issues we believe to be relevant for your consideration prior to your Budget next Spring.

We appreciate the pressures on your time prior to the Budget and would greatly value an early opportunity to meet you informally to discuss the current state of our industry and the problems we face.

The topics I have in mind not only include the impact of your Budget on the UK industry, but also the implications of a number of European Commission Directives.

I should be delighted if you would be prepared to meet us in say, late October, in which case we could leave it to our secretaries to provide a mutually convenient time and place.

Yours sincerely,

Bill Owen.

MINISTER IMMEDIATE

The Scotch Whisky Association

Limited Liability Registered in Scotland No. 35148

TEL: 031-229 4383 TELEX: 72762

20 ATHOLL CRESCENT · EDINBURGH EH3 8HF

REGISTERED OFFICE

FROM

THE DIRECTOR GENERAL

CH/EXCHEQUER
REC. 15SEP1989
ACTION Mr. K. Sedgwick
COPIES PMG, EST, Mr Scholar, Mr Culpin, Mr Michie, PS/C+E

HM TREASURY 15 SEP 1989

HFOB/ST/RCE 14th September 1989

The Rt Hon Nigel Lawson PC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Dear Chancellor,

You have been good enough in recent years to see a small delegation from my Council prior to your Spring Budget. That you personally were unable to do so last year was a considerable disappointment to us and we very much hope that you will feel able to spare the time to see us this year.

We of course realise that you have many demanding commitments to deal with but if you can see us, we wondered whether any of the following dates would be convenient from your point of view - 1st, 7th, 8th, 12th or 13th December? If none of these should be suitable, we shall certainly endeavour to fit in with whatever date would be most convenient to you.

Our delegation is likely to be the same as that which saw Peter Lilley and Peter Brooke last year, namely David Connell, our Chairman; Sandy Gordon, our Vice-Chairman; Ivan Straker, the Chairman of our Public Affairs Committee; Donald MacKay, our Economic Consultant; and myself.

We do very much hope you will feel able to see us yourself this year and I shall in any case be sending you a Report nearer the time on the various taxation matters concerning Scotch Whisky which we would hope to discuss with you.

With kind regards meantime,

Yours sincerely

Bill Bewsher

H F O Bewsher

A711

CH/EXCHEQUER
REC. 15 SEP 1989
ACTION Mr K. Sedgwick
COPIES PMG, EST,
Mr Scholar
Mr Culpin
Mr Michie
PS/C+E

The Scotch Whisky Association

Limited Liability
Registered in Scotland No 35146
TEL: 031-229 4383
TELEX: 727628

20 ATHOLL CRESCENT · EDINBURGH EH3 8HF
REGISTERED OFFICE

FROM
THE DIRECTOR GENERAL

HFOB/ST/RCE

14th September 1989

15 SEP 1989

The Rt Hon Nigel Lawson PC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

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With kind regards meantime,

Yours sincerely

Bill Bewsher

H F O Bewsher

fp.nh/ao'd/19

UNCLASSIFIED

FROM: R G MICHIE (FP)
DATE: 19 SEPTEMBER 1989
x 4922

1. MR GILHOOLY
2. MCU
3. CHANCELLOR

I agree 19/9

cc PS/Paymaster General
PS/Economic Secretary
Mr Culpin, FP
Mr A B O'Donnell, FP
PS/C&E
Mr P Collins - C&E
PS/IR
Mr D Shaw - IR

BUDGET DEPUTATION: SCOTCH WHISKY ASSOCIATION (SWA)

1. The Scotch Whisky Association's (SWA) letter of 14 September asks for a meeting to discuss their Budget representations.

2. You have already indicated that you would like the Paymaster General to meet Budget deputations from the drinks and tobacco lobbies, and his office advise that he is free on Tuesday 12 December. A meeting has been "pencilled" in for 10.30, subject to the Paymaster's agreement. We will co-ordinate the necessary briefing when the detailed representations are received.

3. No doubt the Association will be disappointed at not meeting you personally and may, as last year, follow up their initial request with a further plea via an MP. But having been asked to meet with your Ministerial colleagues last year, it should not come as a surprise if you decline to meet them in person this year also.

4. A reply is attached.

R. George Michie

R G MICHIE

fp.nh/rm/100

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

H F O Bewsher Esq
Director General
The Scotch Whisky Association
20 Atholl Crescent
Edinburgh
EH3 8HF

21 September 1989

Dear Mr Bewsher

Thank you for your letter of 14 September suggesting a meeting with a small delegation from your Council.

Although I was unable to meet your representatives in person last year, I was given a full report of the points raised at your meeting with Peter Lilley and Peter Brooke, and I do assure you that your representations were considered most carefully in the run up to my Budget.

This year, I have asked the Earl of Caithness, the new Paymaster General, who has delegated responsibility for Customs and Excise taxes, if he would meet your delegation and report to me afterwards. His office has "pencilled in" a meeting for Tuesday 12 December at 10.30 am. Perhaps you could ask your office to confirm that this is satisfactory.

I understand your Council may be disappointed that I will not be attending the meeting myself, but I will, as ever, be taking careful note of the Association's representations, and will be given a full report of the points raised at the meeting.

Yours ever
Nigel

NIGEL LAWSON

The Scotch Whisky Association

Limited Liability — Registered in Scotland No. 35148

TEL: 031-229 4383 — TELEX: 727626

20 ATHOLL CRESCENT · EDINBURGH EH3 8HF

REGISTERED OFFICE

FROM
THE DIRECTOR GENERAL

HFOB/ST/RCE

29th September 1989

The Rt Hon Nigel Lawson PC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

PAYMASTER GENERAL
REC. 2 OCT 1989
ACTION Mr Mickie
CX CST FST EST
Mr Culpin
Mr Gilhooly
Mr A O'Donnell -FP 4SA/1
Miss Wallis
PS/C+E Mr P Collins - C+E
PS/IR
Mr D Shaw - IR

Thank you very much for your letter of 21st September.

Although naturally disappointed not to have the opportunity again this year to put our representations to you personally, we would certainly wish to take advantage of your kind offer to meet the Earl of Caithness. In that regard, I have already telephoned his Private Secretary to confirm the appointment pencilled in for 10.30 am on Tuesday 12th December.

There are, as you know, certain taxation issues - notably excise duty and the Corporation Tax treatment of maturing stocks - which remain of great concern to the Industry, notwithstanding the very considerable help you have given in regard to the former in recent Budgets. We shall be raising both these aspects with the Paymaster General and are grateful for your assurance that you will take "careful note" of our representations.

With kind regards,

Yours sincerely

H F O Bewsher

cc The Rt Hon The Earl of Caithness ARICS
Paymaster General

x5169

PPS/Ch.

The Scotch Whisky Association

Limited Liability — Registered in Scotland No. 35148

TEL: 031-229 4383 — TELEX: 727626

20 ATHOLL CRESCENT · EDINBURGH EH3 8HF
REGISTERED OFFICE

Tony pp on Budget files?

FROM
THE DIRECTOR GENERAL

HFOB/ST/RCE

29th September 1989

The Rt Hon Nigel Lawson PC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

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With kind regards,

Yours sincerely

Bill Bewsher

H F O Bewsher

cc The Rt Hon The Earl of Caithness ARICS
Paymaster General

The Scotch Whisky Association

Limited Liability   Registered in Scotland No. 35148

TEL: 031-229 4383   TELEX: 727626

20 ATHOLL CRESCENT · EDINBURGH EH3 8HF
REGISTERED OFFICE

FROM
THE DIRECTOR GENERAL

HFOB/ST/RCE   29th September 1989

The Rt Hon Nigel Lawson PC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

PAYMASTER GENERAL
REC. 2 OCT 1989
ACTION Mr Michie
Cx CST FST EST
Mr Culpin
Mr Gilhooly
Mr A O'Donnell - FP
Miss Wallis
PS/C+E Mr P Collins - C+E
PS/IR
Mr D Shaw - IR

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With kind regards,

Yours sincerely

H F O Bewsher

cc The Rt Hon The Earl of Caithness ARICS
   Paymaster General

fp.nh/ks/85

FROM: K SEDGWICK (FP)
DATE: 2 OCTOBER 1989
x 5169

1. MR MICHIE
2. MR GILHOOLY
3. MCU
4. FINANCIAL SECRETARY

cc PS/Chancellor
PS/Paymaster General
Miss Hay
Mr Francis - ST
Mr Shaw - IR
Mr Parker - C&E

BUDGET DEPUTATION: COUNTRY LANDOWNERS ASSOCIATION

The Country Landowners Association's (CLA) letter of 28 September encloses their 1990 Budget representations and asks for a meeting to discuss them.

2. The CLA are on the "core list" of organisations to be seen by Ministers and we presume that you will want to meet them this year. Last year the CLA were met on 8 November. We shall of course arrange briefing once the meeting has been arranged.

3. I attach a reply.

K SEDGWICK
Fiscal Policy Division

fp.nh/ks/86

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October 1989

The Chancellor of the Exchequer has asked me to thank you for your letter of 28 September on behalf of the Country Landowners Association, and to meet a small delegation from your Association. I am delighted to do so.

Perhaps you could ask your office to contact my diary secretary, Sarah Cowx on 270 5103 to arrange a date. It would also be useful to know in advance which of your detailed representations you would like to discuss.

I look forward to meeting you.

PETER LILLEY

COUNTRY LANDOWNERS ASSOCIATION

BP

29 SEP 1989

The Rt. Hon. Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
LONDON SW1P 3AG

FP
PREV CORRES
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28th September 1989

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Dear Chancellor

BUDGET 1990

The Country Landowners Association has consistently supported your policy of reducing taxes. Without loss of revenue to the Exchequer lower taxes have created a thriving, entrepreneurial economy very different to that which existed under the penal tax regime of the late 1970s.

I hope you will not mind, however, if I say that whereas the Government's approach to income and corporate taxes has been admirably clear, both Capital Gains Tax and Inheritance Tax remain structurally complex, yield relatively little and are costly to administer. Although the burden on business property is alleviated by a host of special reliefs, these reliefs are themselves complicated and expensive to the taxpayer in professional fees. We favour a substantial reduction in the rates of both taxes - perhaps over a period of time (as you previously, and very successfully, achieved with Corporation Tax). Meanwhile a great measure of simplification could be achieved by exempting business property (with appropriate anti-avoidance safeguards) from these Capital Taxes instead of imposing a tax charge and then relieving it. The greater freedom for productive capital that would result and the income thereby produced should more than compensate the Exchequer for any initial loss of revenue.

If you decide it is not possible to be so radical in 1990, we hope you will widen the scope of the Capital Tax reliefs available to include all business assets. We are particularly concerned that business activities such as modern-day landownership and integrated estate forestry are excluded from some or all of the reliefs even though for VAT purposes no such distinctions are made. To allow all business assets to qualify for these reliefs would result in simplification as well as consistency amongst the different taxes.

/..................

16 Belgrave Square, London SW1X 8PQ Tel. 01 235 0511

President: G.E. Lee-Steere Deputy President: R.N. Swarbrick Director General: James Douglas CBE

On a specific point, the development of share farming which allows many young people to start up in business is being particularly hampered by the special Herd Basis rules which were drawn up long ago. We have been discussing the problems with the Inland Revenue and I hope you will be able to act, where necessary, to remove the present difficulties.

We would welcome the opportunity of discussing our ideas with you in greater detail and also any of our enclosed technical representations . We do value the exchange of views which has taken place in the past. There is, I believe, still some unfinished business from last year, in particular relating to Trusts.

Yours sincerely

[signature]

President.

THE COUNTRY LANDOWNERS' ASSOCIATION

1990 BUDGET

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THE COUNTRY LANDOWNERS' ASSOCIATION

1990 BUDGET

TECHNICAL REPRESENTATIONS

CAPITAL ALLOWANCES

1. Balancing events for Agricultural Buildings

Allowances for Agricultural Buildings are now given at a rate of 4% over a period of 25 years. Optional balancing charges or allowances are available when a balancing event occurs. Balancing events are presently limited to the sale or destruction of the agricultural building.

At a time of great structural changes in agriculture many agricultural buildings may cease to have any economic value before the 25 year period is up. It may also not be commercially practicable to sell such buildings and the dictates of preservation can often prevent demolition.

It is therefore recommended that balancing events should include cases where the District Valuer agrees on a claim that the agricultural building has become of negligible value.

2. Capital Allowances for Pollution Prevention Expenditure

At the present time, landowners are under increasing pressure to spend substantial sums on measures to preserve and protect the environment. Thge present grant aid scheme does not provide assistance for the erection of buildings or structures even though the toxic effluence in rainwater run-off can be substantially reduced by covering silage, walkways and "dirty concrete". Under the tax rules such expenditure may qualify for ABAs, but only at a write-off of 4% p.a. The CLA recommends that where buildings and structures are erected for the purposes of reducing pollution (perhaps limited to cases where an appropriate certificate is issued) the expenditure incurred should qualify for an enhanced capital allowance of at least 25% p.a. (A precedent for introducing a higher allowance on the grounds of national concern was that introduced for Fire Protection Expenditure).

INCOME TAX

3. Relief for Loan Interest

In most cases the letting of land and buildings on an agricultural estate is in reality a business enterprise. Nevertheless, unlike farmers, agricultural landlords are not entitled to relief for money borrowed to defray the cost of repairs which can often be substantial. Indeed expenditure on maintenance usually exceeds that on capital improvements for which relief is provided for borrowing costs. We recommend that the interest on loans taken out to meet repair costs on agricultural estates should be allowed against taxable income of the same estate.

4. Allowance for Repairs to Listed Buildings

The owners of the 413,000 listed buildings in Great Britain bear heavy costs in preserving the heritage for the benefit of the country as a whole. They are willing to do this, but too often resources which they should be encouraged to devote to this purpose are absorbed by taxes instead. This subject is expanded in detail in the discussion paper "Listed Houses - Incentives for Conservation", published by the Historic Houses Association. Many CLA members suffer from the problems highlighted in that paper, and would welcome tax reliefs of the type canvassed there.

5. PAYE and NIGC for Casual Employees

Government imposes upon employers the heavy burden of administering the PAYE and NIGC regulations. Before giving anyone a job, the employer has to consider not only whether he can afford to pay the agreed wage, but whether he can also afford the time and cost of administering the PAYE regulations, and undertake the risk of being penalised for operating them wrongly (a point rightly emphasised in the introduction to the Employers Guide to PAYE).

The extreme complexity of the procedures now make this burden a very onerous one, especially for members with livelihoods from fruit farms, hop farms and other labour intensive enterprises heavily dependent on seasonal workers. Furthermore, because the procedures lack coherence the workers themselves perceive them to be unfair and to maintain a constant supply of labour many farmers are being forced to pay the deductions out of their own profits. In some cases applying the rules has added as much as 20% to the employer's labour costs, and this figure can only increase with the introduction of interest on unpaid PAYE in 1992.

The result of the present regulations is unsatisfactory both for the Revenue and employers. Faced with procedures which are unclear, unfair and difficult to operate, some employers have enevitably failed to apply them correctly. The remainder, however, suffer a competitive disadvantage compared with their counterparts in Belgium, Germany and Luxembourg (where a flat-rate system is operated) and France (where there is no deduction by the employer).

The time has come for the abolition of the present procedures and their replacement by a single flat-rate deduction system.

6. PAYE Threshold

The £1 per week limit for the P46 procedure is now totally unrealistic and continues to place upon employers a costly and time wasting paper exercise. The procedure needs to be considered afresh and it is suggested that for low paid employees and casuals a revised P46 procedure be implemented. A system similar to the S.C.60 tax voucher currently in operation in the building industry whereby if the payment is less than the single person's allowance currently £53 per week no tax would be deducted when a valid National Insurance Number has been provided by the employee. If a National Insurance number is not produced tax will be deducted at the basic rate. Upon cessation of the employment copies of the voucher would be completed and forwarded to the PAYE office. The National Insurance number now enables the Revenue Authorities to locate the tax payer via the computerised tracing procedure now in operation.

This would produce savings to employers and the Inland Revenue.

7. Dwellings occupied by Farming Company Directors

For some employees, the provision of a dwelling may properly be regarded as a form of remuneration, properly subject to income tax. For others, however, living in a particular dwelling is one of the duties of the employment. The position of such "representative occupiers" is normally recognised and safeguarded by the tax system. Company directors are, however, treated less favourably than other employees.

In agriculture it is essential that many employees should live in accommodation specified, and provided by the employer. This ensures that they are quickly available during emergencies or bad weather. Such considerations apply to senior and managerial staff, as well as junior employees. Where the farming is carried on through a company, some of the employees who, under normal criteria, would qualify as "representative occupiers" will be directors. Farming is generally a family business, and therefore, as well as being directors the senior employees will have significant shareholdings. This means that, even if they satisfy the rules for representative occupation, because it is necessary to live in a particular house to do the job properly, they are still taxed under the general rules, and will now be subject to the penal provisions of S 146 ICTA 1988 where the house costs over £75,000 (a limit

that has not been, but should be, indexed in line with house price increases to £200,000).

The provisions which discriminate against directors are contained in S 145(5) ICTA 1988. The rules were introduced in the 1977 Finance Act and at that time were heavily and justifiably criticised by members of the present government. The observations then made by the present Secretary of State for the Environment still hold good:

> "We really must get this prejudice about directors out of our skins. The reason for this prejudice is historical . . . There is nothing intrinsically wicked or rich or evil about being a director . . . If there has to be this special income line, which I do not agree with, I believe that the tax should be the same for everybody, whether they have £5,000 more or less and that the rules should be the same. But if on top of that we are going to have a difference between directors and non-directors the partiality is horrible and should be removed."(Official report Standing Committee D debate on 21st June 1977 col. 797).

The present Chancellor also remarked on the absurdity of specifying only a 5 per cent shareholding as being a material interest sufficient to deprive a full time working director of the exemption (col. 803).

Unless the fiscal impediments to disincorporation are removed - and no changes have occurred following the Inland Revenue's Consultative Document on this subject published last year - it is strongly recommended that sub-section (5) of S 145 ICTA 1988 be repealed, so that directors will be placed in the same position as other employees in relation to the taxation of dwellings provided by employers.

8. Additional Rate charged upon Income of Discretionary Trusts

Although reduced to 10% in the 1988 Finance Act, the "additional rate" of tax charged upon the income of discretionary trusts still remains an anomalous tax charge once this government decided to abolish the Investment Income Surcharge. The additional rate upon trust income creates extra work for Trustees and beneficiaries (who will have to make repayment claims) and the Inland Revenue. We recommend the abolition of the additional rate.

9. Additional Rate Charged on Trustees of Maintenance Funds

Apart from the general representation made at paragraph 8 above, there are particularly good reasons why the additional rate should not be charged on the Trustees of Maintenance Funds (under Schedule 1 Inheritance Tax Act 1984). Such funds at present can only apply income upon the maintenance of National Heritage property to which public access is given. Both Government and Opposition have been anxious to support this cause. Furthermore, as the income of such Funds can never be withdrawn for personal benefit, the tax treatment of Maintenance Funds should be distinguished from other discretionary trusts. The abolition of the additional rate would greatly help private owners to ensure sufficient income is available to meet the ever increasing cost of maintaining the heritage.

10. Repeal or Reform of Section 397 ICT 1988

Section 397 is penalising full-time farmers who have every intention of making a profit but who have suffered losses as a result of circumstances beyond their control. There is now an increasing indication that the tax penalty imposed by the Section is also leading to job losses in the industry. Against the background of persistent high real interest rates, production quotas loss of grants and falling land values, many farmers after three or four years of losses are looking to cut their immediate overheads to avoid the operation of the Section and the easiest course of action is to lay off farm workers.

We strongly believe that the present Section 397 is outdated against the background of the present dramatic decline in the profitability of agriculture and we recommend its repeal so that farmers are placed in the same position as other traders. There appear to be no reason why farming as a trade should be singled out for restriction of relief. Section 384(1) ICTA 1988 would still remain as a protection against deliberate abuse and would prevent relief for losses being given for "hobby" farmers.

11. Forestry

When the abolition of Schedule B was discussed at Committee Stage of the 1988 Finance Act, the present Financial Secretary noted:

"I am not saying that the solution that we have arrived at must endure for ever, but we want to see how the changes that we have made work out. I understand that the problem of maintenance and yearly upkeep worries people...."

(Official Report, Standing Committee A Col. 563 21st June 1988).

The information on the effects of the abolition of Schedule B is being collected. But to wait and see how the changes work out is, in our view, a dangerous philosphy to adopt in the case of forestry. If damage is being done it will be difficult to rectify at a later date. And the temporary retention of Schedule B for existing owners will distort statistics and make them less meaningful.

In our view the problems of maintenance of existing woodland should be tackled immediately. To provide sustained and proper management of woodlands a very limited and targeted relief should be introduced which would allow maintenance expenditure on woodlands less any income to be set-off against any agricultural income of the estate on which the woodlands were sited. This would recognise:

(a) the intimate relationship that woodlands bear to agricultural land in many instances; and

(b) the long duration - especially in the case of broadleaved woodlands - of the production cycle; and

(c) the recurrent nature of management costs.

CORPORATION TAX

12. Companies purchasing their Own Shares

The CLA welcomed the provisions of S 219 ICTA 1988 as it removes the fiscal barrier of A.C.T. to the efficient structuring of the shareholdings of unquoted trading companies within the limited circumstances to which the legislation applies. A general relaxation of the provisions of the section would be welcomed as its restriction means that there are many circumstances outside its ambit where the possibility of an A.C.T. liability on a company purchase results in sales of shares to third parties, the consequent loss of family control and the disruption of the company's business.

Property holding companies should be brought within S 219 ICTA 1988 as the implications of an A.C.T. liability on such a company purchasing its own shares are no less than in the case of trading companies and disruption to such companies could have a knock on effect on the activities of trading companies. Also, the requirements as to a substantial reduction in the vendor's interest should be relaxed where sales take place over a period of time to fund Inheritance Tax being paid by instalments.

CAPITAL GAINS TAX

13. General

We welcomed the removal of CGT from the inflationary gains of the 1970's by the 1982 rebasing introduced in the 1988 Finance Act. However, we are becoming increasingly concerned that the tax is too complex and more recent measures (e.g. the revisions to gift hold-over relief introduced in 1989) have only added to that complexity. It is clear from our advisory service that CGT computations cause our members and their professional advisers great difficulty. We urge Government to consider ways in which this tax can be simplified and reformed. We believe that the options should be presented in a consultative document which looks at the reform of CGT as part of a restructuring of all capital taxes.

14. Encouraging more Agricultural Tenancies

The loss of Capital Gains Tax Retirement and Roll-over reliefs by owners who let farms to tenants, instead of farming it themselves means that Capital Gains Tax, even after the radical reforms of 1988, remains a major fiscal disincentive to the creation of more tenancies, and distorts investment decisions by leaving owners with little choice but to concentrate investment upon the "in hand" land which they are farming themselves.

There are numerous cases where a farmer who has farmed his land in-hand for a number of yars considers letting his land. However, when his adviser informs him that he would not benefit from roll-over relief if he ever wished to sell up and start a new business or that he would lose the retirement relief exemption if he sells the farm having reached 60, then it is most unlikely that a new tenancy would be created.

We urge the government to build upon the successful abolition of the investment income surcharge in the 1984 Budget and the radical reform of Capital Gains Tax in 1988 and remove from the tax system these final, major obstacles to the creation of more farm tenancies.

15. Roll-over Relief for Property held in Life Interest Trusts

Since 1979 most taxation reforms have ensured that there is parity of treatment between property held in life interest trusts and property in absolute ownership. Following the changes made to retirement relief in 1985 and 1988, and to gifts into and out of life interest trusts for Inheritance Tax purposes in 1987, it now is anomalous to deny roll-over relief for property held in life interest trusts where the life tenant occupies and uses the property for the purposes of a trade carried out by him. We strongly recommend that roll-over relief should not be denied where the trustees of a life interest trust replace property in circumstances that relief would be available had the life tenant owned the property absolutely.

16. Disincorporation

The shareholders of a family company effectively suffer a double charge to Capital Gains Tax on liquidation. Tax is charged once on the disposal of its assets by the company; then the net proceeds of the company's assets are taxed again on being distributed to the shareholders because the liquidation is treated as a disposal of the shares. The reduction in the rates of Corporation Tax, coupled with the withdrawal of Capital Allowances, makes it more important than ever that the Capital Gains Tax should not discourage sensible, commercial steps such as the incorporation of the business.

This double charge is without doubt the main deterent to the adoption of the company as a medium for family farming businesses. It also and prevents the re-organisation of existing businesses. The re-basing of Capital Gains Tax in 1988 offers a temporary palliative but does not permanently resolve this problem. The Inland Revenue have put forward some innovative and helpful proposals in their consultative document "Disincorporation". Subject to the comments the CLA has already made on these proposals , we hope that legislation to alleviate the double tax charge will shortly follow. We regret that this has not been possible in the two years since comments were invited.

17. Replacement of Business Assets (Roll-over Relief)

Relief under S.115 Capital Gains Tax Act 1979 has helped prevent Capital Gains Tax withdrawing capital from a business when certain assets are replaced by other assets.

However, the application of the relief is restricted by the definition of qualifying assets contained in s.118 Capital Gains Tax Act 1979. The CLA warmly welcomes the revisions made in 1988 to include Milk and Potato Quotas within S118. However, further revisions still appear necessary in the light of the present requirements of businesses. We believe in particular the following changes be considered:-

i Extending Head B to include moveable, as well as fixed plant and machinery.

ii Permitting gains accruing in respect of non-qualifying assets which give rise to income arising under Schedule A to be rolled-over into qualifying assets.

18. Retirement Relief

The CLA welcomed the substantial changes in the value of retirement relief made in 1988. Nevertheless, the structure of the relief remains a hotch-potch of detailed and hightly complex rules. The following changes are recommended:-

i There seems no reason for the rule which says that a period of ownership, of a business by one spouse shall count towards the 10 years ownership required by the successor only if the original owner retires completely on the occasion of the inter-spouse transfer.

ii Relief will be refused if a farmer, instead of disposing of his land immediately upon retirement, lets it to a tenant. No retirement relief will be available on a later disposal however short the letting period. The result of this rule is to choke off one potential source of the new tenancies which Government is anxious to see increase following the passage of the Agricultural Holdings Act 1984. It is suggested that retirement relief be available on the disposal of farmland let to a tenant to the extent that retirement relief would have been available to the owner at the date he let it to the tenant.

iii Relief is restricted where land is owned by a partner or shareholder and farmed by his partnership or family trading company, and a rent is paid. Little purpose is served by such restrictions and this is recognised in the granting of roll-over relief where rent does not affect its availability. The tax system should not seek to influence the relationship between and form of return enjoyed by the various parties to a family farming enterprise whether partnership or company. It is therefore suggested that unrestricted retirement relief be allowed in all cases where a disposal of land is associated with a disposal of a partnership interest or shares in a family company, regardless of any rent paid.

iv It is suggested that maximum relief be allowed where there has been a break of less than two years between two business activities if the person making the material disposal can show he has been in business for a period of 10 years within a period beginning 10 years <u>plus</u> the length of the break, before the material disposal.

v The ownership of commercial woodlands does not count as a "business" under the rules for retirement relief. Nevertheless, the owner of woodlands is, in practical terms, carrying on a business in the same way as any other trader. This is recognised for many capital tax purposes such as Capital Gains Tax roll-over relief (S 121(1)b Capital Gains Tax Act 1979) and Inheritance Tax Business Property Relief (Part V Inheritance Tax Act 1984). It is suggested that woodland owners should also be eligible to claim Capital Gains Tax retirement relief especially as the capital tax charges on woodland owners have been kept following the abolition of the income tax charges in 1988.

vi The provision which allows relief for retirement on ill-health grounds can act most unfairly in the case of a husband and wife partnership where both spouses are below the age of 60 and one is forced to retire because of illness. If the other spouse cannot solely continue the business no relief will be due on that spouse's share of the capital gains. It is suggested that relief should be available in such circumstances.

19. Annual Exemption - Carry Forward

It is difficult for owners of land to take advantage of the annual exemption for £5,000 of gains. Land must generally be sold in one lot; it cannot, in reality, be disposed of gradually over a period of years. Thus the owner of land which cost, say, £20,000 and is sold for £50,000 will be taxed on a gain of some £25,000 (ignoring indexation) because he has benefited from only one annual exemption. Had he instead invested his £20,000 in quoted securities, sold for the same price over a period of say 5 or 6 years, the whole gain would have been covered by annual exemptions.

To achieve fairness it is suggested that unused annual allowances be capable of being carried forward for a period of 10 years. This is all the more important following the increase in the rate of tax for large gains introduced in 1988.

20. Relief for gifts

The C.L.A. regrets the recasting of the relief for gifts made in the 1989 Finance Bill. We believe the new legislation adds unnecessary complexity and restricts the free movement of capital by imposing a CGT charge on gifts of certain assets at a time when their values are unrealised. In particular we believe that all assets transferred to individuals out of a life interest settlement which were previously held in an Accumulation and Maintenance Trust should be assets qualifying for gifts hold-over relief. This would prevent Trustees from transferring capital absolutely into the hands of beneficiaries of A & M Settlements for fiscal reason when prudence and sound management would suggest that the capital be held in a life interest trust until the beneficiary had "proved" himself. Alternatively we would welcome an increase in the 25 year age limit that applies to A & M Settlements.

21. Encouraging Conservation

Where conservation land is sold to a charitable body such as a Wildlife Trust, the gain should be exempt from Capital Gains Tax. This would in effect, result in an extension of the "douceur" system whereby the relief would be shared between the landowner and the charitable body.

INHERITANCE TAX

22. General

The increases in the threshold that have taken place in the last three years are very welcome. However, the Association believes that Inheritance Tax still takes too large a slice of what remains relatively modest estates. In particular the real incidence of tax on middle range estates around £170,000 - £440,000 is higher than under Capital Transfer Tax in 1974.

In his 1988 Budget Speech, the present Chancellor noted in relation to Income Tax:-

> "I believe that 40% is an acceptable top rate of tax. But bearing in mind that the basic rate of income tax is also the starting point, 25% is too high."

If that is true of Income Tax then, a fortiori, it is true of Inheritance Tax with a starting rate equal to its top rate. To remedy this siutation we recommend that the threshold should be substantially increased to at least £200,000.

23. Cumulation period for PETs that have become chargeable

At present if a PET becomes a chargeable transfer because the donor fails to survive the gift by seven years, then in computing the tax liability on the PET it is necessary to cummulate it with immediately chargeable lifetime transfers made in the seven years prior to the PET. Theoretically, immediately chargeable transfers made up to 14 years prior to death can have an effect on the liability at death. In certain instances where an immediately chargeable transfer is made between 14 and 7 years before death, the making of a PET can make the donor worse off.

We recommend that in computing the Inheritance Tax on a PET that has become chargeable, immediately chargeable transfers made in the period of 7 years before the donor's death should be the only immediately chargeable transfers to be cummulated with the 'failed' PET.

24. Gifts with Reservation: the 7 Year Rule

The "relevant period" in which regard is had to whether there is a reservation of benefit by the donor is the seven years immediately prior to death (or, a shorter period starting with the date of the gift and ending with the donor's death).

We believe that this rule introduces too much uncertainty into the Inheritance Tax regime and, especially where the property gift has been replaced perhaps several times, the rule may prove unworkable in practice. We recommend that any benefit reserved which occurs after the seven year period immediately following the date of gift should be disregarded. This should both simplify the present arrangements and provide adequate protection aganst tax avoidance of the death charge.

25. Gifts with reservation of benefit: the value added back

The CLA has been in correspondence with the Capital Taxes Office over what in practice amounts to a gift with reservation (GWR). We are very grateful for the official guidance given.

However, the major worry expressed by members on the GWR provisions is that the slightest reserved benefit could bring back the whole value of previously gifted property on their death. Even if steps are taken to honestly ensure that commercial arrangements are entered into, the present GWR provisions make lifetime gifts of real property hazardous.

We believe that life-time giving of real property could be advanced if the penalty for GWR were limited to the value, at the date of death, of any benefit reserved by the donor in the relevant period. Similarly, where a benefit ceases to be reserved in the relevant period, the value to be added back into the donor's estate should be limited to the value, at the date the benefit ceased to be reserved, of any benefit previously reserved by the donor since the date of the gift.

26. Transfers of Agricultural and Business Property

Under Inheritance Tax, agricultural or business property relief is not available unless the donee retains the property gifted to him (or similar replacement property).

We believe that this rule will introduce distortions into the market for agricltural and business property. For example, the recipient of a farm may find in two or three years time that the farm is no longer a viable proposition. Should he attempt to make better use of he land for some non-agricultural purpose he will need to consider the additional tax imposed by the possibility that his benefactor dies in the "relevant" period. 7 years is too long a time for land to be kept in unprofitable use by a quirk in the tax system. Furthermore other intended beneficiaries of the donor who may have prudently insured against the death of the donor could find that their Inheritance Tax bills are far greater by some capricious action by another beneficiary. It cannot be right in principle that one man's tax bill should be effected by the actions of an other.

We recommend that agricultural and business property relief be available if the relevant conditions would be satisfied by a notional transfer of the property by the donee 3 years after the date of the original gift.

27. Transfers between Spouses

The CLA welcomes the retention of the CTT exemption for transfers between spouses in Inheritance Tax. However, there remains a significant deterrent to inter vivos transfers between spouses in that the transferee spouse cannot take over from the transferor spouse an entitlement to Business Property Relief or Agricultural Property Relief which the transferor spouse has already built up. This, for example, means that if let land is transferred, the transferee spouse is not entitled to agricultural relief until it has been owned a further seven years. We therefore recommend that, just as for transfers on death, the transferee spouse should have the benefit of the entitlement built up by the transferor spouse.

28. Holiday Accommodation

The letting of holiday accommodation is economically important to many farms and estates and indeed to the rural economy generally. The CLA therefore welcomed the income tax and Capital Gains Tax reforms in the 1984 Finance Act. As much as anything, the benefit of the legislation has been felt in making the system simpler and more workable by reducing the importance of the artificial distinction between "trade" and other economic

activities. However, as no specific provisions were enacted for Capital Transfer Tax there is now considerable doubt as to whether commercially let holiday accommodation within S504 ICTA 1988 does, or does not, qualify for the Inheritance Tax relief for Business Property. It is therefore recommended that legislation be introduced specifically stating that the commercial letting of holiday accommodation shall be treated as a business for Inheritance Tax purposes.

29. Disposals after Death

When land is sold within a short time after the death of the owner, the Revenue will often seek to replace the earlier, estimated value of the land with the price in fact realised. No allowance is made for the cost of disposal with the result that the beneficiaries effectively bear tax on something which they don't receive. It is suggested that, the sale price of a property sold after death should be reduced by the costs of selling before being taken to be the value at the date of death.

30. Accumulation and Maintenance Settlements: Agricultural and Business Property Relief

The Capital Taxes Office has confirmed that agricultural and business reliefs will be lost if a donor who has settled property which is subject to either of those reliefs, dies within 7 years of the transfer and

either (a) the trustees advance a share to a beneficiary absolutely

or (b) the trustees give a beneficiary an interest in possession.

This appears to be a quirk of the legislation as this result clearly is at variance with gifts of property between individuals. We recommend that Section 113A and 124A CTTA 1984 are amended to ensure relief is not lost pro tanto.

31. Forestry

The abolition of the income tax charge on forestry does not achieve fiscal neutrality whilst an Inheritance Tax charge remains. We believe that woodlands should now be exempted from Inheritance unless a new income tax relief is introduced as suggested in para 11 above) because:-

(a) The rotation of commercial forestry will usually span more than one generation. Consequently no revenue expense is relieved though arbitrarily the capital value is taxed once a generation.

(b) The planting of new broadleaved woodlands could be particularly effected by the retention of the Inheritance Tax charge. Such woodlands sterilise the land for many generations during which no significant income is produced.

(c) To create new investment into forestry requires an incentive commensurate with those available for alternative options. The removal of the Inheritance Tax charge may encourage the longer term investment of private capital from a broader sector of the population to replace the previous, limited, incentive provided by Schedule B which was targeted almost exclusively on high income earners.

We accept there would need to be certain safeguards to prevent 'deathbed transfers' - perhaps beneficial ownership of the woodlands for 7 years would be a necessary condition of exemption.

STAMP DUTY

32. Threshold

Ad valorem Stamp Duty is chargeable (at a current rate of 1%) on conveyances or transfers on sale of land costing over £30,000. The threshold of £30,000 has remained unaltered since 1984 whereas house prices generally have risen faster than inflation, and in the south-east of England the vast majority of first time buyers now pay Stamp Duty. We therefore recommend that the threshold is raised to at least £80,000.

We also recommend that the threshold becomes a nil rate threshold ie. where duty is chargeable it is chargeable only on the excess of the purchase consideration over the threshold since the imposition of duty on the full consideration for a transfer penalises purchases of property marginally above the threshold.

NATIONAL INSURANCE

33. Class 4 Contributions

Class 4 contributions are a heavy burden upon the self-employed. They do not entitle the payer to any benefits over and above those available to non-payers. They are merely an additional and unjustified tax burden upon the self-employed. In the interests of simplicity it is recommended that the Class 4 contributions are abolished. Failing this, full tax relief for Class 4 contributions should be allowed following the reductions made in National Business contributions for employees since October 1989.

34. Employers' Contributions

The National Insurance contributions payable by employers are a tax upon employment. Inevitably the result is to restrict the number of jobs which employers can offer. It is recognised that the Government has already taken steps to lighten this burden on employers but it is suggested that, in view of the present high rates of unemployment, the employers' contributions should be reduced further.

VALUE ADDED TAX

35. Protection of Listed Dwellings

From 1st April 1989, alterations to protected domestic dwellings may be zero-rated but repairs and maintenance continue to be standard rated. This appears to be an absurd anomaly which discourages retention of our heritage in its original form. In view of the fact that the cost of repairs and mantenance to listed dwellings is often far greater than for other private dwellings and because the owner incurs this expenditure for the benefit of the community as a whole, we strongly recommend that such work should be zero-rated.

36. Partial Exemption - De Minimis Limits

Since 1st April 1987 the de minimis limits (which allow registered traders to recover all their input VAT where exempt input tax is incurred but falls below certain specified limits) have been drastically reduced. In our experience the new limits are too low. Many small traders who previously fell within the limits, and therefore recovered all their input tax even though they incurred small amounts of exempt input tax (eg on repairs to tenanted property) will cease to do so. Furthermore the adminstrative burden of operating the rules will now affect even more small traders who already find VAT compliance a major burden.

Given that the new rules were introduced with the principal aim of preventing large-scale VAT avoidance by companies, we recommend that the previous limits be restored for registered traders with turn-overs of less than £250,000 p.a.

37. Farmhouse Inputs

Where farmhouses are used both as a dwelling and to run a farm, VAT on farmhouse expenditure has to be apportioned between business and non-business use of the dwelling, and only the former is recoverable. In practice this presents no problem where there is a separate farm office, but in the majority of cases there is a business use of the entire house. Previously, Customs and Excise allowed recovery of one-third of the VAT as a business input, a practice which saved the time and expense

on both sides in examining each case on its merits. Customs and Excise have indicated that the previous practice has led to an over-recovery in some cases. Each case is now examined individually. The result is that many members now face an invidious choice between accepting recovery fractions as low as one-tenth and spending more time and money necessary to prove the claim than the actual amount of VAT at stake. It is manifestly unjust that taxpayers should be put into this position and it is therefore strongly urged that an automatic recovery fraction of one-quarter be introduced."

38. Recovery of VAT on Capital Inputs

Under new VAT regulations coming into effect on 1st April 1990, landowners who recover VAT charged on purchases of land and buildings must keep detailed records of the use of the item over the ensuing 10 years period in case an adjustment is subsequently due in favour of Customs & Excise following a period of non-business use. Although the new rules will only apply if the value of the item is £250,000 or more, they will nevertheless create anothe VAT compliance burden for farming business. We recommend that business with a turnover of less than £250,000 p.a. (the limit used in the 'VAT: Small Business Review' document, No 16/87) should in any event be excluded from these rules.

ACB
September 1989

fp.nh/ks/98

FROM: K SEDGWICK (FP)
DATE: 5 OCTOBER 1989
x 5169

PS/PMG

cc PS/Chancellor
PS/Financial Secretary
Mr Gilhooly
Mr Michie
Mr Shaw - IR
Mr Collins - C&E

BUDGET DEPUTATION FROM THE AA

The attached letter from the AA requests a meeting with a Treasury Minister to discuss their 1990 Budget representations.

2. Over the past couple of years their representations have usually been weighted on the indirect tax side and the Economic Secretary has seen them. We presume that the Paymaster General will be content to see them this year.

3. If the PMG is content to see them, we suggest you contact the AA to arrange a date and ask them to send in their representations in good time, so that we can arrange adequate briefing. It would also be worth checking that their representations are not likely to be too heavily weighted on the direct tax side, i.e. company car scales etc, in which case it might be more appropriate for the Financial Secretary to see them.

4. I would be grateful if you would let me know the outcome when you have spoken to them.

K SEDGWICK
Fiscal Policy Division

Mr. Michie

For you: not IR? ... deal

4/10

The Automobile Association

Head Office: Fanum House, Basingstoke, Hampshire RG21 2EA

Telephone: (0256) 20123 Extn. Direct Line: (0256) 492050 Telex 858538 AABAS G Facsimile: (0256) 493389

Director General: Simon Dyer

Please quote our reference:
PP/JPA/EC

Private Secretary
Office of the Chancellor of the
Exchequer
H M Treasury
Whitehall
London

3rd October 1989

Dear Sir

I refer to a recent telephone conversation between our offices about a possible meeting for the Association's Chairman and Director General with the Chancellor or one of the other Treasury Ministers to discuss motoring taxation and related matters in the the run-up to the 1990 Budget.

As you may recall, the Association's Chairman has called on the Chancellor in previous years, last year a meeting was held with the Economic Secretary.

I should be most grateful if you could let me know whether the Chancellor would be able to receive the Association this year or, if his schedule is already full, whether we could see the Chief Secretary, Financial Secretary or Economic Secretary. Most urgent at this stage is the identification of some dates and times when a meeting could take place. Perhaps your office could contact me or my colleague David Williams (on 0256 492197) when the appropriate internal inquiries have been made at your end.

Yours faithfully

J Anderson

John Anderson
Manager, Government Affairs
Public Policy Department

CH/EXCHEQUER
3 OCT 1989 3/10
MR MASSINGALE IR
MR GILHOOLY

20/10

TOBACCO
Advisory Council

PMG 19 OCT 1989 — 1

Glen House, Stag Place, London SW1E 5AG. Telephone: 01-828 2041/2803. Telex: 8953754 TOBCOM. Facsimile: 630 9638.

PAYMASTER GENERAL
REC. ... OCT 1989
MR K SEDGEWICK (FP) & ATTACHMENT.
CX / FST / EST
MR CULPIN
PS / CTE
MR MICHIE
MR WILMOTT
MR GRAY
MR CLEAVER } CUSTOMS
MR P. COLLINS

From W. C. Owen
Chief Executive

The Earl of Caithness
Paymaster General
HM Treasury
Parliament Street
London SW1 3AH

18 October 1989

Dear Paymaster General,

I have pleasure in enclosing our submission on tobacco taxation setting out the issues which we suggest are relevant in the development of the 1990 Budget strategy as it may affect the tobacco industry.

We were naturally pleased with the Chancellor's decision to hold duty rates in this year's Budget, which has greatly contributed to the continuing stability of the UK manufacturing industry. Importantly, for the UK manufacturers whose sales have declined by almost 30% since 1979, the penetration of cheap imported brands has levelled off. Whilst this to an extent reflects the measures taken by the UK industry, it is very largely a result of the market conditions engendered by the recent period of duty stability. Maintaining this balance largely depends on the continuation of moderate fiscal treatment which has been of benefit to the industry and is why we argue in our submission for a continuing "standstill" on tobacco taxation.

Furthermore, with the Government commitment to reducing the rate of inflation, an increase in tobacco taxation can only, in the circumstances, be counter productive.

My colleagues and I look forward to developing these and the other arguments in this submission when we meet with you on * 1 November. I will be accompanied by Mr Peter Wilson, Chairman of TAC and Chairman of Gallaher Tobacco Ltd and Sir Robin Haydon, consultant to TAC.

We have written separately to the Chancellor enclosing a copy of the submission.

Yours sincerely.

Bill Owen.

HAVE ... TO REARRANGE
* NOW TUES 14th NOV - 2:00

fp.nh/ks/124

FROM: K SEDGWICK (FP)
DATE: 19 OCTOBER 1989
x 5169

1. MR MICHIE
2. MCU
3. PAYMASTER GENERAL

cc PS/Chancellor
PS/Financial Secretary
Mr Culpin
Mr Gilhooly

PS/C&E
Mr Wilmott - C&E
Mr Gaw - C&E
Mr Cleaver - C&E
Mr P Collins - C&E

BUDGET DEPUTATION: TOBACCO ADVISORY COUNCIL (TAC)

The Tobacco Advisory Council wrote to you and the Chancellor on the 18 October enclosing their 1990 Budget submission.

2. The meeting has been rearranged for Tuesday 14 November at 2.00. Mr Cleaver at C&E will be providing briefing and arranging for official support.

3. I attach a short reply for you to send to the TAC.

K SEDGWICK
Fiscal Policy Division

fp.nh/ks/123

Treasury Chambers, Parliament Street, SW1P 3AG

W C Owen Esq
Chief Executive
Tobacco Advisory Council
Glen House
Stag Place
LONDON SW1E 5AG

October 1989

Thank you for your letters of 18 October to the Chancellor of the Exchequer and myself, enclosing your submission for the 1990 Budget.

As you know, our meeting has been rearranged for Tuesday 14 November at 2.00. I look forward to meeting you then.

EARL OF CAITHNESS

TOBACCO
Advisory Council

PMG 19 OCT 1989 — 1

Glen House, Stag Place, London SW1E 5AG. Telephone: 01-828 2041/2803. Telex: 8953754 TOBCOM. Facsimile: 630 9638.

PAYMASTER GENERAL

MR K SEDGEWICK (FP) & ATTACHMENT.
CX / FST / EST
MR CULPIN
PS / CTE
MR MICHIE
MR WILMOTT
MR GRAN
MR CLEASBY } CUSTOMS
MR P. COLLINS

From W. C. Owen
Chief Executive

The Earl of Caithness
Paymaster General
HM Treasury
Parliament Street
London SW1 3AH

18 October 1989

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We were naturally pleased with the Chancellor's decision to hold duty rates in this year's Budget, which has greatly contributed to the continuing stability of the UK manufacturing industry. Importantly, for the UK manufacturers whose sales have declined by almost 30% since 1979, the penetration of cheap imported brands has levelled off. Whilst this to an extent reflects the measures taken by the UK industry, it is very largely a result of the market conditions engendered by the recent period of duty stability. Maintaining this balance largely depends on the continuation of moderate fiscal treatment which has been of benefit to the industry and is why we argue in our submission for a continuing "standstill" on tobacco taxation.

Furthermore, with the Government commitment to reducing the rate of inflation, an increase in tobacco taxation can only, in the circumstances, be counter productive.

My colleagues and I look forward to developing these and the other arguments in this submission when we meet with you on 1 November. I will be accompanied by Mr Peter Wilson, Chairman of TAC and Chairman of Gallaher Tobacco Ltd and Sir Robin Haydon, consultant to TAC.

We have written separately to the Chancellor enclosing a copy of the submission.

Yours sincerely.

Bill Owen.

Have [illegible] 14th Nov - 2-3.

TOBACCO
Advisory Council

Glen House, Stag Place, London SW1E 5AG. Telephone: 01-828 2041/2803. Telex: 8953754 TOBCOM. Facsimile: 630 9638.

From W. C. Owen
Chief Executive

The Rt Hon Nigel Lawson MP
The Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1 3AH

FP

18 October 1989

PMG

Dear Chancellor,

I have pleasure in enclosing our submission on tobacco taxation setting out the issues which we suggest are relevant in the development of the 1990 Budget strategy as it may affect the tobacco industry.

We were naturally pleased with your decision to hold duty rates in this year's Budget, which has greatly contributed to the continuing stability of the UK manufacturing industry. Importantly, for the UK manufacturers whose sales have declined by almost 30% since 1979, the penetration of cheap imported brands has levelled off. Whilst this to an extent reflects the measures taken by the UK industry, it is very largely a result of the market conditions engendered by the recent period of duty stability. Maintaining this balance largely depends on the continuation of moderate fiscal treatment which has been of benefit to the industry and is why we argue in our submission for a continuing "standstill" on tobacco taxation.

Furthermore, with the Government commitment to reducing the rate of inflation, an increase in tobacco taxation can only, in the circumstances, be counter productive.

My colleagues and I look forward to developing these and the other arguments in our submission at our forthcoming meeting on 1 November with your colleague the Earl of Caithness to whom we have written separately.

Yours sincerely,

Bill Owen.

CHANCELLOR'S BUDGET 1990

TOBACCO INDUSTRY
SUBMISSION

TOBACCO ADVISORY COUNCIL

OCTOBER 1989

TAXATION OF CIGARETTES

1. FISCAL BACKGROUND

1.1 Introduction

Under Conservative Governments since 1979 there have been substantial changes in the UK tobacco industry - many of which have been the direct result of fiscal action. It is, therefore, an appropriate time to review these changes and to consider the possible impact of future fiscal policy on the Industry.

1.2 Market Trends

The harsh fiscal treatment of tobacco in the early/mid 1980's resulted in the UK tobacco industry reaching a critical situation in 1986, highlighted by -

* A severe reduction in total market sales
* Rapid growth in cheap imported cigarette sales
* Factory closures and reducing numbers of employees

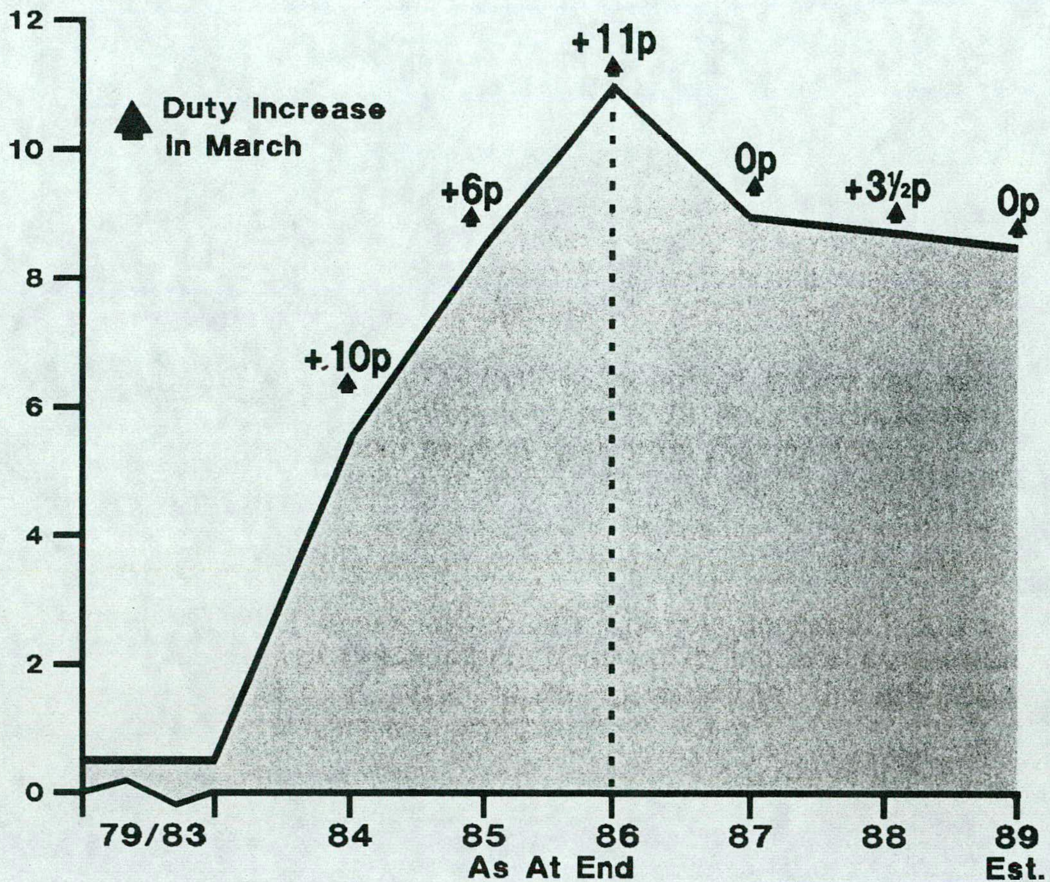
The moderate fiscal policy adopted at the last three Budgets, coupled with the initiatives taken by UK manufacturers such as holding retail prices for longer periods, establishing lower priced products to counter the trade-down to cheap imports, continuing with strong main media support for major image brands and continuing with reorganisation/restructuring initiatives, has resulted in greater market stability.

Although sales to the trade have been distorted in recent years - particularly in 1987 - by the imposition of pre-Budget restrictions on despatches, it is estimated that the total cigarette market in the UK has remained broadly stable since the adoption of the moderate fiscal policy on cigarettes.

An important benefit of this policy has been the reduction in the sales of cheap imports, whose market share has levelled off at about 8.5%, as the following chart illustrates -

THE RECENT MODERATE FISCAL POLICY HAS CONTAINED THE MARKET SHARE HELD BY CHEAP IMPORTS

% Market Share Held
By Low Price Imports



Despite the recent market stability, it is estimated that UK cigarette sales in 1989 will be some 22% below the 1979 level of 124 billion. However, because of the influx of cheap imported cigarettes, UK produced cigarette sales have declined by almost 30% over this period.

1.3 Smoking Among Secondary School Children

There has been a continuing reduction in cigarette smoking by young people, contrary to references frequently made in the run up to Budgets. An attached annex on this subject sets out the results of the recently published Office of Population Censuses and Surveys study carried out on behalf of the Department of Health, which clearly demonstrates the reduction in the incidence of smoking among secondary school children.

1.4 Fiscal Discrimination

On three occasions in the last decade - 1981, 1984 and 1986 - the excise tax on cigarettes has been increased by a disproportionately high amount relative to other main sources of excise tax. As a consequence, the total tax burden on cigarettes has risen at a faster rate than other excise taxable goods.

Cigarettes now bear the highest incidence of excise tax and, not surprisingly, sales of cigarettes since 1979 have declined by more than any other excisable product apart from pipe tobacco.

1.5 Employment

The employment levels associated with the tobacco industry are much greater than the numbers involved in tobacco manufacturing alone, comprising a wide range of activities through tobacco importation to retailing and distribution.

The total number of people employed in both the tobacco industry and in associated industries amounted to almost 300,000 in the early 1980's but has reduced to around 170,000 currently. A significant proportion of the job losses were caused by the Government's fiscal action in its early years in office.

Factory closures have taken place in Basildon, Belfast, Carrickfergus, Glasgow, Manchester, Newcastle, Stirling and Swindon, with the total number of people directly employed in the tobacco industry reducing from 40,000 in 1979 to only around 16,000 currently.

2. 1990 BUDGET AND THE FUTURE

The UK tobacco industry has managed to recover from the critical state of 1986 largely because of the Government's moderate fiscal policy since that date.

However, the recent stability is very fragile and key issues in relation to the future taxation policy on cigarettes are -

* Inflation
* Import and Export Trade
* Inequality of Cigarette Taxation
* 1992

2.1 Inflation

The Government has declared its main objective is to contain inflation. In the evidence given in April 1989 to the Treasury and Civil Service Committee on last year's Budget, this objective was reinforced by the Chancellor who gave his reason for not increasing excise taxation as follows -

"At a time when there is a danger of inflationary expectations deteriorating it does not make sense gratuitously to do anything to exacerbate these expectations."

With inflation still running above the forecasts contained in the Financial Statement and Budget Report 1989-90, this reason for not increasing excise taxation is still valid for the 1990 Budget.

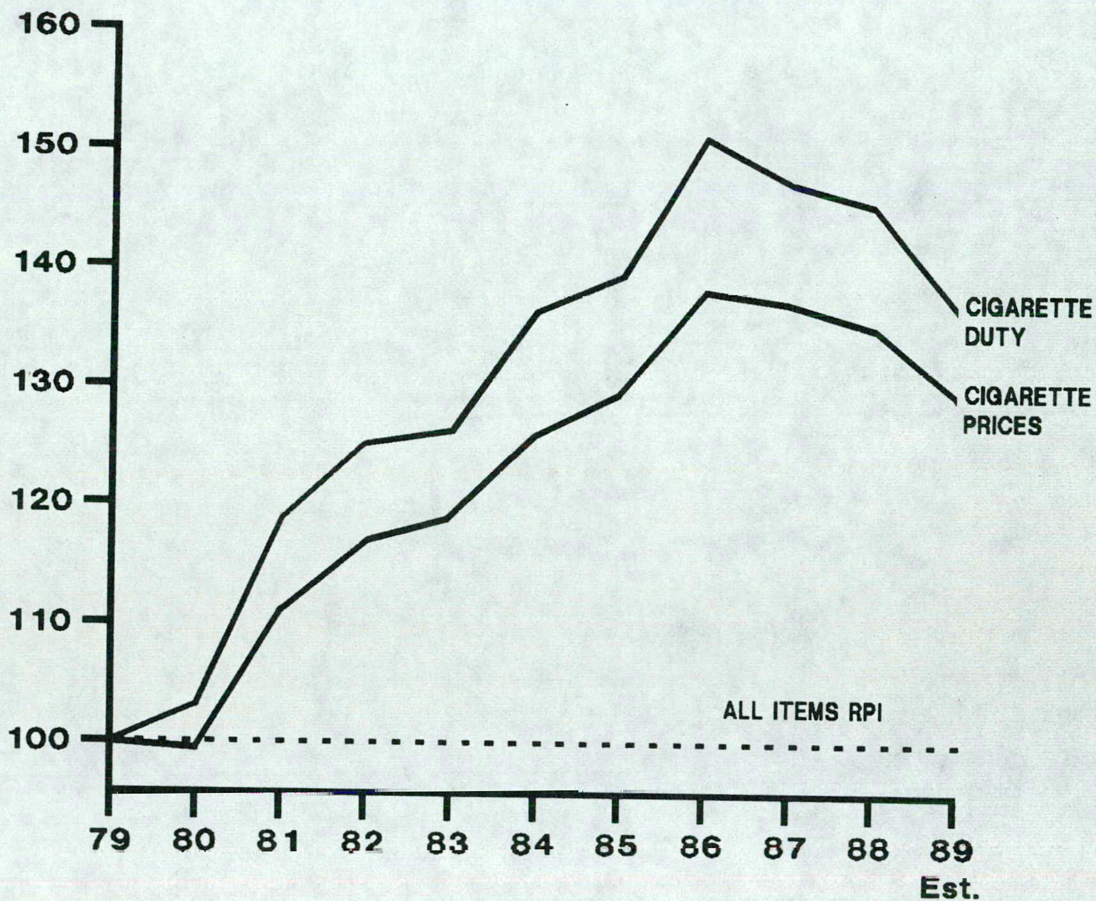
Indeed, it is particularly relevant for cigarette taxation since independent research has demonstrated that it is a relatively inefficient way of raising additional revenue compared with other forms of excise tax because an increase in cigarette taxation has a disproportionately upward effect on inflation.

Despite this, cigarette taxation has been continuously increased to the extent that the cigarette RPI has outstripped the all items RPI whichever year is taken as a base, except for the immediate post war period 1947-1951 and the recent years of 1986-1988.

The movement in the cigarette Index compared with the index for all items over the last decade indicates that cigarette prices have increased by about 30% above the general rate of inflation whilst the duty burden on cigarettes has increased by 37% in real terms, as the following chart illustrates -

IN REAL TERMS CIGARETTE DUTY/PRICES HAVE SIGNIFICANTLY OUTSTRIPPED INFLATION SINCE 1979

Index cf
All Items RPI



In order to bring cigarette prices back into line with inflation would require a duty reduction of about 36p per 20 - equivalent to over three-quarter percent off the current rate of inflation.

2.2 Import and Export Trade

The sensitive fiscal handling of cigarette taxation over the last three years has resulted in the imported share of the UK cigarette market falling from a peak of around 11% at end-1986, to about 8.5% currently (approximately 8 billion cigarettes per annum) - the level at which it appears to have broadly stabilised.

However, anything other than a continuation of the present moderate fiscal policy would be likely to revive the growth of the imported sector.

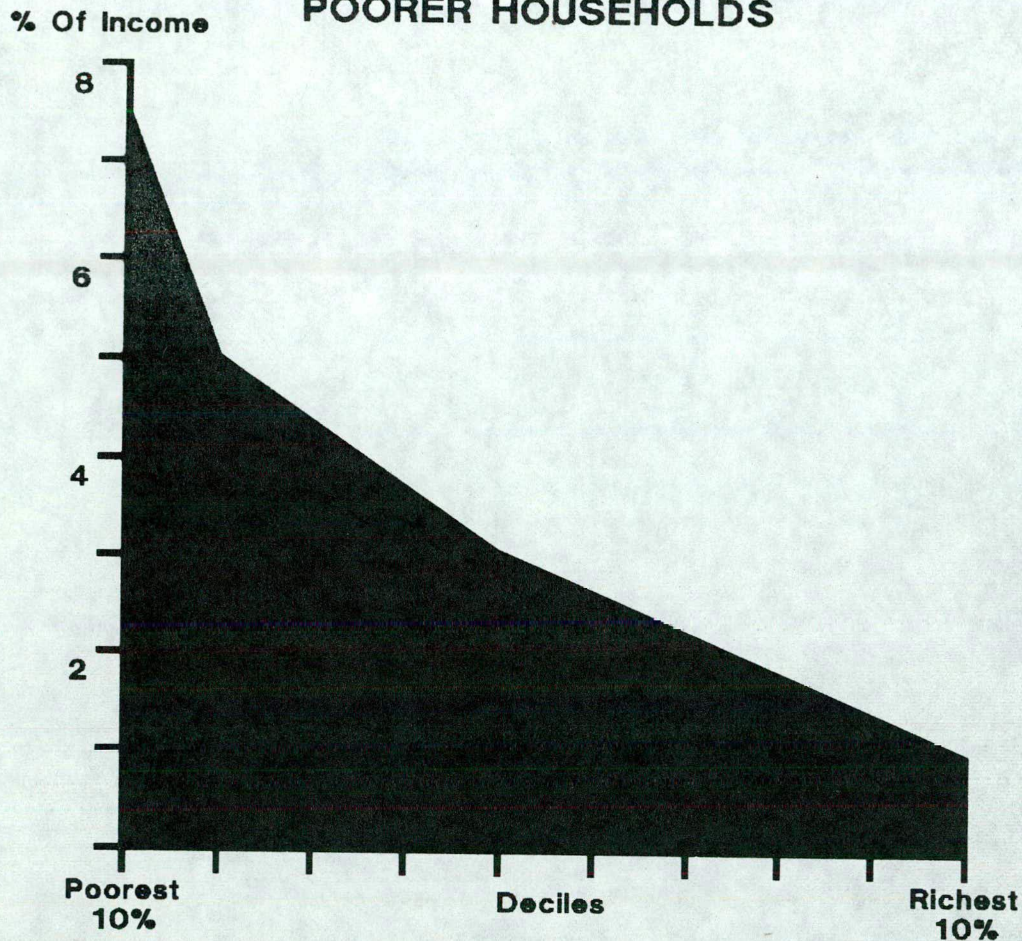
The growth of imported cigarette sales since end-1983 has coincided with a reduction in cigarette exports and the decline in domestic production has placed immense pressure on UK manufacturers to maintain their competitiveness in world markets.

The cost competitiveness of the UK industry must not be further disadvantaged in favour of foreign competition. The responsible action taken by UK manufacturers has not only resulted in a lower increase in tobacco prices over the last year than on all other major commodities included in the Retail Price Index but has also helped to maintain a creditable balance of payments performance.

2.3 Inequality of Cigarette Taxation

There are around 17.5 million consumers of tobacco products in UK - almost 70% of whom are in the C2DE social classes. Consequently, tobacco taxation is the most regressive of all central Government taxes, with expenditure on tobacco accounting for around 8% of the total income of the poorest families in the country, including non-smoking families, and over one-third of households paying more in tobacco taxes than in income tax.

The extent to which tobacco taxation is particularly regressive is illustrated as follows -



Source: London Economics

In addition, as fewer people smoke, the proportion of smokers accounted for by the C2DE social groups is increasing thus making tobaco taxation even more regressive.

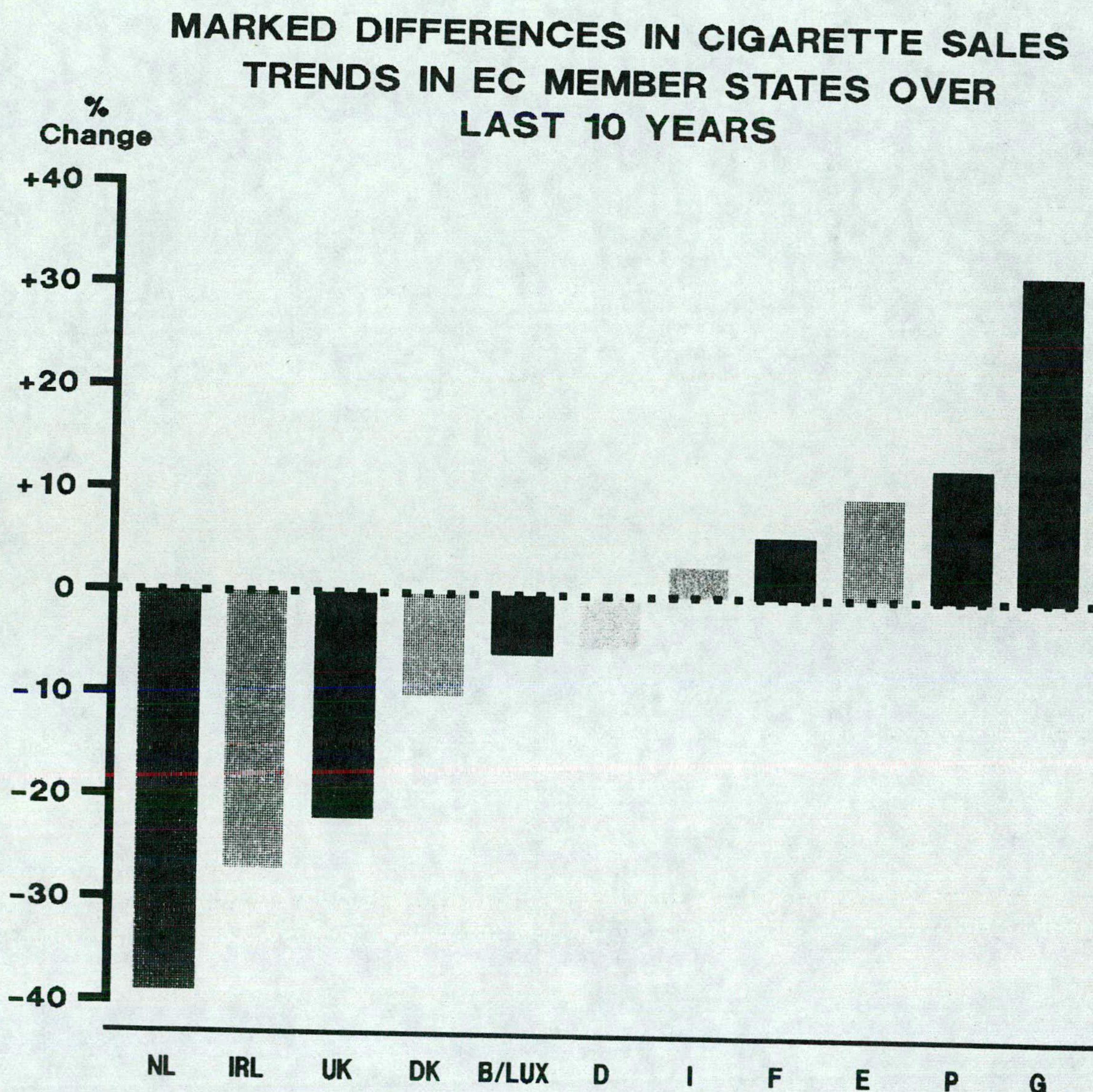
This is against a background in which official statistics indicate that although real incomes have risen by 6% in the last 10 years, the poorest sections have seen their share of household income fall.

It is clear that any increase in tobacco taxation would bear particularly heavily on those least able to afford it and would damage the Government's popularity with this sector of the public.

2.4 1992

The UK remains the third highest EC country in terms of the burden of cigarette taxation and, relative to other Member States, it has become less attractive to purchase cigarettes in the UK, thus weakening the UK's competitiveness both at home and abroad.

Over the last decade, the UK cigarette market has declined at a faster rate than in all other Member States except Ireland, and also the Netherlands - where the decline is distorted by a massive transfer of trade from cigarettes to handrolling tobacco in the mid-1980's. The relative market changes since 1979 are illustrated on the following chart -



As previously stated, cigarette sales in the UK have declined by 22% over the last 10 years. In contrast, sales have increased in all of the Mediterranean countries which have low duty burdens - Greece, Spain, Portugal, France and Italy. These countries now account for around 55% of total EC cigarette consumption cf. 48% in 1979.

Any move towards tax harmonisation, even a more flexible approach based on minimum duty rates, is likely to require tax increases in those countries with relatively low cigarette taxation. It would clearly be helpful to the Single Market exercise, therefore, if high tax countries such as the UK do not continually add to their rates, thereby increasing the likely minimum tax requirement, and making it more difficult for low tax countries ever to catch up.

3. CONCLUSION

The fiscal policy adopted at the 1987, 1988 and 1989 Budgets has brought some stability to the UK cigarette market, which was declining dramatically in the early 1980's, the advantages of this policy have been -

* A levelling off in total UK cigarette sales

* A containment of import penetration to about 8.5% of the total market

* A stabilisation in the cost competitiveness of UK manufacturers

* A respite from tax increases, particularly beneficial to the less well off

* Not further increasing UK tax levels above those of most EC countries

* The assistance towards Government's key economic policy objectives of reducing both inflation and unemployment

The industry feels, therefore, that the arguments put forward for a freeze on cigarette and handrolling tobacco taxation accepted at last year's budget are still valid, particularly in the light of the current level of inflation, the high surplus of Government finances and the adverse balance of trade figures.

- - - - - - -

TAXATION OF PIPE TOBACCOS AND CIGARS

PIPE TOBACCOS

The fiscal policy for pipe tobaccos has been well established by the present government, who have not increased the tax burden on pipe tobaccos at each of the last seven Budgets.

The arguments in support of this action remain as follows -

* Almost half of pipe tobacco consumption is accounted for by smokers aged 60+
* Over half of pipe tobacco smokers are in C2DE social groups
* Pipe tobacco manufacture is concentrated in areas of already high unemployment - Northern Ireland and Liverpool
* UK pipe tobacco prices are the second highest in the EC behind Ireland

Although pipe tobacco duty has been held at each of the last seven Budgets, total sales have still declined by some 43% since the Conservative Government took office in 1979 and the rate of decline appears to be accelerating - with a current sales fall of some 9% per annum.

CIGARS

Cigar duty has been increased only once in the last five years. However, despite this lenient fiscal treatment, sales are currently some 7.5% below the 1979 level.

As in the case of pipe tobaccos, there remains a strong justification for holding the excise tax level on cigars, viz -

* Contrary to popular image, over 50% of cigar smokers are in the C2DE social groups
* Three-quarters of UK cigar production is located in areas of high unemployment - Glasgow and South Wales
* The duty incidence on UK cigars is still amongst the highest in the European Community
* The EC Commission is proposing a tax incidence on UK cigars in the range 34%-36% compared with the current UK tax incidence of around 45%.

\- - - - - - -

ANNEX

OPCS Office of Population Censuses & Surveys

PRESS NOTICE

St Catherines House, 10 Kingsway, London WC2B 6JP

01 242 0262

Press Enquiries: Extn 2000

24 July 1989

SMOKING AMONG SECONDARY SCHOOL CHILDREN IN 1988

The latest OPCS survey of teenage smoking in England shows that the fall in smoking among boys noted in the previous survey has been sustained, and confirms that smoking has fallen among girls. However, girls are still somewhat more likely to be smokers than are boys - in 1988, about 7% of boys and 9% of girls regularly smoked at least one cigarette a week.

% who smoked at least one cigarette a week

	Boys	Girls	Total
1982	11	11	11
1984	13	13	13
1986	7	12	10
1988	7	9	8

The results of the survey, which was carried out in October 1988 among secondary school children in the first to fifth forms, are published* by OPCS today, Monday 24 July.

*Smoking among secondary school children in England in 1988 by Eileen Goddard, HMSO, £9.00 net, ISBN 0 11 691267 7

THE WAY AHEAD

SUBMISSION FOR 1990 BUDGET

General Council of British Shipping

30/32 St Mary Axe London EC3A 8ET

Telephone : 01 - 2832922

Fax : 01 - 6268135

The General Council of British Shipping is the trade association for the British companies who own and manage ships. Nationally and internationally, it represents the views of ship operators, lobbying government and Parliament. Together its 144 member companies own or operate around 650 ships of 20m dwt from 200 grt upwards. In addition, there are many smaller vessels, some highly specialised in areas such as offshore oil support, which are represented by bodies associated with GCBS.

BRITISH SHIPPING - THE WAY AHEAD

A Memorandum by the General Council of British Shipping

SUMMARY

1. In the last 12 months our Norwegian, Danish and German competitors have seen substantial improvements in their fortunes. The Norwegian International Shipregister has grown by 86%. The Danish and German fleets have both turned from decline into growth.

2. This is against the backdrop of improvements in shipping markets that are as yet patchy and inadequate. But they give a foretaste of worthwhile opportunities for British shipping too, if its ageing fleet can be replaced.

3. Shipping is uniquely exposed to intense international competition. Almost all of the UK's major competitors receive significant help from their governments. Many have introduced new measures recently. The most effective are those of Norway, Denmark and FR Germany.

4. Investment in shipping is not attractive in the short term in the UK. Consequently, the British merchant fleet continues to decline and to age. UK registered ships on average are 13 years old and the total fleet, at 15.5m dwt, is down 8% on the last year. A fleet of around 13m dwt by 1992 is forecast, but new orders are at only half the rate to maintain a fleet of even that size.

5. British shipping companies have tremendous skills and expertise, at sea and ashore. But many have already diversified and few are captive members of the shipping community. For the United Kingdom to keep these skills the industry needs support. Without it, they could leach away within a very few years.

6. This would be a permanent blow to the balance of payments, to trade generally, and to a dozen other industries which draw heavily on maritime expertise. It would also severely damage the country's defence credibility. GCBS believes that already there are 300-400 too few ships, and far too few UK seamen to man them, for British shipping to meet its NATO commitments.

7. The need for help is urgent, as ship prices are likely to continue to increase dramatically in the next five years as old ships have to be replaced. Those companies who can build at today's prices will enjoy a tremendous advantage well into the next century. There is therefore both a small window of

opportunity and a longer-term threat to the viability of those who have to postpone investment.

8. Fortunately, a comparatively cheap remedy exists. The Government accepts the need to help many other sectors of British industry where the playing field is uneven - indeed most receive more Government support than does shipping. The EC Commission also accepts the need for government help to match outside competition so that the Community can enjoy the benefits that flow from a strong shipping industry. Pending the rolling-back of other countries' aids, which the Government - and GCBS - would like to see, a modest degree of pump-priming is needed for a period of, say, five years.

9. The effect on Government revenues of short-term aids to reinvestment is transitory - improved first-year allowances and roll over relief have costs which are subsequently recouped through increased corporation tax payments, and are really dependent on the scheduling of investment. Our best estimate is an average cost of £200m p.a. over the 5 year period in terms of deferred revenues. Aid to employment costs is estimated to be worth about £60m p.a. The pay-off for the whole package in direct cash terms alone would be a major contribution to the Balance of Payments that will otherwise be lost, and a substantial increase in the government's tax income from thriving shipping companies and the employment of British seafarers.

December 1989

BRITISH SHIPPING - THE WAY AHEAD

INTRODUCTION

1. The purpose of this paper is twofold. It describes the world scene in 1989, which has been marked by the quite exceptional improvement in the position of some of our European competitors, in Norway, Denmark and Germany. It then deals with the state of the UK fleet, the practical circumstances facing the industry now and, most importantly, the measures which other countries have recently adopted to respond to these factors. The message is one of opportunities opening up in most shipping sectors. The question is whether Government policy will assist UK shipping companies to take advantage of these opportunities, or whether the field will be left to our Continental and other competitors. Secondly, it stresses the value that the British shipping industry brings to the nation - to trade and employment, to the balance of payments, to the City of London, and to our defence capability.

2. In this analysis, the paper highlights two particular areas which require urgent attention if UK shipping companies are to make their full potential contribution to the country's welfare. These are the need for a positive climate for both re-investment in ships and for the employment of British seafarers.

THE OUTLOOK TODAY

The World Scene

3. 1989 saw the continuing tremendous growth of the Norwegian fleet, up from 12.9m dwt in January 1988 to 29.1m dwt at end-October 1989. Almost all this tonnage was under the Norwegian International Shipregister, and the Norwegian fleet as a whole has now increased by 86% in the last 12 months and by 216% since January 1987.

4. Marked improvements were also shown by the Danish and German fleets. Both have turned round from decline to significant growth. Numbers in the three fleets show these changes in direction quite clearly:

	1986	1987	1988	1989
Norway	876	764	870	1363
Denmark	540	513	471	488
FR Germany	1300	1003	832	838.

(Source: Lloyd's Register; mid-year figures)

5. These fleets had in common major efforts by their governments to provide a favourable investment climate. It is clear that action to reduce their labour costs has also provided

a major boost, which long-standing investment incentives alone were unable to provide.

6. These developments took place against a background of marked, but not exceptional, improvements in many sectors of the market. Nevertheless, increases in freight rates to date have been insufficient alone to justify new investment. Government action to enable owners to prepare themselves for the necessary further improvements has been decisive in these three countries.

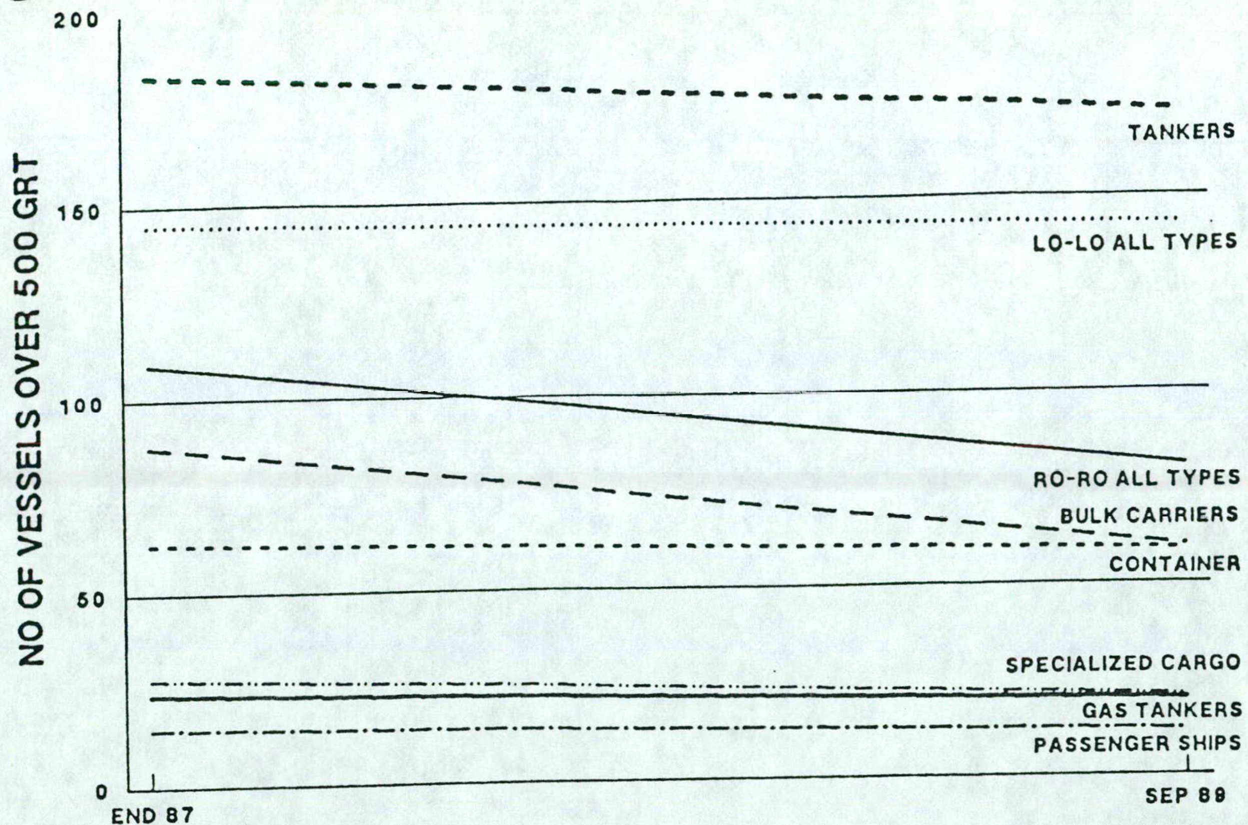
7. An analysis of the market position is contained in Annex A. To summarise, the world shipping scene overall looks better than it did five or even two years ago. In some respects, it is cautiously encouraging that most owners, banks and yards so far appear anxious not to return to the crazy days of give-away ship prices and highly leveraged financing. But for many owners, and particularly in the UK, the relief is only relative. Age and salt water continue to eat away at their assets and current freight rates are far below the levels at which investment in a newbuilding replacement would generate a proper return on the large sums involved. For example, a new 150,000 dwt tanker costing $60m must earn at least $40,000 per day to justify that investment - current rates are only $18,000 per day. Only those that are favourably placed will be able to take advantage of the opportunities now opening up and of the further improvement in markets that will almost certainly occur in the next few years.

8. A new threat is on the horizon. Demand for new ships is set to increase dramatically over the next five years and beyond, as existing vessels just have to be replaced. Yet few of the shipyards closed down in the 1970s and 1980s will ever re-open and so prices can be expected to continue to rise. Those companies who replace their tonnage now will carry a far lower burden of capital costs that those who defer fleet renewal.

The UK Fleet

9. Unfortunately, British owners are not favourably placed and as a result the UK directly-owned merchant fleet has continued to decline. At end-September 1989 the fleet of trading vessels over 500 grt, stood at 582 ships of some 15.5m dwt, of which some 33% by tonnage was registered in UK mainland ports, 35% in British Dependencies and 19% in the Crown Dependencies.

UK OWNED FLEET BREAKDOWN



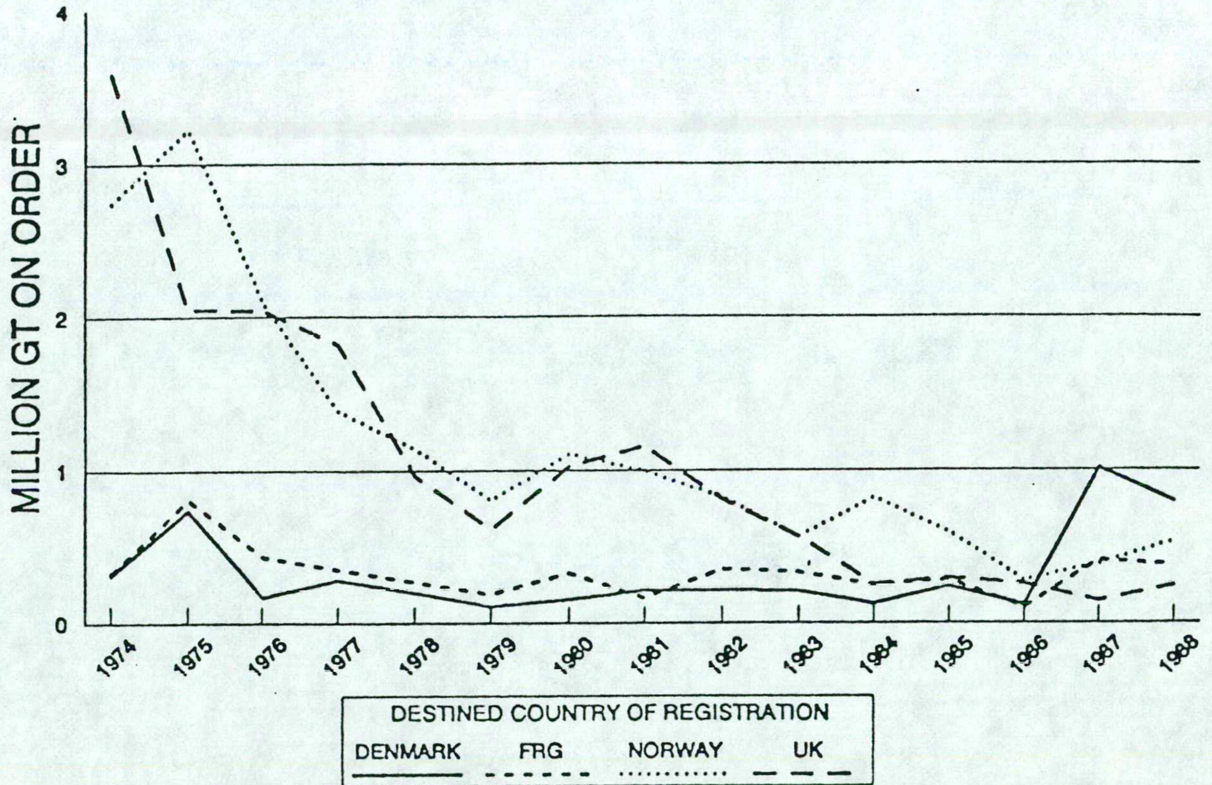
SOURCE: Lloyds Register

10. Nevertheless, the UK-controlled foreign-trading fleet produced gross foreign exchange earnings of £2.7bn in 1988, or £3.5bn taking account of import-saving effects. The net contribution of this fleet to the Balance of Payments was £521m, or £1.35bn including gross import savings. To these figures should be added the import-saving effect of the British fleet's involvement in UK coastal trade.

11. The UK industry includes well-respected household names whose quality of management and financial and operating strengths have been clearly demonstrated during the recent lean years. The larger companies are almost all part of larger industrial conglomerates, in which the shipping division has to prove its commercial value if it is to be retained. The companies engaged in the industry combine entrepreneurial flair, first-class management, experienced staff and technical expertise, covering every sector of the industry. They are totally capable of competing with other countries' shipping industries, provided the overall environment is similar.

12. The reason for the decline is that, despite the recent improvement in trading conditions, it is still difficult for many UK owners to justify investment in ships at a time when this is becoming increasingly urgent. The consequence is that, despite a welcome improvement since the bleak period in 1986-87 when 12

months passed without a single newbuilding order being placed by a UK owner for UK registration, the rate of renewal of the fleet remains far too low.



SOURCE: Lloyds Shipbuilding Returns

13. The UK-registered fleet in mid-1988 had an average age of 12.7 years against a normal economic life under West European conditions of between 15 and 20 years. In the container sector, the average age was 14.7 years. The UK age profile was significantly higher than that of most of our major competitors as can be seen from the following table, (the Norwegian figure is high owing to the very large investment in second-hand vessels over the previous two years):

Country of Registry	Average Age of Fleet Years (mid-1988)
Sweden	6.9
Belgium	8.2
Japan	8.2
FR Germany	8.3
Taiwan	8.9
Netherlands	9.1
Korea	9.7
Denmark	9.8
Panama	10.4
France	11.3
Norway	11.4
World fleet	**12.2**
UK	**12.7**
Liberia	12.8
Greece	13.4.

(Source: OECD Review "Maritime Transport 1988")

14. The latest available figures for the UK-owned fleet show that in the twelve months to mid-1989 the situation has deteriorated significantly, with the average age of the UK-registered fleet rising to 13.1 years and that of the whole UK directly-owned fleet, under all flags, being 12.9 years.

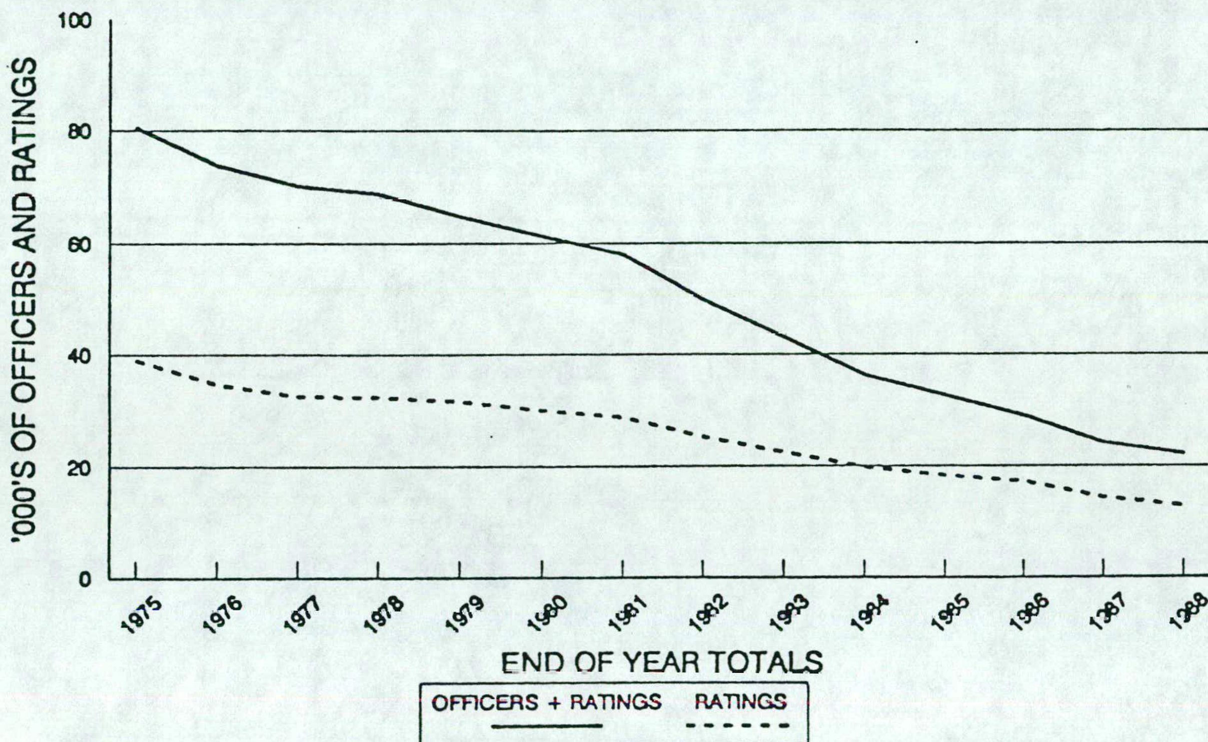
15. On the basis of the current order book, which stands at 12 vessels for UK registration, the renewal cycle of the UK-registered fleet is 29 years. In practice this means inevitable continuing contraction, as old ships reach the point where they cannot compete with new ones. After a certain age, the increasing cost of repairs and maintenance, and the higher fuel and crew costs of old ships outweigh the advantage of lower capital costs of written-down ships. In many sectors, notably containerships, new vessels also carry more than the old designs that they replace and hence offer economies of scale. And ship operators cannot provide the ultra-reliable and speedy service demanded by their customers in many trades, unless they periodically renew their assets to take advantage of technological developments.

16. In September 1988, a GCBS survey of its members indicated a likely further decline, under present conditions, of 20-25% over the 4 years. In the first 12 months of that period, this forecast has been more than borne out with the fleet declining by some 8%. Even to maintain the 1992 fleet at around the

13m dwt that this forecast indicated, nearly 900,000 dwt needs to be ordered each year, representing an annual investment of some £450m. This is nearly twice the level of orders on the books at mid-1989. A UK directly-owned fleet of around 6m dwt within only a few years is thus a real possibility - with the UK-registered fleet likely to be only a fraction of that.

17. An allied problem is the diminishing number of British seafarers. During the depths of the slump, British owners had to cut back their operations, flag out many remaining ships and suspend recruitment if they were to survive. As a result, British seafarers have diminished greatly in number. The numbers registered with the Merchant Navy Establishment have fallen from 33,350 officers and 31,600 ratings in 1979 to 9,300 officers and 12,850 ratings by September 1989. (Perhaps a further 5,000 officers and ratings work on non-MNE ships.) The fall is equivalent to the working population of a major town - Southampton, for example.

NUMBER OF COMPANY SERVICE CONTRACT
AND REGISTERED SEAFARERS ON THE MNE'S REGISTER



SOURCE: GCBS

18. Even in today's improved markets, operating costs are crucially important, and crew costs are the main variable. For many operators the yard-stick is the cost of a crew drawn from the highly competent officers and ratings available from the low cost countries of the Far East.

19. If UK owners flag out, these seafarers become available to them. But in the longer term this is the route to national maritime insignificance. Not only do British companies prefer on commercial and operational grounds to have British seafarers managing their assets, they need to bring ashore trained ex-officers to fill many management posts. Many allied industries - ports, insurance, loss adjusting, classification societies and others - likewise rely on a continuing supply of trained officers. It is far better for the wages of seafarers serving on UK directly-owned ships to flow into the UK economy than for them to drain away elsewhere. And of course in countless wars, from the days of King Alfred to those of General Galtieri, Britain has relied heavily on the British merchant seaman, often at a heavy cost in casualties.

WHAT WENT WRONG?

20. Why is the British industry afflicted with these two problems - shortage of investment funds and a growing shortage of trained seafarers?

21. The answer is that the British Government is almost alone in leaving shipping to the unfettered play of market forces. Other governments have not, thereby making our position all the worse. It is a fact that shipping is far more exposed to international competition than almost any other industry. The rate of return is affected by what the most advantaged operator can accept. Although over the 15- to 20-year life of a ship, the income flows and foreign-exchange earnings can be good, the British capital market is singularly ill-suited to take a long-term view. Most shareholders are pension funds, insurance companies and other institutions, investing other people's savings in a highly competitive environment, where the yardstick is this year's return on capital. An investment in shipping is excellent in the long term for British companies and for the nation. Inherent "short-termism" is now obscuring a long-term view. As a result, without Government assistance to help us enter the race, British shipping may miss the opportunities that are now opening up.

22. The British Government's view is not shared by the European Commission. A similar basic economic situation faces all European shipowners. This is recognised by the Commission, which in August 1989 published a comprehensive and useful analysis of the present shipping climate in its consultative document on the second stage of a Community shipping policy. Among other things, the Commission highlighted that:

- while the problems facing shipping have eased in the last year, the changes in economic conditions do not eliminate the structural comparative disadvantages in regard to crew costs and tax treatment from which Community shipping suffers as against many third-country fleets;
- the loss of a Community fleet would have an adverse influence on the quality and cost of transport to and from the Community and thus damage the Community's trading position;
- there would also be significant damage to Community interests in terms of employment, balance of payments and defence.

The Commission concluded that urgent action needs to be taken by Members States if EC shipping is to serve the Community effectively. It is unfortunate that its proposals do not match its analysis, but it has only a limited role, particularly in respect of tax incentives.

23. Indeed, it is strange that the British Government should have such pure policies in respect of shipping (apart from some minor - but appreciated - aid for training and crew relief costs). It certainly does not practise the same virtues in respect of other industries against which British shipowners must compete for funds. The Enterprise Initiative covers consultancy costs for many aspects of commercial operations. The Eureka Initiative gives incentives to promote British technological penetration of European markets. The Regional Initiative scheme gives assistance to industry in many parts of the country. None of these are directed to shipping. Nissan, for example, has received £125m over five years since 1984 to set up operation in the UK and this assistance is scheduled to continue in the future if Nissan expands its investment here. Airbus is still a heavily subsidised loss-maker. In the transport sector, subsidies are used to support rail freight and even the scheduled airline industry is protected by a closely knit web of inter-governmental agreements.

24. Within the context of the European Community, the Government also accepts the Common External Tariff, which provides all land-based manufacturing industries with a considerable degree of protection. In addition, the Common Agricultural Policy is notorious for the high level of subsidy it provides to the farming community. Other investors receive assistance through European Community regional aid and European Coal and Steel Community conversion loans.

25. All these measures increase the attractiveness of investment in other industries. They all indicate a realistic acceptance by the Government that pure "market forces" are not enough if the other players have rigged the market. But, in shipping, the Government simply argues that other countries should wind down their aid. While this is a laudable objective, it is quite unrealistic as a response to our immediate problem.

26. British shipping should not be taken for granted. Two-thirds or more of UK directly-owned ships are owned by companies or groups which are already diversified into other industries. They know that other investments are more immediately profitable, they have the expertise to exploit them and they, like all companies, have a duty to their share-holders to obtain the best possible results for them. These companies could get out of shipping altogether and still survive as profitable - probably more profitable - entities.

27. Some UK companies - the oil companies are good examples - maintain fleets to provide a service for their main activity. They have so far decided that the balance of advantage lies in providing at least part of that service with owned ships. They could well decide to provide it entirely with chartered-in ships, and allow a foreign shipowner bear the burden of achieving profitable ship operations.

28. There is no inherent reason why other shipping services customarily provided with owned tonnage cannot use chartered, foreign-owned ships. Already some ferry and some container services used chartered-in ships.

29. The disadvantage of moving to chartered-in shipping is the erosion of both company and national expertise in ship-operation. In time, only the chartering option will be available and the company (and the nation) will have to pay the price that the open market demands. Chartering is also potentially a very expensive option, with costs subject to wild variations - for example, charter rates for container ships have doubled since 1986.

THE SANDS OF TIME

30. The blunt facts are that:

- this island nation has witnessed a drop in shipping investment that leaves the UK-controlled fleet (and UK-based seafaring labour force) heading towards the point when its massive reservoirs of skill and expertise, both ashore and at sea, will have been largely dispersed. The road to recovery will then be terribly long, steep and stony;

- the commercial opportunities in the present markets are better than for many years. A short look into the future is sufficient to convince GCBS that they will get significantly better still, as old ships have to be scrapped. If these opportunities can be seized, they should bring significant rewards both to the companies in question and to the nation;

- unless UK owners are put into a position to act quickly, the opportunities will be gone. The further dramatic increase in ship prices forecast for the 1990s represents a major threat to the viability of those owners who cannot reinvest now.

31. The opportunities are there for the taking. But they will have to be supported by positive and urgent action by the Government to enable British shipping companies to take a longer view than is now possible and thus to match their competitors.

HOW THE COMPETITION HAS RESPONDED

32. As indicated in the GCBS briefing paper "A Level Playing Field for Merchant Shipping?", published in May 1989, most of our European competitors (both inside and outside the Community) have in fact taken recent action to respond to the continuing decline of their national fleets. Some have long had policies of great value to their shipowners, but many have focused in recent years on improving the investment and operating climate in which their shipping companies exist through positive policies in regard to taxation and fiscal treatment. Others have concentrated on reducing manning costs, either by providing incentives to continue the employment of their nationals, or by permitting the employment of non-nationals at lower rates. Many have applied a combination of the two. Some countries have used the mechanism of a "second" or "international" register to achieve this objective; others have incorporated incentives directly into their national maritime policies. Since the GCBS paper was published, several further support packages have been introduced by Community Governments.

33. Government action in the three successful cases mentioned in Paragraphs 3-5 above can be summarised:

- **Norway**. Since the establishment of the International Register (NIS) in 1987, which permitted substantial reductions in crew costs, the tonnage under the Norwegian flag has trebled (as detailed in paragraph 3). The fleet has been substantially boosted by a long-term policy of tax incentives to invest in K/S limited-partnership schemes, designed to draw in funds from highly-taxed personal incomes. Norwegian K/S companies alone have attracted an influx in the last 2 years of US $2bn (one per cent of the cost of replacing the entire world fleet!), which demonstrates that with the right encouragement and with the

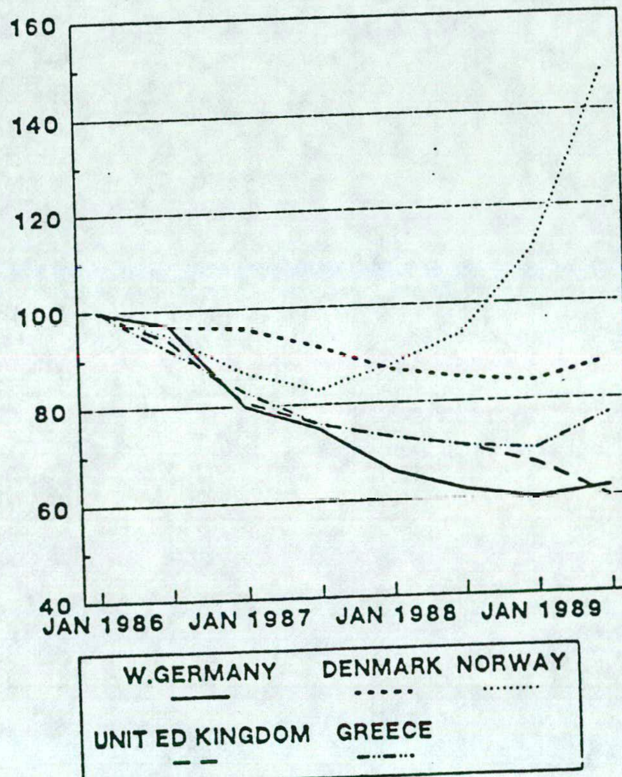
prospect of a reasonable return, substantial investment is available;

- Federal Republic of Germany. Since the establishment of the supplementary register in May 1989, the decline (28% since January 1987) has been reversed. In addition, long-standing tax incentives in Germany such as special depreciation and reinvestment incentives have produced a national fleet with an average age of only 8.3 years, with 70% less than 10 years old;

- Denmark. Since the establishment of the International Register in September 1988, 70% of the deep-sea fleet has now joined it. The fleet has expanded because of long-standing taxation and manning incentives such as limited partnerships, accelerated depreciation and tax concessions for seafarers. Its average age is under 10 years and there are 56 new ships on the order book.

34. It is worth noting that the largest European shipping industry, that of Greece, has long benefited from extremely low levels of corporate taxation, based on tonnage rather than profits. This gives Greek owners a particular advantage at times of improving shipping markets. Seafarers are also subject to very low levels of income tax.

35. The following diagram shows the fleet development in the three countries in which an international or second register has been recently established, as well as in Greece and, for comparison, the UK.



SOURCE: Lloyds Register

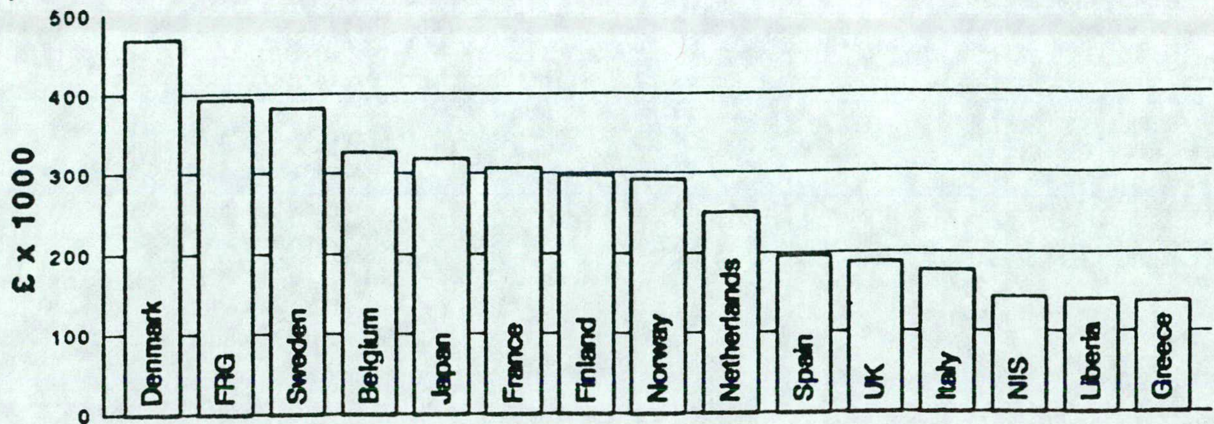
36. It must be remembered that the competition facing UK carriers is not only from within Europe but from the very competent owners from the Far East. Owners in Japan, Korea and Taiwan all receive considerable protection and support from their Government. In all, the GCBS Briefing Paper identifies between 70 and 80 different maritime administrations, amounting to nearly 80% of world tonnage which give major aid in one way or another to ships operating on their registers. In Europe alone, Belgium, Finland, France, Ireland, Netherlands, Portugal, Spain and Sweden have either recently introduced new measures or have them under active consideration. Market forces are certainly not dominant on the supply side of shipping. UK shipping companies are facing an unequal struggle in international trades.

37. Research undertaken by Professor Goss of the Department of Maritime Studies of the University of Wales, sponsored by GCBS, has investigated the overall value of this assistance. The draft report shows that, in the field of subsidies and corporate taxation alone, our major European competitors operate in a business climate considerably more conducive to investment in and the profitable operation of shipping.

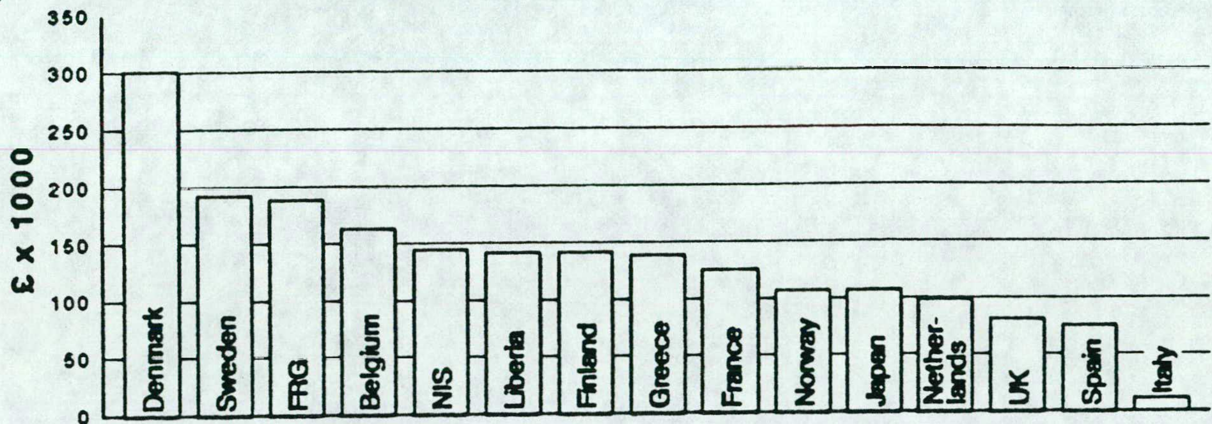
38. The value of various countries' fiscal regimes depends to some extent on the level of profitability of the industry. In times of high prosperity (15% pre-tax rate of return), the UK regime is not too bad - 8th out of the 15 regimes studied, but still inferior to those of Belgium, Denmark and Greece within the EC, and Finland, Sweden, Norway-NIS and Liberia outside. But in the far more realistic scenarios of low and medium profitability (5% and 10% rate of return respectively), characteristic of the shipping industry in recent decades, we are far worse off - 11th and 13th out of 15 respectively.

FISCAL INCENTIVE TO INVEST IN NEW SHIPS
ASSUMED DISCOUNT RATE OF 8%, INFLATION 5%

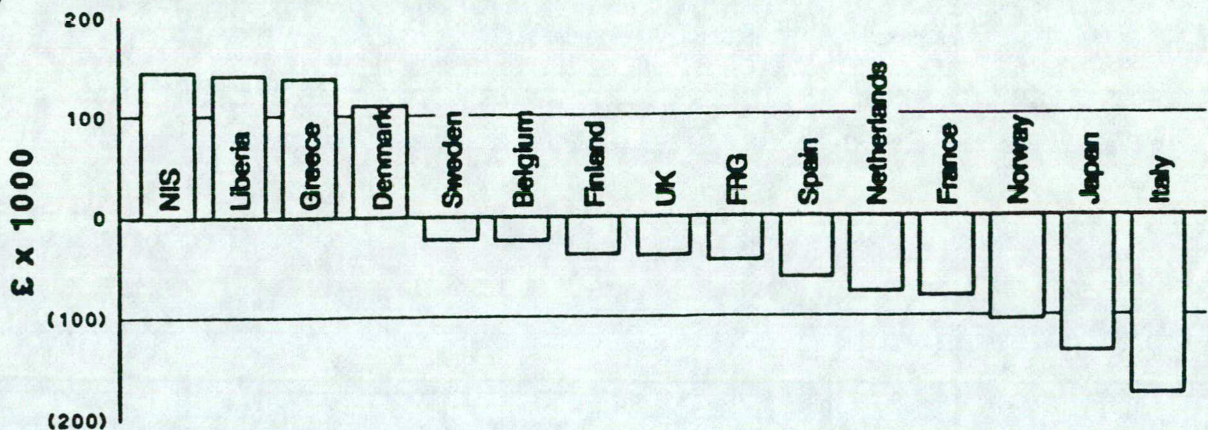
a) Pretax Rate of Return 5%



a) Pretax Rate of Return 10%



c) Pretax Rate of Return 15%



SOURCE: Prof R O Goss

39. More important than the UK's position in the league table is the effect in cash terms of the different fiscal regimes on an investment in shipping. Taking the situation of medium profitability, the Dutch owner is 21% better off, the French 54%, Greek 70%, Belgian 99%, German 130% and Danish shipowner 268% better off under their tax systems than their UK counterpart. All this is external to the influence of the particular shipowner and has nothing to do with the relative efficiency of the fleets concerned.

40. What British shipping certainly does <u>not</u> need or seek is "cradle to grave" subsidies. What is needed, however, is a relatively small amount of pump-priming, in order to allow UK owners to reinvest in new ships and in trained British seafarers to meet the opportunities of the next decade. Relatively small-scale, low-cost measures would make an enormous difference to the ability of UK shipping to meet the nation's needs. Paragraphs 41-53 below describe what these measures could be. Immediate action would give a breathing space while the British government persuades other shipping nations to dismantle their systems of support.

THE WAY FORWARD

41. GCBS acknowledges, without apology, that its message is not a new one. The hard fact is that there are two areas - capital costs and manning costs - in which early action remains necessary if the decline of the UK fleet is to be reversed and the potential benefits to the nation of the British shipping industry are to be realised. What is new is that some of our competitors have taken action on both fronts, with splendid and entirely predictable results.

42. The first relates to **AIDS TO INVESTMENT**. The Government has rejected significant special treatment for shipping since 1984, when the fiscal regime which had led to 16m dwt of new ships being built over the previous decade was withdrawn. But this is still the single, most important area in which Government action could have an impact. There are two principal ways in which the investment regime for companies could be imposed - accelerating depreciation and roll-over relief - and useful minor assistance could also be given by altering the rules of the Business Expansion Scheme.

43. By far the most efficient way of improving the internal rate of return on ship investment is to provide for **accelerated depreciation**. A 100% ship allowance as a First Year Allowance would make the internal rate of return on investment in a new or good quality second-hand ship far more attractive.

44. While in any investment decision other factors (for example, risk assessment) are taken into account, the examples in Annex B, summarised below, illustrate clearly the improved viability of investment, and the improvement in the internal rate of return, which would result from a 100% allowance for two different types of ship. In most cases, the effect would be to increase the present rate of return to the shipping companies concerned by around 100%.

	RATE OF RETURN			
	OECD Finance		100% Equity Finance	
	25% Writing Down Allowance (present)	100% Ship Allowance (proposed)	25% Writing Down Allowance (present)	100% Ship Allowance (proposed)
Short Sea Bulker	14%	34%	9%	12%
Container Ship	8%	15%	4%	9%

45. Such a measure introduced for a 5-year period would prime the pump for a rapid investment programme to restore and re-invigorate the UK merchant fleet.

46. Improved terms for **Roll-over Relief** for Corporation Tax would be of particular value to operators in the bulk sectors. Many of these rely on trading their assets, as well as trading with them, to maintain overall profitability. Their objective must be to buy in a depressed market and sell when prices are high. Secondhand ship values fluctuate markedly, as recent months have shown. It is in this way that many Greek and Norwegian entrepreneurs have built up their fleets.

47. Yet such activity is incompatible with current rules for "roll-over" relief of balancing charges, which require a new purchase to be made in the same accounting year as the old vessel is sold. This allows no real scope to time purchases to a falling market. So a British bulk ship operator is at once 35% worse off than his Greek counterpart (who pays no corporation tax at all) or his Norwegian colleague who - like owners in Denmark,

Germany, Netherlands, Spain, Japan and USA - can place the proceeds of his sale in a tax-free reserve.

48. Over the last two years, a number of shipping ventures have been able to make modest use of the **Business Expansion Scheme**. If the terms were more adapted to the market, it could produce considerable investment. Unfortunately, the opening-up of the BES to investment in assured tenancies of domestic properties has attracted most investors to these virtually risk-free ventures. Property Enterprise Trusts in Enterprise Zones - also attracting 100% personal income tax relief for investment in commercial properties - have absorbed even more private investment funds.

49. Yet paradoxically, a major limitation in the value of BES to shipping lies in the restrictions imposed on BES ship schemes, particularly the requirement that the vessel shall not be chartered out for more than twelve months at a time. This limit was introduced to import a significant element of risk-taking into BES shipping ventures, but has the effect of severely curtailing the ability of ship schemes to raise supplementary loan finance for the vessels they wish to buy. A lengthening of the permitted period of charter would greatly ease these financing problems by providing greater security of earnings and would go some way to offset the effects of the cap on BES funds. In the industry's view, the right period of permitted charter would be five years, but any increase would be of value.

50. The second area concerns **MANNING COSTS** which must be reduced if British seafarers are to be employed. There is a major opportunity here, for many European countries' wage and social security costs are so high that they cannot hope to bridge the gap with world costs and continue employing their nationals. Hence the NIS approach is to permit the use of non-Norwegian nationals almost without restriction. But UK costs are lower and government action could lead to greatly improved employment opportunities for UK seafarers.

51. The action needed is to eliminate National Insurance and Income Tax liabilities in regard to seagoing employment, in order to align the overall cost of operating UK-manned ships more closely with that of lower-cost competitors in world shipping markets, without reducing real wages to third world levels. As mentioned in paragraph 32 above, such measures have been adopted by a number of European governments.

52. It is vitally important that a mechanism be incorporated which ensures that the same net pay is received by the national seafarers, that they remain fully eligible for social security benefits, state pensions etc, but that the full advantage arising from the reduced income tax liability feeds through to the shipping company itself. This has been achieved in different ways in different countries. For example, in Sweden, the law

provides that the income tax payments of seafarers must be refunded to the employer; in addition, there are no employers' National Insurance contributions. In Denmark, income tax and social security payments were abolished in regard to seafarers at a time when the national collective agreements were to be renegotiated and a scheme now operates whereby special arrangements are adopted upon the acceptance of given net pay levels of remuneration.

53. UK shipping companies need comparable treatment if they are to compete on equal terms. Although the current income tax regime provides a welcome incentive for some seafarers serving on deep-sea ships to continue at sea, its impact is too uncertain to lead to lower costs overall for owners. The measures proposed would cut some 18% of the industry's wage bill.

THE COST TO GOVERNMENT

54. The cost of the investment incentive elements of this support package is difficult to quantify with close accuracy. It depends critically on the degree of take-up, timing, and the interface between the two types of measures. Both schemes would affect the future profile of revenue cash-flows rather than their quantum, with the costs of initial relief being balanced by greater corporation tax in subsequent years, including tax on the operating profits from the new tonnage.

55. Based on an annual investment in tonnage of £1 billion over the five-year period (ie 40 ships averaging £25m apiece) the average annual cost of 100% First Year Allowance to the Exchequer in deferred corporation tax compared with the present system of 25% reducing balance depreciation would be about £150m. The first year would have a high figure of £260m, which declines rapidly to only £75m in year 5. It is our belief that these amounts would be largely (if not entirely) offset by corporation tax due on the additional profits generated over the years by the operation of the new assets.

56. For Roll-over Relief, current annual levels of disposals are about £300m of fully-written-down vessels. It is assumed that one half of these are in any case covered by present arrangements for roll-over relief within the same accounting year. The deferred tax on balancing charges on the remaining £150m of disposals amounts therefore to around £50m p.a. which, again, would be recovered later on.

57. The proposed changes to arrangements for seafarers' income tax and national insurance contributions are also difficult to estimate, but it is thought that they would have an annual cost to Government of under £60m.

VALUE TO THE NATION

58. Why should shipping be given special treatment? Just because the foreigners throw their money away, why should we? Isn't it just another activity - like textiles and making hi-fis and motorcycles - where we should give up trying to compete with the Far East? Should we not let those governments who are prepared to subsidise world shipping do so to our benefit as users of shipping services?

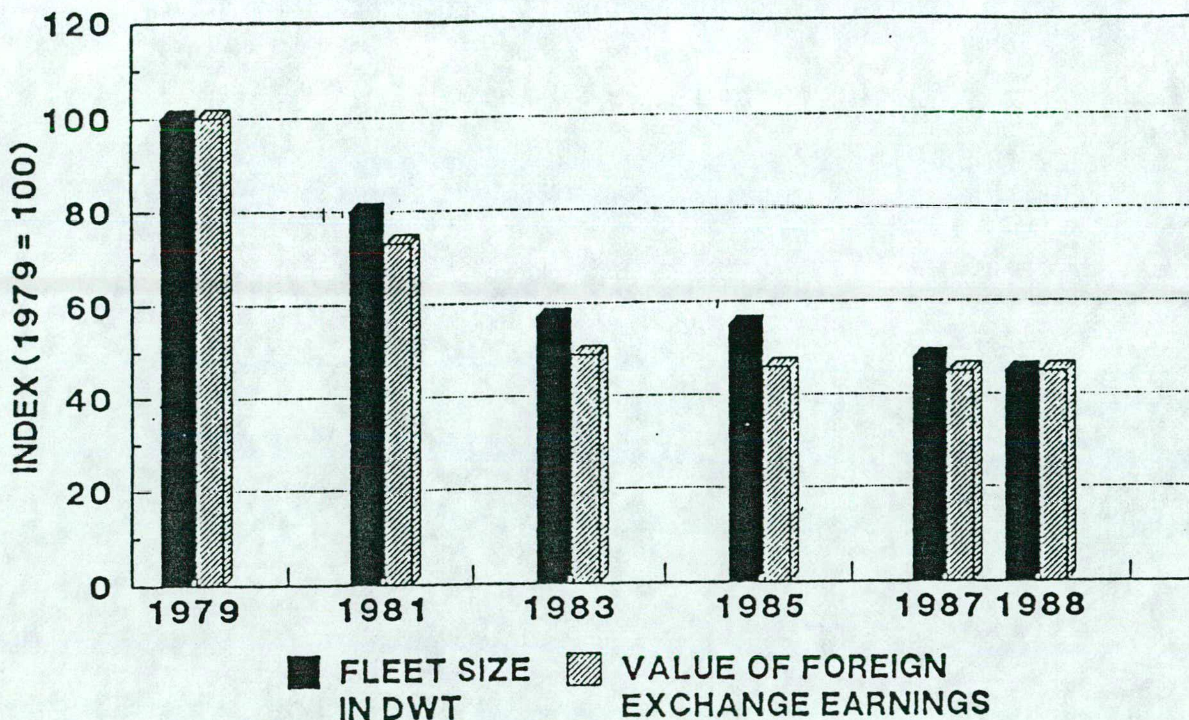
59. Firstly, as we have mentioned in paragraphs 23 - 25 above, the treatment would not be that special. What is special at present is that shipping is more exposed and less assisted than most other industries.

60. Secondly, there are real and concrete advantages to the nation in restoring and maintaining a strong merchant fleet. Shipping is a vital service in time of both peace and war. It makes a major contribution to our economy. It is not just a fashion industry that we can safely leave to others to provide. That is certainly the view of the other great island trading nation, Japan! Emphatically, it is not a "smoke stack" industry, where the UK cannot compete because our management is too arthritic. Given the right economic climate, UK shipping can again be a world leader. The advantages are set out below.

Balance of Payments

61. There are few, if any, more efficient methods of earning foreign currency than by shipping. Other industries contribute to the balance of payments through a series of substitutions with all the inefficiencies that that implies. Shipping is more direct and involves far less leakage.

62. Although the Department of Transport has recalculated the basic statistics, it cannot be denied that British shipping companies make a major contribution to the balance of payments - £3.5bn gross and £1.35bn net (including foreign exchange saved when British imports are carried in British ships) in 1988. They are the third major invisibles contributor (after tourism and insurance but before civil aviation, banking and pension funds) and could therefore make a much bigger impact relatively quickly given a healthy investment environment. A detailed analysis of the overall contribution of shipping was issued by the GCBS in May 1989 under the title "British Shipping and the Balance of Payments". Past evidence of the ratio of fleet size to foreign currency earnings illustrates a close correlation (see table).



SOURCE: CSO Pink Book & Lloyds Register

63. A UK fleet 50% larger than today (approximately equal to that of 1982) should benefit the balance of payments by a further £1.8bn or so in gross terms. Such a growth is by no means unreasonable - the Norwegian fleet grew by 86% in the last 12 months as a result of a combination of tax incentives and the virtual elimination of national crewing requirements. In contrast, the predicted 1992 fleet of 13m dwt without government assistance, would lead to a reduction in the current contribution of about £½bn.

64. There are those who claim that there are long-established and deeply-entrenched trends for even modest growth in the UK economy to lead to increases in imports outstripping increases in exports. Even if one does not fully accept that view, there is very little ground for optimism that the balance of our trade in goods will improve. Against the likely background of a £20bn deficit in the country's balance of payments in 1989, modest and short-term help to the shipping industry must be a good investment by the nation.

Economic Value of the Industry

65. The commercial and social contribution made by the shipping industry to the nation was summarised at the beginning of this paper. The "shipping industry" in fact comprises several very different, but essential industries: deep-sea liner (largely containerised), bulk trades (both liquid and dry; both deep-sea and short-sea), ferry, cruise and offshore, all of which give direct and stable support to the movement of trade and British citizens. Ninety-five per cent of our trade, both with Europe and the rest of the world, and two-thirds of travellers across the English Channel still move by sea, despite the higher profile and expansion of the airline industry.

66. The industry provides employment for some 27,000 British nationals at sea and a further 13,000 shore-based jobs. Rationalisation and technological developments - on top of the decline in fleet-size - have reduced the numbers over the years, but seafarers remain an important and skilled labour force, which is a genuine national resource. The scope for greater employment of British nationals is dependent on fleet-size and the level of manning costs which can be achieved compared to the competitive world market.

Allied Industries

67. The City of London still derives considerable revenue and strength from its position as the world capital for shipping and its multitude of maritime-related activities. It is the centre for marine arbitration, insurance, loss-adjusting, P & I clubs, shipbroking, chartering, classification, and other similar businesses. It provides a home base for the International Maritime Organisation and several other international shipping and seafaring associations. In short, it remains the traditional hub of the maritime world and gains considerable income from such activities.

68. It is notable that the Norwegians and the Greeks have both recognised the value of these ancillary industries and have begun respectively to try to develop and market the attractions of Oslo and Piraeus on the world scene as alternative maritime centres. They have explicitly recognised the importance of developing their own shipping industries in this connection and this provided one of the prime motivations for the establishment, for example, of the Norwegian International Ship Register (since NIS vessels have to be managed from Norway). With the advances in telecommunications of recent years and closer political and economic integration in Europe, other countries acknowledge the positive impact such activities can make on their balance of payments and see an opportunity to take London's position. The importance of this was recognised by the Government earlier this year when it abandoned plans to tax worldwide earnings of foreign

residents (which would have driven much of London's Greek shipping community abroad).

69. However, to support many of these activities, an experienced and skilled workforce with a practical maritime background is required. Such a workforce cannot be built up nor replaced at short notice. Maritime training has a long lead-time; training periods for officers vary from 4 to 10 years and further experience at sea may also be required. Without a merchant fleet there can be no recruitment, no training, no sea-experience.

70. Long-term vision is therefore critical if the influence of the City in maritime affairs is not to be diminished. If it is not to lose these lucrative sources of income, action must be taken soon to ensure the continuing flow of experienced seafaring personnel.

Defence

71. Finally, but not least, there is the defence requirement that the Merchant Navy fulfils. The advantages of a strong merchant fleet in times of tension are well understood. It is only the UK directly-owned fleet that can be relied upon in such times to heed the nation's or NATO's call. The UK's contribution to NATO's conventional deterrent rests entirely on the ability to supply a large number of cargo ships to bring reinforcements and supplies across the Atlantic. British shipping could now have real difficulties in meeting its tasks of supporting and augmenting the Royal Navy; reinforcing Europe and Norway; bringing military supplies from North America; and bringing also essential raw materials, manufactured goods and food to keep industry and the population alive during a conflict of any duration.

72. GCBS believes that there is now a shortfall of 300-400 ocean-going, trading ships between the fleet currently available and what the UK needs to cover both its own requirements and its contribution to NATO. The Government has already acknowledged that there is a parallel cause for concern about the availability of crews who can be relied on to man ships in a crisis. This case has been developed in detail in a GCBS briefing paper entitled "British Shipping and Defence", published in September 1989.

73. Paradoxically, the new mood in Eastern Europe, forces reductions and American cutbacks in Europe shift the emphasis more than ever to trans-Atlantic reinforcement and resupply, and so to merchant shipping.

74. Shipping companies have to be motivated by their commercial interest if they are to retain the support of their shareholders and survive. But there is a market convergence between the commercial interest and the national interest - both are best

served by a climate in which British merchant shipping can flourish.

CONCLUSION

75. The industry and the nation need a new era of effective co-operation between Government and the British shipping industry - co-operation which will enable the industry to provide the maximum contribution to the national interest. The potential is very clear at a time when the world's shipping markets have turned the corner and appear to be entering a new era of positive development. At the same time the major threat of heavily increased ship prices is looming and early action is needed. There is only a small window of opportunity.

76. This has been recognised by other governments, particularly in Europe, which have taken measures to ensure that their fleets benefit from the resurgence. The need has also been recognised by the European Commission. The value of such action has been clearly shown by Norway, Denmark and Germany. Only the British Government is out of step. Although there are long-term merits in seeking to persuade other countries to remove their systems of support, it is unrealistic to expect them to do this in the short term - non-European governments have to curb their measures too. As a result, this nation runs the risk of missing out on that opportunity and on the consequent financial returns and wider benefits - to the Balance of Payments, our other economic and City interests, and our defence capabilities - if it continues to sit on its hands, while the sands of time run out.

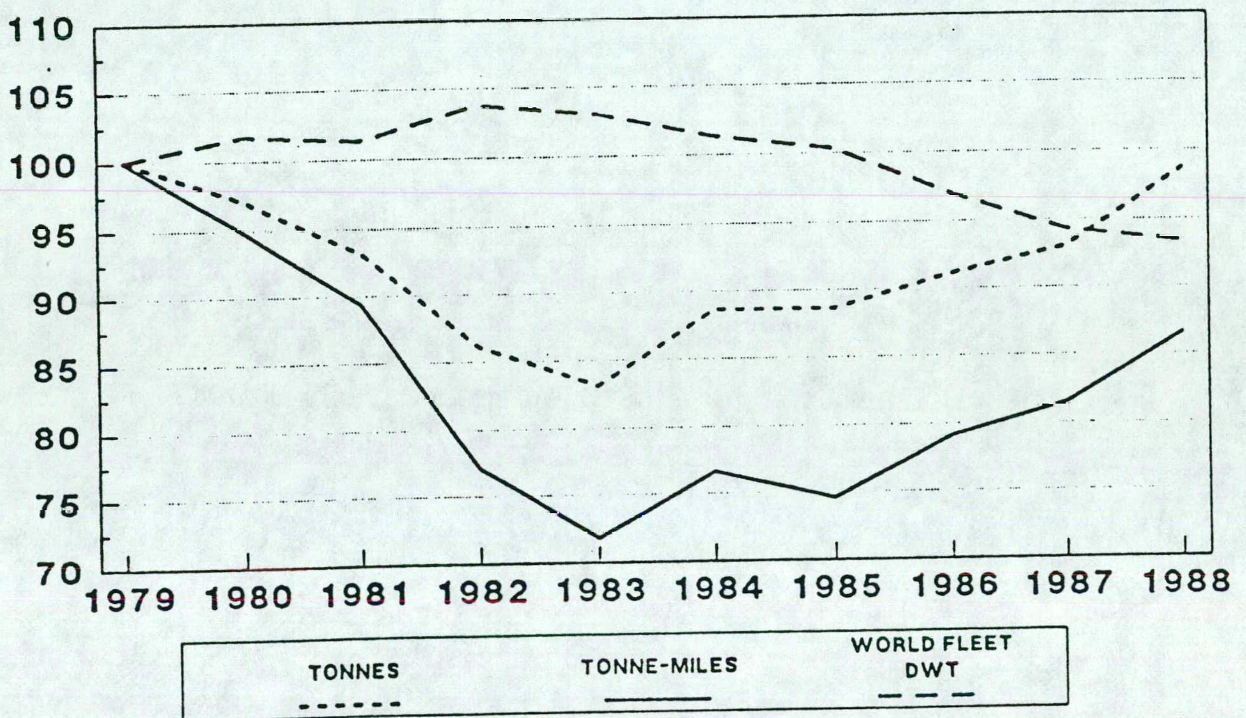
77. The General Council of British Shipping therefore calls on the Government to give British shipping industry the positive policy support which is available to shipowners elsewhere. The availability for five years of a 100% First Year Allowance, minor improvements to the rules for Roll-over Relief for balancing charges and to the Business Expansion Scheme, and the elimination of National Insurance and seafarers' income tax liabilities would give British shipping companies and British seamen the opportunity to reverse the recent decline and make their full contribution to the country's economy and national interest, in peace and in war.

ANNEX A

THE SHIPPING MARKET IN 1988/89

1. The overall outlook in shipping is better in 1989 than it has been for many years. There has been a significant up-turn in many, but not all, parts of the shipping market. However, it is being welcomed with caution because the financial improvement was from a very low base position, because similar signs of resurgence have often proved illusory and short-lived in the past, and also because unrestrained optimism could lead to excessive newbuilding orders, thus destroying the improvement.

2. 1988 was year of growth for world trade, and shipping benefited. In tonnage terms, seaborne trade increased by 6%, almost to the record levels of 1979. It has continued to grow, albeit more slowly, in 1989 and the record may well be surpassed this year. In tonne-mile terms, although there was real growth, volumes still remained well below the 1979 record levels, owing to changes in the pattern of trade over recent years.

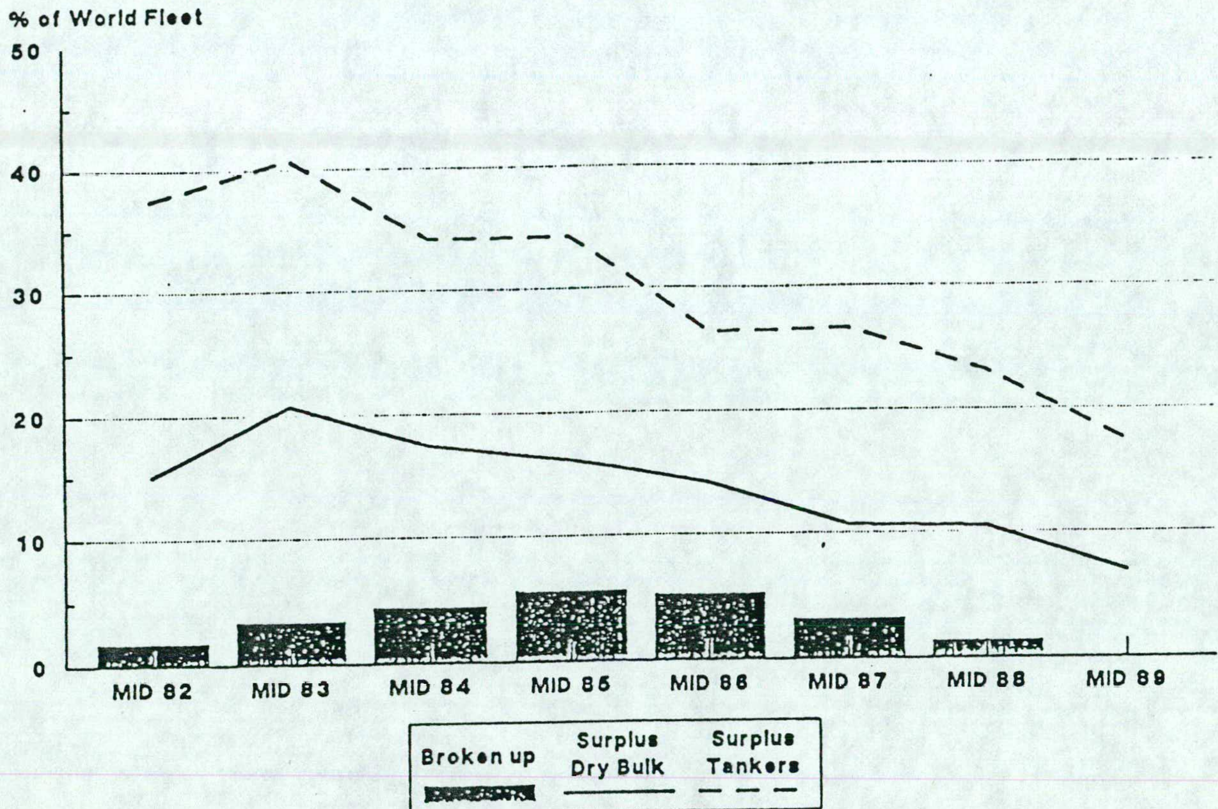


SOURCE: Lloyds Register & OECD review "Maritime Transport 1988"

3. Different sectors of the industry were affected in different ways, with tanker operators enjoying almost continuous improvement during 1988, whereas dry bulk volumes have largely flattened out after a substantial surge in the first part of 1988.

4. This increase in trade, coupled with the lowest level of newbuilding deliveries for 25 years, led to a much closer balance

between supply and demand for shipping services, with consequent improvements in freight rates. In 1988/9, virtually all laid-up dry bulk carriers and most tankers returned to normal trading, and there was a 60% decrease over 1987 levels in the tonnage sent for scrap.



SOURCE: Lloyds Shipping Economist & Lloyds Register

5. In addition, in 1988, lower fuel prices together with the improvement in the markets removed any incentive to save fuel costs through slow steaming. Most of that hidden surplus capacity was therefore also removed.

6. The improvement in freight rates has been generally firm and constant in the <u>deep-sea dry cargo</u> time-charter and trip-charter markets. The short-sea dry bulk and the tanker markets are more volatile and differ from trade to trade. However, here too, the underlying trend is one of improvement, although this is not necessarily steady. For example tankers have suffered a downturn after a sharp rise at the end of 1988.

7. The position has been less satisfactory in the <u>deep-sea liner</u> sector, where there is still over-capacity in the container trades, although less dramatic than the chronic surpluses that have afflicted the bulk trades for so long. This oversupply has kept freight rates under pressure and in some cases has forced a drop in the tariff levels. However, the negative effects have to some extent been off-set by the increase in trade volumes. Liner shipping companies, which have a stronger commitment to a particular trade than in most dry bulk markets, have to take a longer view when considering their investment decisions. Many

container fleets, in Northern Europe in particular, are renewing their fleets. Indeed, during this year alone, virtually all foreign deep-sea containership operators have taken delivery of new tonnage or placed orders (83 ships totalling 3.5m dwt in orders alone). UK operators have been almost absent from the picture with only three newbuildings.

8. Assuming a reasonable level of scrappings over the next few years, the liner companies with new tonnage will be able to benefit from the 30% increase in efficiency in terms of costs per container carried provided by the latest ships. Those without will be severely handicapped and less able to provide the level of service that shippers demand.

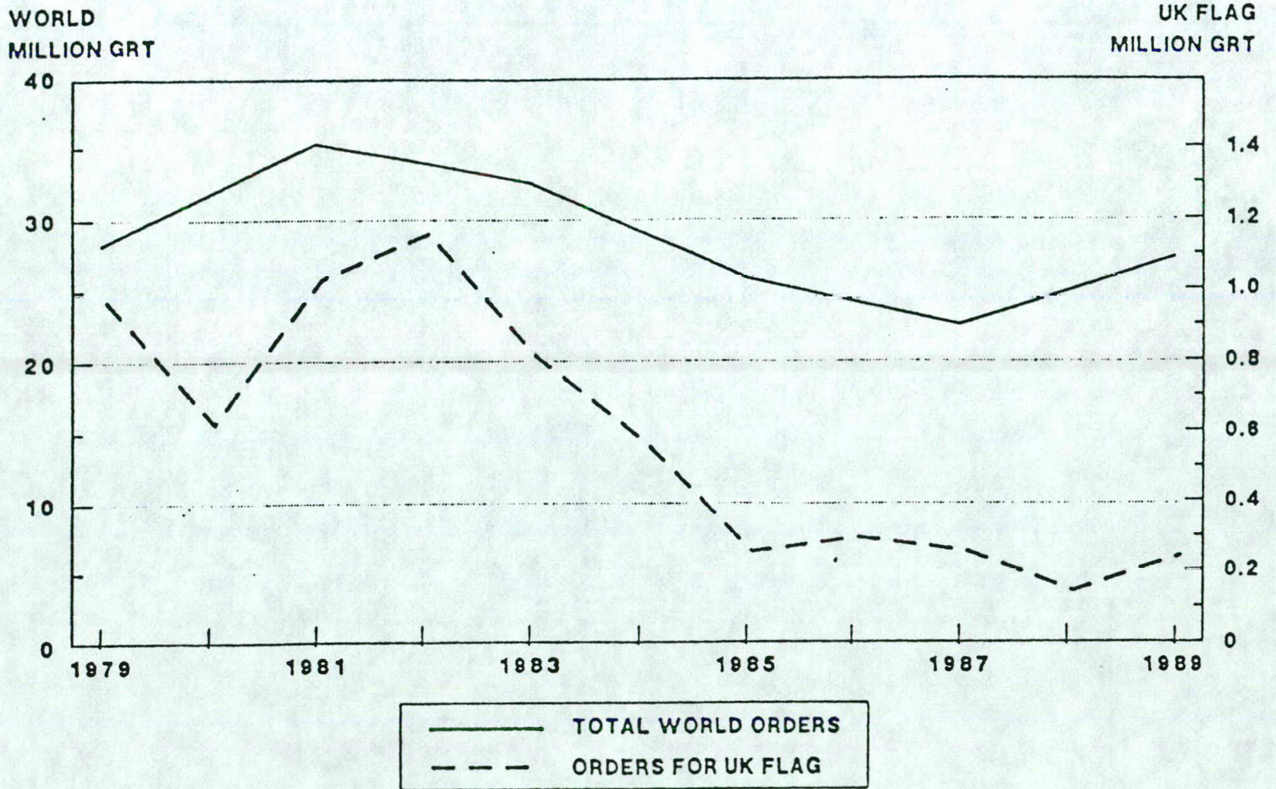
9. **Cruise shipping** has shown continued expansion with new tonnage continuing to come into all sectors, whether 4-day "bulk" cruises out of Miami, the 5-star Caribbean market or small Adventure Cruise operations. Despite forecasts of continued growth in cruise demand there are fears that some sectors will become over-tonnaged, especially now that Japanese operators are dipping their toes in the market.

10. The **ferry business** within Europe has continued to develop positively and demand has been buoyant in terms of both passengers and vehicles transported. Competition is still intense on most routes and operations have generally been "trading up" into larger ships with a wider range of passenger facilities - almost of cruise-ship standard. This may be near to the maximum on routes to Scandinavia; operations on UK routes to the Continent and Ireland are farther behind, but have to bear in mind the likely effects of the Channel Tunnel, and a possible fundamental change in their costing structure if the EC imposes VAT on fares and withdraws duty-free facilities after 1992.

11. There are grounds for hope that the overall improvement in the market will continue. **Orders for new ships**, although increasing, have remained at lower levels than these of the early 1980s, partly because the governments of Korea and Japan appear to have tired of subsidising their yards to "buy" orders at below cost. The last year has consequently been marked by a substantial upwards surge in newbuilding prices and as a result many operators are seriously considering running on old tonnage. The major classification societies have developed condition assessment programmes to assist extending the economic working lives of existing ships beyond the normal 20-year span.

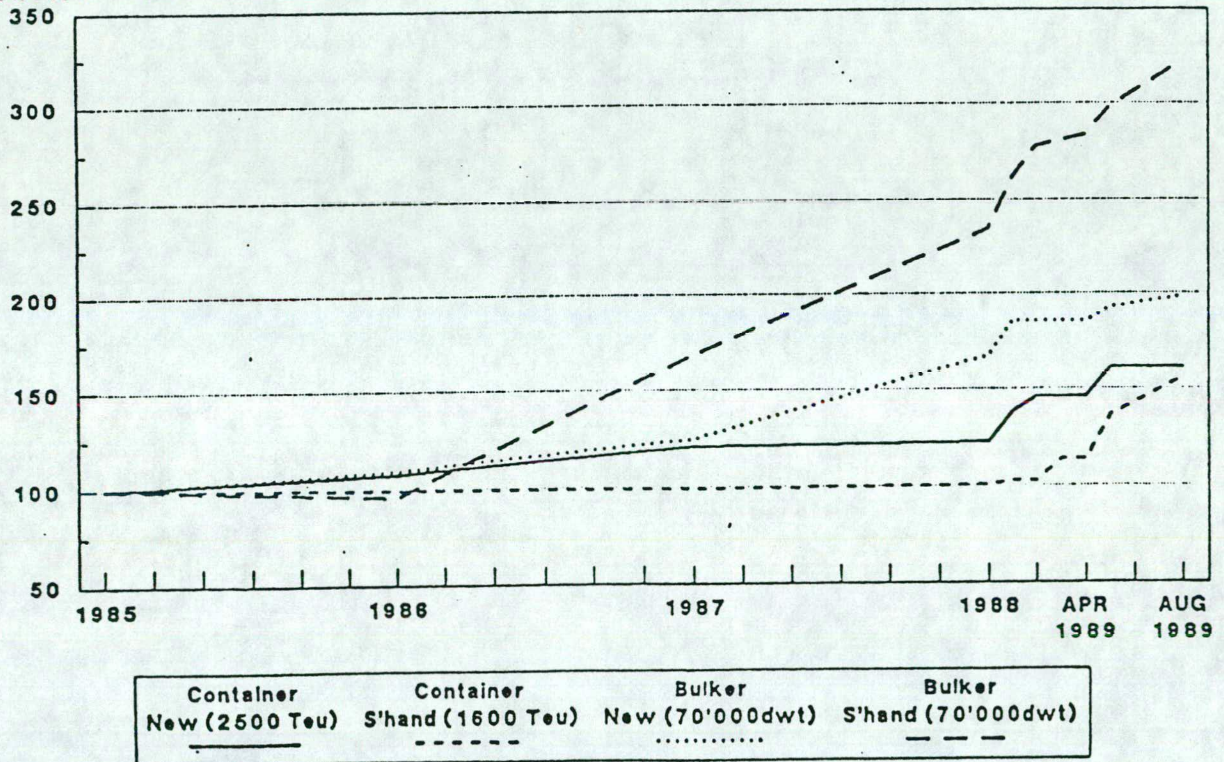
12. This price surge is likely to assume the proportions of a major threat during 1990s. The November 1989 report of a major analyst (County NatWest) estimated that the higher newbuilding prices now established will be subject to continuing and significant increases throughout the 1990s, fuelled by a markedly higher level of demand, particularly in the latter half of the decade. In the liner sector particularly, many of our competitors have active replacement programmes.

WORLD AND UK ORDER BOOK



SOURCE: Lloyds Shipbuilding Returns

NEW AND SECONDHAND SHIP PRICES



SOURCE: Lloyds Shipping Economist

13. The improvement in revenues, coupled with this increase in new ship prices has naturally led to a marked rise in **second-hand ship values** - between 40% and 60% in some sectors - and which as yet shows no signs of abating. For the first time in a number of years, there has been substantial activity in the second-hand market. Norwegian, Greek and Far Eastern owners have been particularly active.

December 1989

ANNEX B

EXAMPLE 1: 3,000 DWT SHORT SEA BULK CARRIER

Net cash flow arising from finance costs, operating costs, earnings and capital allowances at 2 different rates.

£ M

	OECD FINANCE		100% EQUITY FINANCE	
YEAR	25% Writing Down Allowances	100% Ship Allowance	25% Writing Down Allowances	100% Ship Allowance
0	-0.6	-0.6	-3.0	-3.0
1	+0.1	+0.9	+0.6	+1.4
2	+0.1	-0.1	+0.5	+0.3
3	0	-0.1	+0.4	+0.3
4	0	-0.1	+0.4	+0.3
5	0	-0.1	+0.4	+0.3
6	0	0	+0.3	+0.3
7	0	0	+0.3	+0.3
8	0	0	+0.3	+0.3
9	+0.2	+0.2	+0.3	+0.3
10	+0.3	+0.3	+0.3	+0.3
11	+1.6	+1.6	+1.6	+1.6
12	-0.4	-0.4	-0.4	-0.4
RATE OF RETURN	14%	34%	9%	12%

NOTES:
Cost of ship £3m
Sale price, year 11, £1.25m
Annual earnings £600,000
Annual operating costs £317,000
OECD finance - 80% credit over 8½ years @ 8%
25% WDAs - current system of capital allowances ie 25% on reducing balance
100% SA - a 100% ship allowance

EXAMPLE 2: 3,500 TEU CONTAINERSHIP

Net cash flow arising from finance costs, operating costs, earnings and capital allowances at 2 different rates.

£ M

YEAR	OECD FINANCE		100% EQUITY FINANCE	
	25% Writing Down Allowances	100% Ship Allowance	25% Writing Down Allowances	100% Ship Allowance
0	-7.6	-7.6	-38.0	-38.0
1	+0.8	+10.8	+6.7	+16.7
2	+0.3	-2.2	+5.9	+3.4
3	-0.1	-2.0	+5.3	+3.4
4	-0.3	-1.7	+4.8	+3.4
5	-0.3	-1.4	+4.5	+3.4
6	-0.3	-1.1	+4.2	+3.4
7	-0.2	-0.8	+4.0	+3.4
8	-0.1	-0.6	+3.9	+3.4
9	+1.8	+1.5	+3.7	+3.4
10	+3.7	+3.4.	+3.7	+3.4
11	+14.6	+14.4	+14.6	+14.4
12	-3.4	-3.4	-3.4	-3.4
RATE OF RETURN	8%	15%	4%	9%

NOTES:
Cost of ship £38m
Sale price, year 11, £11m
Annual earnings £31.5m
Annual operating costs £28.1m
OECD finance - 80% credit over 8½ years @ 8%
25% WDAs - current system of capital allowances ie 25% on reducing balance
100% SA - a 100% ship allowance

NATIONAL ART-COLLECTIONS FUND
20 John Islip Street, London SW1P 4JX
Telephone 01-821 0404
Fax: 01-630 7715
Patron: Her Majesty the Queen
Charity Registration No. 209174

Pse action ont to Mr K Sedgwick, etc.

HM TREASURY
26 OCT 1989
FP
cc APS/CHX
CHX 32540/89

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
LONDON SW1P 3AG

24th October 1989

Dear Nigel

FINANCE BILL 1990

Here are the views of the NACF. We hope very much that in view of the extremely troublesome rise in the price of works of art you could see your way to adopting our suggestions.

I do not imagine you need further documentation on the strength of art prices. Not only do the prices themselves hit the headlines regularly, the profits made by the sale rooms show very clearly what has been happening.

If you or your officials would like further discussion on the details in the attached memorandum, I hope you will let me know.

Yours ever

Nicholas

CH/EXCHEQUER
REC. 26 OCT 1989
ACTION
COPIES TO

Chairman:
Sir Nicholas Goodison, FSA
Honorary Treasurer:
Lord Faringdon
Director:
Sir Peter Wakefield, KBE, CMG

Finance Bill 1990
Memorandum from the National Art Collections Fund

Our proposals for the Finance Bill 1990 stem from the need to find ways of reversing the fast declining ability of this country's museums and galleries to acquire works of art. Prices of works of art have again risen sharply. This regrettable fact argues strongly for ending the long freeze on the purchase grants of the public collections. Equally, the arguments for providing further encouragement to private individuals and corporations to help fill the gap have grown stronger.

We propose the following measures which we believe would be powerful incentives for greater private sector assistance to the arts:

1. <u>Annual tax offset for gifts by individuals</u>

   Individuals should be allowed to offset agaist tax each year their donations to the arts. Covenanting is an expensive administrative burden upon charities and deters individuals from spontaneous acts of generosity.

2. <u>Gifts of works of art by individuals</u>

   There is reason to believe that individuals would often give works of art more readily than cash. There is already provision for remission of certain taxes upon death. An important step forward would be to grant remission against tax for gifts of works of art to public collections during the lifetime of the donor. A system on these lines works well in Australia, and need not be open to some of the abuses which the United States system (the recent modifications of which have done great damage to their museums) suffered from. We attach some notes on the Australian system and would be glad to help in devising a workable system in the UK.

3. <u>Corporate gifts</u>

   More corporate support of our public collections is greatly needed. This could be encouraged by the following measures:

   a) Deduction of corporation or income tax to be allowed on a donation of a work of art to a public collection. The deduction could not exceed a certain percentage of taxable income in any one year.

   b) At present companies can make tax deductible cash donations to public collections to buy a work of art. Companies might be more inclined to do this if they could associate themselves with the museum or gallery by borrowing back the work of art for a limited period of say, three to five years. Under present legislation such a loan back might invalidate the original tax advantage.

cont'd

4. <u>'In Lieu' provisions</u>

The advantage of giving works of art to a public collection in lieu of inheritance tax has been seriously eroded over the past few years, while the attraction of a gamble in the auction rooms has increased. The balance of advantage would to some extent be redressed if the tax remission was raised from one quarter to one half.

A combination of these four courses would help to relieve the serious crisis faced by our public collections. The first recommendation would have a broad application across the arts. The other three would be confined to helping our public art collections, and would therefore by highly efficient and targeted measures of tax remission. They would amount to a reinvestment by the State of a very small part of the very large tax revenue currently taken in the form of Inheritance Tax and Capital Gains Tax and earned from the large and profitable art market in this country.

(encl.)

Confederation of British Industry
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From
John M M Banham
Director-General

25 October 1989
JMMB/RB/10.07

26 OCT 1989
FP
cc APS/CHX
CHX
32543/89

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London SW1P 3AG

Dear Chancellor,

Budget 1990
Technical Tax Proposals

I have pleasure in enclosing our Technical Tax Proposals for the 1990 Budget.

In line with our aim of promoting the international competitiveness of British business these proposals have been drafted and assembled under the main theme headings of "Competitiveness" and "Burdens on Business". They comprise suggestions for dealing with aspects of the UK tax system which hinder British firms in competition with foreign businesses and for removing identified restraints on enterprise. They also identify areas where unnecessary and onerous compliance and administrative burdens are imposed on business by the UK tax legislation, and where the tax system is out of line with the realities of modern commercial life. In addition, we comment on the tax legislative process itself.

In order to assist you in your Budget planning we are forwarding these proposals for your early consideration. Copies are being sent to your colleagues at the Treasury and also to officials at the Inland Revenue and at H M Customs and Excise.

We would be very pleased to discuss these proposals with you or your colleagues and to learn of any comments you may have on our suggestions.

Yours sincerely,
John

John M M Banham

Encl.

Budget 1990 Technical tax proposals

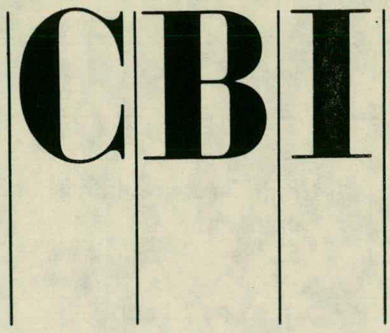
H M Treasury

with compliments
MINISTERIAL CORRESPONDENCE UNIT

Spare Copy

Treasury Chambers
Parliament Street
London SW1P 3AG
Tel: 01 - 270

Budget 1990
Technical tax proposals



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Introduction

This document contains the CBI's technical tax proposals for the first UK Budget of the 1990's. The advent of the Single European Market will mean that British business will face increased competition from Europe and around the world. We continue to stress the need for greater investment in training, new plant and new products, to improve efficiency at home and competitiveness internationally.

The CBI has in the past identified three main elements in promoting international competitiveness:

- minimising the direct and indirect burdens imposed on business by central or local government or the EC Commission
- promoting policies to secure a strong and internationally competitive industrial base to complement strengths within other sectors of the economy
- seeking to remove those competitive handicaps which are outside the control of individual businesses.

These remain our general guides.

Some of our proposals this year are new, but many are repeated from previous years, as we continue to regard them as essential to encourage change and increase the British share of world markets.

In order to have a document of manageable proportions we have not repeated all the items which are still outstanding from past submissions, but they remain on the table and we may return to them.

In Appendix I we have listed some items which have been raised over many years but which have not yet been brought to a conclusion.

In Appendix II we have identified issues which are the subject of separate representations.

Tax legislation – reform of legislative procedures

Technical amendments

We have in past submissions recognised the difficulty of fitting all our suggested changes into a typically overcrowded Budget programme. However, the considerable amount of space which was made available in the 1989 Finance Act for Government proposals of a highly technical nature suggests that such self-restraint on our part may have been somewhat misplaced. The Bill was long and complex, yet failed to include proposals put forward by business to simplify the tax system and reduce the burden of compliance.

We regard this as a missed opportunity and urge that space be found in the 1990 Finance Bill to deal with some of the problems identified in this document. Otherwise, as we have said in the past, the alternative must be a separate Technical Tax Bill.

Consultation

We attach great importance to the role which consultation can play in the development of tax legislation, and we have been pleased to note the expansion of the consultative process in recent years.

Against that background, we found it most disappointing that on many technical provisions in the 1989 Finance Bill there was no opportunity for prior consultation. In our view, the original Bill and its passage through the Parliamentary process - during which important Clauses were withdrawn completely and amendments substituted - suffered accordingly. Some Clauses were not available at all until the Committee stage, leaving inadequate time for comment and representations.

Subordinate legislation

Our views on the use of secondary legislation were set out at length in our 1989 Budget Proposals. We simply reiterate our concern at the use of such legislation, and repeat our request that where it is proposed to produce a new regime of taxation in particular areas, subordinate legislation should not be used to make substantive changes in the law, but should be strictly confined to administrative matters. Where regulations are required, they should be published at the same time as the relevant Clauses, so that the proposed legislation can be examined as a whole. Experience has shown that, since scrutiny of subordinate legislation is severely constrained, the debates on the Bill provide the only opportunity for real discussion in Parliament.

Retrospective legislation

We repeat the view expressed in our representations for the 1988 Budget, namely that the CBI deplores in the strongest possible terms the principle of taxation by retrospective legislation.

We note particularly the Economic Secretary's response during the Parliamentary debates this year (Hansard, Standing Committee G, 13 June 1989, col 421) that, if there were future problems with the normal test case procedure on points of principle, the Government would have to take appropriate action. This is a matter on which we believe all sides share a common interest in avoiding the creation of additional work.

General review

We reiterate our eagerness to participate with Parliament, officials and other interested parties, in a general review of the whole legislative process on tax matters.

Competitiveness

Government can influence the climate and environment in which business operates. In this part of our paper we concentrate on a number of aspects of taxation where Government can assist business to prosper by making necessary changes in the law.

In identifying aspects of UK tax law which handicap UK business, we have been concerned not so much with direct comparisons between the treatment of particular items in the UK and abroad, but with areas where we feel that, given the general structure of UK taxation and the importance of international trade, the UK tax system hinders UK business in relation to that of its rivals.

This part covers two main areas: A. International Business and B. Corporate Finance.

A International business

In previous years we have made the point that, for British businesses to function well in international markets and compete successfully as exporters, importers or traders overseas, we need a taxation climate no less favourable than the best practice to be found abroad. So long as our competitors have tax advantages they will have an edge in the commercial market. We have previously identified a number of areas where improvements could be made, and this year we again draw attention to the following:

1 Pooling of overseas tax

Relief for foreign tax is often lost because the foreign tax on any particular source can only be set against the UK tax on that source in the same basis period. This increases costs and makes it difficult for UK companies, for example, construction and related companies or companies in the electronics industry, to secure internationally competitive contracts. This difficulty could be tempered if it were possible for UK companies to pool overseas taxes.

Such pooling would not be a subsidy; it would merely even out the tax payable by these companies, enabling them to secure overseas work, thus bringing foreign exchange and orders for plant and materials to the UK. This would also accord with commercial reality in that companies generally carry on one business and are assessed on that basis.

Pooling of overseas taxes can be achieved in different ways, as follows:

(a) by pooling all income from overseas of whatever nature and treating it as one source

(b) by pooling all income from the same overseas country and treating it as one source

(c) by pooling all income from the same overseas company and treating it as one source.

We *propose* pooling on the basis in (a) above as giving the most equitable result.

In addition, whichever basis of pooling is applied, we *propose* that unrelieved foreign tax should be available for carry forward to offset against the UK tax on income from the same source in the following and subsequent years, or for carry back to the previous year on the same terms.

2 Double taxation relief – payments from abroad for technical and advisory services

In most modern double taxation relief agreements the definition of 'royalties' is broad enough to encompass payments for technical and advisory services. A problem exists, however, where there is no agreement or where an up-to-date treaty has not yet been negotiated. Double taxation relief is not then available for the foreign tax charged on these payments where the source is regarded by the Inland Revenue (the Revenue) as being in the UK.

The case for double taxation relief in this area seems to be accepted by the Revenue, but at present it appears that it is being held in reserve as a bargaining counter in tax treaty negotiations. This is unfair on the taxpayers concerned and has the effect that when tendering for third-party contracts in these circumstances, it is necessary for them to gross up for the withholding tax, thus rendering the tender less competitive and risking the loss of the contract.

We *propose* that the Revenue should reconsider the position and grant an extra-statutory concession comparable with that for royalties.

3 Underlying tax on pre–merger profits

In certain overseas jurisdictions the concept of 'merger' permits all the assets, liabilities and reserves of one company to be combined with those of another under a merger agreement; distributable profits retain their characteristic and are distributable by the surviving company.

Where a dividend is paid to a UK parent company by, for example, a US company resulting from a merger, and such dividend is derived from pre-merger profits transferred to the surviving company, the Revenue practice is understood to be to deny double taxation relief in respect of the underlying foreign tax paid on those profits. The argument is that the dividend in question is paid out of profits, the tax on which has not been 'borne by the corporate body paying the dividend' (Section 799, TA 1988), and that the extension of relief to dividends from second-tier companies under Section 801 (2), TA 1988, is not permissible because the transfer of profits was not by way of 'dividend'.

This is a real problem for which legislation is the only solution. We have been informed of specific examples relating to companies in Belgium, Canada and South Africa, as well as the United States.

We *propose* that this inequity be solved by adding a fifth subsection to Section 799, TA 1988, as follows:

> '(5) For the purposes of subsection (1) above, foreign tax borne on the relevant profits shall be deemed to have been paid by the company paying the dividend where the dividend is paid out of profits acquired in a merger.'

4 Foreign employees working in the UK

The tax treatment of foreign employees working on temporary assignments in the UK continues to ignore the unavoidable burdens of additional expenditure on housing and education which have to be met by, or on behalf of, such individuals. We regret that even the limited relief suggested by the Government in the Second Consultative Document issued by the Inland Revenue on 25th January 1985 has not been implemented, and in the run up to the European Market we urge further consideration of this matter.

We *propose* that, in the case of short-term employment in the UK - say, up to three years - there should be special relief for additional housing and education costs; in particular, the additional charge imposed by Section 146, TA 1988, (where the cost of providing accommodation exceeds £75,000) should not apply.

We further *propose* that, as regards travel between the overseas place of abode and the UK by the employee's spouse or children, Section 195(6), TA 1988, should be amended to cover three journeys per year in each direction, and Section 195(10), TA 1988, should be amended to include any child aged 18 or over still undergoing full-time education at a school or college.

There are other tax aspects of international employment not touched on in the legislation, for example, the question of pension contributions. When a foreign national is seconded from overseas, and becomes an employee of a UK company within an international group, he will most likely remain a member of the pension fund of the overseas company. In this circumstance, he will be denied tax relief for his pension fund contributions, and risks being taxed on contributions made on his behalf by his UK employer.

This is completely at variance with the treatment of the foreign national who, although working in the UK, remains employed by an overseas company. He will get relief for his pension contributions under Section 192(3), TA 1988, on the grounds that his contributions 'correspond' with contributions to an approved fund in the UK.

We *propose* that the same treatment should be accorded to the foreign national who is seconded to and employed by a UK company.

B Corporate finance

Suitable financial arrangements are necessary to enable British business to win orders in a competitive world and there are areas of tax law which need amendment to remove impediments to the free flow of funds. One such area concerns the treatment for tax purposes of profits and losses arising from exchange rate fluctuations, and we will be responding separately to the Revenue's consultative document on this topic.

All businesses require ready access to sources of funds and the ever-changing types of financial instruments available in international money markets. At present, UK tax law inhibits corporate treasurers from tapping these sources.

Suggested amendments to the tax legislation which would assist the making of better corporate financial arrangements are set out below:

1 Incidental costs of raising capital

The old restriction on allowing tax relief on the incidental costs of obtaining finance by means of loans or the issue of loan stock, on the grounds that the expense was related to capital, was partly overcome by Section 77, TA 1988. This relief should now be extended to the incidental costs of raising all types of finance. We have in mind particularly equity and short-term note issue programmes in the UK or elsewhere. The relevant fees, etc, are expenses of the companies concerned in raising finance just as much as the costs of raising longer-term loan capital. There is no good reason for continuing to penalise these forms of finance. Loans and new equity capital may be provided by existing shareholders, or from outside the company by new participators. This tax bias against equity capital should now be removed so that all the costs of raising finance are deductible. Lack of deductibility is a deterrent to raising more capital, thus leaving businesses under-capitalised. It affects small firms as well as large. We also have in mind that the deductibility of the costs of raising capital is one of the considerations in choosing the method of financing, and consequently it can bring about distortions in capital markets.

2 Short interest

The rules regarding the deductibility for tax purposes of interest are too restrictive to permit free use of all the facilities available in present-day financial markets. For example, no deduction would appear to be available for short interest paid on funds borrowed for use on fixed capital projects, other than interest payable to a UK bank, discount house or member of a UK stock exchange. Also, in the case of investment companies and other non-trading companies, short interest which is not payable to a UK bank, discount house or stock exchange is not allowable as a deduction, either as a charge on income or as an expense of management.

This can be unnecessarily restrictive to the activities of a parent company, which is a true holding company, financing subsidiaries and intermediate holding companies in a group. Also, it would frequently be desirable that surplus funds in operating companies should be lent short-term to the holding company of the group or sub-group, but for the absence of tax relief. Furthermore, holding companies which might like to issue sterling commercial paper at interest rather than at a discount are prevented from doing so by this legislative restriction. In view of the Government's encouragement of the issue of sterling commercial paper a restriction of this nature should be removed, and we would like to know what justification is advanced for its retention.

We *propose* that subsection (3) of Section 338, TA 1988, should be amended to include, as a charge on income, all short interest payments which are not deductible in computing profits.

We note that when this matter was raised by way of a new clause in this year's Finance Bill debates (Hansard, Standing Committee G, cols 697-700) the Financial Secretary said that it would receive further consideration.

3 Group income - Section 247 (5), TA 1988

Another hindrance to a group's management of its finances is Section 247 (5). This specifies that an election to pay interest, without deduction of tax, between group companies does not apply to interest received by a company on any investments, if a profit on the sale of those investments would be treated as a trading receipt of that company. This

makes the use of in-house finance companies, which would otherwise be a valuable aid to efficient management of corporate finance, more difficult.

We find it difficult to understand the reason for the existence of Section 247 (5). If the Revenue still thinks that it should be retained we would like to know why, particularly as its retention creates administrative problems and cash flow losses for a number of groups of companies.

4 Pre–trading interest

Under the provisions of Section 401, TA 1988, a company which commences a new trade can obtain relief for expenditure incurred in the five years before the commencement of the new trade. Relief is only given if the expenditure would have qualified for relief had it been incurred after the start of the trade. Short interest paid prior to the commencement of a trade will therefore normally qualify for relief. The capital allowances legislation contains similar provisions whereby allowances are normally available on capital expenditure incurred on qualifying assets prior to the commencement of trade.

Where, however, annual interest or other annual payments are paid prior to the start of a new trade, there are no provisions under which relief is available for the payment. Interest will frequently be a major expense incurred when first establishing a new trade, for example, where substantial construction is needed, and we consider it inequitable that relief should not be available for annual interest or other annual payments made in the pre-trading period.

We *propose*, therefore, that relief should be specifically available for all interest and other annual payments made prior to the commencement of trade, either as a charge on income or as pre-trading expenses.

5 Relief for the expenditure of resisting takeovers

In recent years there has been an increase in the number of contested takeovers of UK companies, and the target companies have incurred increasing amounts of expenditure in resisting such bids. Existing statute and case law does not clearly determine whether such expenditure is allowable as a deduction in arriving at profits for Corporate Tax. Particular uncertainty arises where the status of the company is that of an investment company rather than a trading company.

It is *proposed* that a specific allowance be made, by statute, in arriving at the profits for UK Corporation Tax, either as a deduction against Case I/Case II profits or as an expense of management, for the costs incurred wholly and exclusively in resisting takeovers.

A similar provision to that proposed was introduced for allowing the incidental costs of obtaining loan finance (Section 77, TA 88,) without the problems of large scale avoidance or undue cost to the Exchequer. This proposal, therefore, appears reasonable and timely in view of the approaching Single European Market.

Burdens on business

It is the Government's declared aim to remove unnecessary restrictions and inhibitions on business activity, to leave businesses free to make profits to create wealth for the country and enhance employment prospects.

In this part we have attempted to identify areas where unnecessary and onerous compliance and administrative burdens are imposed on business by tax legislation, or where the tax system itself is out of line with the realities of modern commercial life.

C The schedular system and other structural problem areas

Though we are about to enter the last decade of the 20th century, business taxation remains heavily dependent upon a number of structural distinctions and limitations, many of them archaic, and all of them inimical to the needs of modern business.

One to which we have repeatedly drawn attention in recent years is the artificial separation of profits into different schedules and cases (see Appendix I). Others lie in the walls erected between income and capital, gains and losses, and between capital losses of different companies in the same group, and in the area of management expenses.

What is needed is a thorough review and modernisation. In the meantime, we *propose* the following as a start in removing some of the worse anomalies:

1 Relief for trading losses

Under present law, interest receivable may be taxed under Schedule D Case III (Section 18, TA 1988) whereas interest payable may be a trading expense and come within the Schedule D Case I computation. Where a company has trading losses brought forward, therefore, its tax position can be significantly affected by the distinction between interest which is a trading expense and interest which is a charge on income. For this reason, as well as our belief that interest income should not be distinguished from trading income, we *propose* that losses brought forward should be available for set-off against other income or profits from whatever source the taxpayer chooses.

Similar considerations apply to rent received.

Now that the same rate of corporation tax will be applicable to trading income and company capital gains, we further *propose* that trading losses brought forward should be available for set-off against capital gains.

2 Relief for capital losses against other income

We *propose* that current capital losses should be available for offset against profits from whatever source for the same period, or as group relief, and unrelieved capital losses brought forward should be available for offset against profits of the same company from whatever source the taxpayer chooses.

Furthermore, capital losses should be available for carry back for three years, to be set against capital gains in the first instance. The justification for this treatment is the spasmodic nature of capital gains and losses, and the assimilation of the capital gains tax rate for companies to the ordinary corporation tax rate on income.

3 Group relief for capital losses

The Revenue accept that a company can transfer the beneficial interest in an asset to another group company prior to sale, to utilise capital losses in that other company. In groups of companies there can be many members with unutilised losses. It may be necessary to fragment the asset being sold to utilise the available losses in all those companies, resulting in work both for the group and for the Inspectors who have to check the computations. There would be no loss to the Revenue if instead of transferring title to the asset, or part of the asset, the companies with losses – whether brought

forward or current – were allowed to surrender their losses to the company disposing of the asset.

We *propose* that the group relief provisions be amended to enable companies to surrender capital losses – whether brought forward or current – to other companies in the same group.

4 Excess charges or management expenses

Section 338, TA 1988, provides for any charges on income paid by a company in the accounting period to be allowed as a deduction against its total profits for the period. Where the income of the period is inadequate to allow relief for all the charges, the right to relief is restricted to the carry forward of that part of the excess which was incurred wholly and exclusively for purposes of the trade (Section 393 (9), TA 1988), or for the purposes of the investment company's business (Section 75 (3), TA 1988). Thus, in either case, there is no right to carry forward relief for charges which relate to payments to charity, nor to carry back any excess charges.

At a time when the Government is seeking to encourage giving to charity, it is illogical to deny relief simply because there are inadequate taxable profits in the year of payment. In addition, it is artificial to treat excess charges differently from other losses. It is suggested, therefore, that Sections 393 (9) and 75 (3) be amended to provide for the carry back for one year and/or the carry forward of all excess charges against profits of whatever nature the taxpayer chooses.

The amendment to Section 75 (3) should also provide for the carry back of management expenses of an investment or insurance company against profits of the preceding accounting period.

D Advance Corporation Tax

1 Set-off of Advance Corporation Tax

Advance Corporation Tax (ACT) paid and not repaid in respect of a distribution is set against the liability to corporation tax on the profits of the period in which that distribution was made.

We *propose* that ACT payments should be set off against the next available corporation tax liability of the company concerned, instead of being deferred as at present.

2 Advance Corporation Tax – change of rate

Section 246(6)(b), TA 1988, provides that, when the rate of ACT changes, an accounting period straddling the change date is deemed to be divided into two separate periods for the purposes of applying the ACT and franked investment income rules.

The necessity for this restriction is understood in the context of the present system, whereby set-off to give relief for tax credits is effected by relating franked investment income (ie distributions received plus the tax credits thereon) to franked payments (ie distributions made, grossed up by the rate of ACT).

The effect, however, is that a company cannot set franked investment income received after the date of change against franked payments made before that date, even though the income is received and the payments are made within the same accounting period.

This restriction causes unnecessary cash flow loss, because the tax credit relevant to that franked investment income cannot be used until ACT becomes payable in respect of a later distribution.

We *propose* that this anomaly be removed and suggest that the above Section be amended as follows:

In line three of sub-section (6) (b) delete from 'then –' to the end of sub-paragraph (b) and insert 'the franked investment income received after that date shall be recalculated as follows:-

i the tax credit relating to that franked investment income shall be ascertained, and

ii the franked investment income shall be recalculated assuming that the tax credit was ACT paid in respect of a dividend paid before 6 April in that period.'

For example, where the rate has been reduced from 27% to 25%, franked investment income of £100 with tax credit of £25 becomes franked investment income of £92.60 with tax credit of £25 (27% of £92.60 = £25).

E Capital allowances

1 Capital expenditure on the acquisition of know–how

Under the provisions of Sections 530 to 533, TA 1988, proceeds received for the disposal of know-how not associated with a transfer of a trade (or part thereof) are charged to tax either as income under Schedule D Case 1 or Case VI, or by being brought into the seller's capital allowance computation as disposal proceeds. The purchaser is normally entitled to relief either as a Case 1 deduction or, if the payment is a capital payment, as qualifying expenditure for capital allowances. There is, therefore, a degree of symmetry, the seller being taxed on his proceeds whilst the purchaser obtains corresponding relief. Where, however, know-how is transferred between parties under common control, such symmetry is only present if the consideration is a revenue payment and relief can be given to the purchaser as a trading expense. If the payment is a capital payment no relief will be given to the purchaser, Section 531(7) providing that the allowances granted under Section 530 are not available in such circumstances, although the seller will generally still be taxed on the proceeds he receives.

A discrepancy also arises where know-how is sold together with a trade or part thereof. The proceeds received for know-how will normally be taxed as a sale of goodwill, but it is possible for the buyer and seller to make a joint election under which both parties are required to bring the proceeds into their capital allowance computations. Such an election is not permitted where the parties are under common control.

Whilst we recognise that it may be necessary to limit allowances by reference to an arm's length price, we consider it inequitable that there should be any fundamentally different approach to the reliefs due to the purchaser of know-how from a party under common control, compared with that available on the purchase from a third party.

We *propose*, therefore, that capital allowances should be available on the acquisition of know-how from a party under common control.

2 Abortive capital expenditure

The Taxes Acts provide that a person who incurs capital expenditure on the construction of a building to which Part I, Chapter I, CAA 1968, applies, or on the provision of machinery or plant to which Part III, Chapter I, FA 1971, applies, may be entitled to capital allowances.

Where the expenditure is incurred but the relevant asset is never completed, in the case of a building it is arguable that it has not been constructed (Section 2 (1) (c), CAA 1968), and in the case of machinery or plant that it has not been provided or has not belonged to the person who incurred the expenditure (Section 44 (1) (a) and (b), FA 1971). Relief for the expenditure may not then be due under the capital allowances codes.

Abortive expenditure may be incurred at the planning stage or later in a long-term project, as a result of changes in the market conditions.

Such abortive expenditure is undoubtedly incurred for the purposes of the trade and should qualify for tax relief. We *propose* that a balancing allowance should be given in the case of an abandoned building which was to have been used for a qualifying purpose as defined by Section 7, CAA 1968; and in the case of plant the expenditure should qualify for writing down allowances.

A simple solution would be to treat the expenditure as if it were demolition expenditure in respect of the asset, so qualifying for relief under Sections 3 (1) (d) and 4 (11), CAA 1968, and paragraph 14 (1) (b), Schedule 8, FA 1971, respectively.

A simple amendment along the following lines would appear feasible:

> 'Notwithstanding anything in the Taxes Acts providing for an allowance in respect of capital expenditure, where a person permanently abandons the construction of a building or the provision of machinery or plant which would have been eligible for relief under any of the said provisions, he shall thereupon be deemed to have incurred that expenditure, together with any incidental costs of the abandonment, on the demolition of the relevant asset. In the case of a building which was to have been used as an industrial building, he shall be deemed to have used it as such throughout the period of construction.'

3 Capital expenditure on computer software licences

The Revenue accept that purchases of computer software which do not qualify as revenue expenditure qualify as plant for capital allowance purposes. However, capital expenditure on licences to use software is not eligible for capital allowances because the payer does not own the asset. The distinction between a purchase and a licence to use software is extremely fine and there is no logic in differing tax treatments.

We *propose* that the definition of know-how in Section 533(7), TA 1988, be extended to include computer software not already included as 'industrial information and techniques'.

F Capital gains tax

1 Enhancement expenditure

We are concerned about the narrow way in which Section 32(1) (b), CGTA 1979, is drawn particularly in respect of assets other than physical assets, especially shares.

A parent company may incur capital expenditure which enhances the value of the assets owned by a subsidiary company, for example, on assessing and planning the development of a mineral asset. If this expenditure is charged out to the subsidiary it decreases the net worth of that subsidiary and ultimately, other things being equal, when the shares in that subsidiary are disposed of the sale proceeds will be decreased by the same amount.

It may not, however, be possible to charge out the expenditure to the subsidiary. In this event, adding it to the cost price of the shares in the subsidiary would achieve the same result in the capital gains tax computation on disposal.

We, therefore, suggest that in these circumstances the expenditure should be dealt with as enhancing the cost of the subsidiary company shares. We do not see any problems for the Revenue in allowing this approach.

2 Re-basing assets held on 31 March 1982

As drafted, Section 96, FA 1988, makes it necessary to ascertain the market value of assets as at 31 March 1982 if they were held on that date and disposed of on or after 6 April 1988. The process of ascertaining market value can cause considerable delay and expense, especially in relation to assets which have no regular published price and which have to be dealt with individually. There could in some cases be a very real problem in carrying out this process by reference to conditions as they existed more than six years ago. One aspect of this may be illustrated by the following extract from a letter sent by the Revenue to a public company:

> 'As I indicated in my letter of 10 March 1988 I have established that my request for the valuation of the shares has been registered by Shares Valuation Division and as it is normal for several years to pass before agreed valuations are forthcoming there is little further I can do at the moment.'

This statement related to a 1984 transaction in shares.

The solution which we *propose* to this problem is to allow the taxpayer to elect for time-apportionment rather than market valuation. This could save the taxpayer and the Revenue considerable expense in manpower and other costs, and it would avoid the sort of delay illustrated in the extract quoted above. A solution to this problem is of importance to small firms as well as large.

3 Indexation: groups and associated companies

Section 114 and Schedule 11, FA 1988, are aimed at the artificial creation of losses through the mechanism of indexation relief. The rules are applied, inter alia, to debts on a security within groups of companies including foreign currency debts.

We believe that the provisions are unfair because they fail to distinguish genuine debts on a security entered into for bona fide commercial purposes from those made to exploit indexation relief. Furthermore, they affect the real value of expenditure already incurred and are therefore retrospective in their effect.

We *propose* that Schedule 11 should exclude foreign currency debts on a security where a motive test similar to that already applied to shares by paragraph 3(3)(c) of the Schedule is satisfied.

4 Indexation: roll-over on business assets and gifts

Roll-over relief on business assets (Section 115, CGTA 1979) is intended to help a business that sells a capital asset and uses the proceeds to buy a replacement. Instead of having to pay tax at the time of selling the first asset, the business is treated as if it had owned a single asset throughout, equal in cost to the first and having the same sale proceeds as the second.

The arithmetical method of the Section is to treat the first asset as sold for a price producing no profit or loss, and to treat the excess of the real sale price over that deemed price as reducing the cost of the second asset. The indexation rules in Section 68, FA 1985, however, create an anomaly. Had there in fact been a single asset throughout, purchased after 31 March 1982, indexation based on the cost price would span the entire period from the date of purchase to the date of sale. If, however, the asset were replaced and the roll-over provisions claimed, indexation would apply only up to the date of replacement, with separate indexation for the replacing asset.

It is true that the indexation allowance on the first asset would have the effect of increasing the indexation on the second asset, since the first indexation would increase the deemed sale price of the first asset and, by reducing the excess that was deducted from the cost of the second, increase that cost. However, that increase in the second indexation would be less than the detriment suffered as regards the first indexation. The discrepancy could be considerable for any asset which greatly increased in value.

The solution we *propose* (but we are very willing to discuss any others) is that the provisions of Section 68 (7) and (8), FA 1985, should be extended to roll-overs on business assets. This would have the effect of treating these roll-overs in the same way as assets transferred within a group on a no gain/no loss basis.

Similar difficulties in the operation of Section 68 are met if relief on gifts is claimed under Section 126, CGTA 1979.

Here, where the same asset is involved all the time, we *propose* that the matter be dealt with like gifts between husband and wife, both as regards indexation and the deferred gain itself. The new owner would then have the benefit of a March 1982 valuation, with full indexation from that date, or the fully indexed cost if the date of the original purchase was later.

5 Roll-over relief

(a) Classes of asset

The classes of asset to which roll-over relief applies are restricted by Sections 115-118, CGTA 1979.

We think that these restrictions are unnecessary. We *propose* that they should be repealed so as to enable roll-over relief to be made available for the gains on the disposal of all chargeable assets owned and used for business purposes, when the proceeds of sale are applied in the purchase of other business assets.

(b) Trade use within a group

Where assets have been owned in turn by more than one company in a group of companies, but they have not been used for the purposes of a trade throughout the whole of the period of ownership by the group, the apportionment to arrive at the amount of the gain available for roll-over on disposal should take into account the trade use in the group as a whole.

6 Company ceasing to be member of a group

Section 278, TA 1970, was introduced to prevent avoidance of tax by what was known as the envelope arrangement. A wholly-owned subsidiary would be formed and an asset transferred to the new company for full market value in exchange for shares in the subsidiary. The shares would then be sold. Where the asset is transferred between a subsidiary and its parent and both leave the group at the same time, no Section 278 liability arises.

The provisions of Section 278 inhibit normal commercial reconstructions and can lead to double taxation. For instance, where on reconstruction goodwill is transferred from subsidiary A to subsidiary B in the same group, and within six years the shares in subsidiary B are sold, a Section 278 liability arises in subsidiary B in addition to capital gains tax on the sale of the shares in the subsidiary, the sale proceeds of which reflect the full market value of the goodwill at date of sale. Since goodwill can be a substantial element in the valuation of the shares the extent of the double taxation can be considerable.

Section 278A provides for exemption in the case of certain mergers, where the merger was for bona fide commercial reasons. No such escape clause is provided within Section 278.

We *propose* that Section 278 be amended by the addition of a subsection to the effect that the provisions of Section 278 shall not apply where the transfer of the asset, and the subsequent sale of the shares, were for bona fide commercial reasons.

In addition, we *propose* that where a Section 278 gain still arises, there should be the same right to roll-over the gain as would have applied had the asset been sold to a third party at the date of deemed sale within Section 278 (3).

G Other burdens on business

1 Disallowance of trading losses and ACT on change in ownership

In 1985 we commented on the Revenue's draft of a proposed statement of practice on the operation of Section 483, TA 1970, and Section 101, FA 1972, (now Sections 768 and 245, TA 1988). Subsequently, we have commented on a revised draft statement of practice, and have attended a meeting, accompanied by other representative bodies, to discuss with the Revenue the problems caused by these Sections.

In their present form and application, they are a deterrent to making the business changes which good management requires. A company which has been making losses will inevitably need changes in the way it is run to make it profitable, and there is frequent doubt as to whether these changes constitute 'major changes' within the terms of Section 768, thus preventing relief for the past losses. Indeed, it is difficult to see why major changes should be the cause of a penalty, if these changes are designed to make the acquired business profitable and to secure employment, rather than to divert profit from existing businesses to mop up past losses.

These Sections have given rise to business uncertainty; in some cases companies have desisted from making changes which are desirable on commercial grounds for fear that tax penalties would be incurred.

Notwithstanding the views expressed by the Revenue at the meeting referred to above, we remain of the opinion that the best way to tackle the problem would be by the introduction, through new legislation, of a motive test which would go a significant way towards reducing that uncertainty. The test should be that Section 768 would apply only in those cases where the primary purpose of the acquisition was to obtain a tax advantage. A similar test should be applied as regards ACT in Section 245, TA 1988, and Section 98, FA 1989.

Bearing in mind wider economic aims, takeovers which would preserve employment in loss-making companies should be encouraged, and not impeded by these Sections or the uncertainty they create.

2 Stamp duty – intra-group transfers

As proposed in the consultative document 'The Scope for Reforming Stamp Duties' issued by the Revenue in March 1983, the 90% ownership required to obtain relief from transfer duty for intra-group transfers should be reduced to 75%, to bring it into line with the normal corporation tax definition of a group. This would avoid the additional and arbitrary burden on business of having two tests.

3 Employee share option schemes

When a company establishes a savings-related or other share option scheme considerable expenditure may be incurred in setting it up. The costs of founding the scheme may not, however, qualify for relief as a deduction when computing the employer's Corporation Tax liability. Given the Government's desire to encourage participation by employees in the ownership and prosperity of the businesses in which they work, we consider it inconsistent that relief should not be given for the costs of establishing schemes for employee participation.

We *propose*, therefore, that relief should be given, either as a Schedule D Case 1 deduction or as an expense of management, for all expenditure incurred by employers in establishing share option schemes, and other schemes encouraging the participation of employees.

4 Charities: payroll deduction scheme

We welcome Section 58, FA 1989, which increases from £240 to £480 the limit on the annual amount of donations to charity for which an employee can

obtain relief under the payroll deduction scheme, (Section 202, TA 1988).

Unfortunately, a resultant side-effect of using this method of making charitable gifts is that the employee donor's 'relevant emoluments' under paragraph 28 (2), Schedule 9, TA 1988, are reduced by the amount of the qualifying donations. This can then restrict by four times that amount the executive share options which the donor may take up. There is no such restriction if the employee chooses to donate to charity by way of deed of covenant.

We *propose* that this defect in the payroll deduction scheme be removed by ensuring that payments made under Section 202 be ignored for share option purposes.

5 Relocation expenses

Payments made by employers to their employees to reimburse the expenses of transferring their residences at company request to higher cost housing areas within the UK are, within limits, regarded by the Revenue as non-taxable. This follows the Extra-Statutory Concession published in October 1987 (previously Statement of Practice 1/85), but it does not extend to payments made to new employees on joining a company. As a result, these payments to newly-joining employees must be grossed up, at great expense to the paying company, to counteract the effect of their being taxable in the hands of the recipients.

To remedy this inequitable result we *propose* that the Revenue should extend their present concessional arrangements to cover the relocation expenses of newly-joining employees. This would be an encouragement to the mobility of labour, and it would bring the matter into line with Extra-Statutory Concession A5(a) which deals with removal expenses and applies to both new and existing staff.

We further *propose* that the Revenue should reconsider its views on the need for the employee to dispose of his old place of residence before he can obtain any tax relief on his relocation expenses. This requirement can cause hardship on transfer within the UK, more so if the transfer is from abroad. It should not be necessary for the employee to give up his home in the old location if he plans to return there eventually.

6 Motor cars used for business purposes

In our 1989 Proposals we recommended that all restrictions on the capital allowances for cars used for business purposes, or on the deductions for the hiring of such cars, should be removed, and they should be dealt with for tax purposes just like any other business assets. This recommendation was not accepted in the 1989 Budget, yet the burden on business is considerable. Nothing is achieved by this cumbersome legislation which could not be achieved by simpler means at considerably less cost to business.

The total number of business cars is not known but is variously estimated at between 1.7 million and 2.5 million, of which over 1.0 million are changed annually. The number of cars which can be bought for less than £8,000 is relatively small and probably more than 80% of business cars now cost more than £8,000. Since capital allowances have to be separately calculated on each car held, bought or sold, this means that businesses are probably listing in the region of 2 million cars annually, with the numbers increasing each year. The quantity of paper which is cluttering up Revenue files must be considerable. We consider it unnecessary to continue to burden business with this work.

We again *propose* that the restrictions imposed by paragraphs 9 – 12, Schedule 8, FA 1971, be removed and cars be dealt with for tax purposes just like any other item of plant.

7 PAYE – tax/NIC complexities

The obligation to deduct income tax from pay was an onerous duty even before 1976. When in 1976 the obligation to deduct and pay National Insurance Contributions (NIC) was added, every attempt was made by the Revenue and the Department of Health and Social Security (as it then was) to ensure that the conflicts between income tax and NIC requirements were reduced to a minimum. Employers had one gross pay figure for both requirements. NIC was calculated on the gross pay, income tax on gross pay less superannuation. No other variations were needed. Since the abolition of the ceiling on employers' NIC in 1985, there has been increasing awareness of the divergence between what is gross pay for income tax and what is gross pay for NIC, making it increasingly difficult for employers to get the figures correct. No account seems to be taken by

either department of the problems employers are facing in the operation of PAYE.

We *propose* that the Revenue and the Department of Social Security should jointly review their requirements and legislation, and consult with business to ensure that the administrative burden of operating PAYE is reduced to an acceptable level.

8 Special penalties in the case of certain returns

In all our responses to the Keith Report we have made it clear that we are opposed to fixed penalties. In the light of this, we are particularly dismayed by the introduction in Section 165, FA 1989, of fixed penalties for the failure to make returns under the PAYE regulations or those for sub-contractors.

It is our view that fixed penalties should be abolished, not added to, so that all penalties become fully mitigable to allow for the particular circumstances of each case. A fixed penalty of £100 for each 50 employees simply ignores the question of culpability.

9 Repayment of tax overpaid

Where there has been an overpayment of tax, or the amount paid under deduction exceeds the ultimate liability, a repayment on account up to the amount which is not in dispute should be put in hand. This could be based on the Revenue computation. The Inspector should not be allowed to hold on to what is undeniably the taxpayer's money, using it as a hostage to get the outstanding matters in the computation settled without the necessity of an appeal hearing.

10 Beneficial loan arrangements

Where an employee obtains a loan from his employer but has to pay the market rate of interest on that loan, or on a part of that loan, it is inequitable that he should have to bear tax under Section 160, TA 1988, whenever the prescribed rate of interest is higher than the market rate.

Section 160 should be amended to ensure that no taxable benefit arises in circumstances where, by reference to normal business terms, there is no benefit. In particular, where the employer makes loans to the public in general in the ordinary course of business, loans made to his staff on the same terms should not give rise to a taxable benefit.

In addition, we would ask for an increase in the limit below which a benefit is exempt. The de minimis limit of £200 in Section 161 (1), TA 1988, was set in 1976, and we believe was intended to allow loans for travel season tickets to be tax free. In view of the increased cost of travel, this limit is no longer adequate to exclude such loans. Moreover, frequent changes in the rate of interest can make calculation of the benefit an administrative burden to the Revenue where there are periodic repayments. There has been almost a threefold increase in the RPI since 1976 which would justify a limit nearer to £600. We therefore *propose* that the limit be raised to, say, £500 and indexed thereafter, to remove the administration work for both employers and the Revenue on the smaller loans.

11 Costs of tax appeals

The decision of a taxpayer whether or not to appeal to the Courts against a tax assessment is made even more difficult by the consideration that if his appeal fails he will have to bear a substantial proportion of the costs. This is particularly so where the amount of tax involved is small, however good his case may be.

We do not agree with the Revenue view that the present practice as regards Court cases is practicable, flexible and generous. Whereas costs are sometimes awarded at VAT Tribunal decisions, and sometimes not, there is no way by which the taxpayer can recoup his costs of an appeal before the General or Special Commissioners. This is particularly onerous because a large part of the costs of fighting a tax case is borne at the Commissioners' or Tribunal level. This occurs because litigants have to do a great deal of preparatory work, which is not repeated at the High Court level, and there are also the costs incurred in producing witnesses.

This is a real problem for smaller businesses who feel that they cannot afford to take a case before the Commissioners or Tribunal.

We therefore *propose* that, prior to a hearing before the Commissioners or a VAT Tribunal, the taxpayer should be given the option of electing for costs to be awarded. If he does so elect then, of course, the award of costs will work both ways and the taxpayer will have to pay the Revenue or Customs costs if he loses.

We further *propose* that if, at any stage in the determination of a particular issue, the taxpayer succeeds and the Revenue or Customs appeal to a higher authority, the taxpayer's costs on a solicitor and client basis should be borne by the Revenue or Customs whether or not their appeal succeeds.

12 Indexation

The principle of indexation of monetary amounts, which already applies automatically to personal allowances, should be applied to all other monetary limits in the Taxes Acts.

H VAT

As in previous years, we commence by expressing our concern at the extent to which major changes in VAT are introduced by way of a statutory instrument, subject only to the negative procedure in Parliament, rather than by way of primary legislation through the provisions of the annual Finance Bill.

We repeat the view that the various VAT regulations should now be codified as part of the Value Added Tax Act, and that the powers of H M Customs and Excise (Customs) to make regulations should be substantially reduced. The present system creates a considerable burden on commerce and industry which is unjustified.

The willingness of Customs to discuss problems is welcome, but adequate consultation before the introduction of new legislation, and a suitable gap in time between the date of its introduction and the date of its coming into force, has been shown to be necessary.

The burden of VAT is of great concern not only to large organisations but to smaller firms also, and a number of the following items are of particular importance to them.

1 VAT on imports – guarantees

We are convinced that the requirement to provide a guarantee against payment of deferred VAT is an unwarranted and costly burden on businesses in all normal cases. It bears particularly harshly upon those small and medium-sized businesses which frequently have difficulty in obtaining adequate finance. If Customs require a guarantee from the trader's bank, the bank will normally reduce the trader's credit facilities by an amount equivalent to the guarantee.

Some larger companies have a credit rating superior to that of the bank which is giving the guarantee. In this circumstance a guarantee would appear to be pointless.

Obviously, we accept that there must be cases where Customs feel that on the history of tax payments, or for other good reasons, a guarantee is necessary. We *propose* that instead of a standard guarantee being required in all instances, Customs should be required specifically to notify those traders for whom they wish to obtain a guarantee, and the trader should have the right of appeal to the VAT Tribunal against the decision of Customs. In this way, the guarantees would be related to the real needs of Customs without burdening business.

We understand that Customs are reconsidering this issue. We would stress the need for reduction in this burden if British business is not to be unfairly penalised when the Single European Market is achieved.

2 New penalty rules: mitigation and appeals

We have expressed our deep concern in our past proposals and correspondence about the harshness of the VAT penalty rules. We reiterate our view that the VAT penalty system should have mitigable penalties, and the taxpayer should have a right of appeal, both as to the size of the penalty, and whether a penalty is appropriate. Until these amendments are made there will continue to be a source of antagonism between the public and Customs, which is reflected by the number of appeals under the present system, and the comments made on it by the VAT Tribunals and other independent commentators.

3 Relief for VAT on bad debts

This is a subject on which we have been making representations for many years. The scope of relief has been increased from time to time, and we acknowledge and welcome that the bad debt problem will now no longer exist for businesses, the annual value of whose taxable supplies is not more than £250,000, and who have applied to account for VAT on a cash basis. However, for all other businesses, large and small, the problem remains,

and we still consider that the VAT regulations should be brought into line with the Income Tax rules, thus giving relief for VAT on bad debts where on normal commercial criteria the debt is regarded as irrecoverable.

No official of the taxation departments is made personally responsible for tax which he fails to collect because the taxpayer has disappeared, or has inadequate means to meet the liability. It is not clear why the unpaid tax collectors, namely the traders, should be required to bear the tax cost in similar circumstances. The trader has already lost the goods supplied for which payment has not been received. It is totally inequitable to make him bear the tax cost on top of that loss, or alternatively force him to incur additional expense in order to prove the debt is irrecoverable.

The requirement for VAT relief for a bad debt – that the debtor should have become insolvent – is too severe, and cuts out many cases where relief ought to be given. Traders may sometimes be driven to initiate insolvency proceedings when they would otherwise prefer not to. Retail traders may incur numerous bad debts of small amount as a result of making credit sales to private individuals. In these circumstances it is more than ever disproportionately expensive to take insolvency proceedings. Furthermore, private individuals who default are particularly prone to disappear without trace, so that no proceedings are possible.

4 Issue of securities

Schedule 6, Group 5, Item 6A, VATA 1983, is an attempt to palliate a central defect in the new regulations on partial exemption. Unfortunately, it is not satisfactory.

Because the new test for obtaining relief for input tax is that it should have been incurred in making taxable supplies – instead of the previous requirement that it was incurred for the purpose of making taxable supplies – the input tax incurred on items such as the costs of the issue of shares and debentures ceases to be recoverable. To correct this, Item 6A exempts underwriting commission, but this is only a partial solution. It takes no account of other issue expenses such as the legal, accountancy and advertising costs involved.

VAT refunds are also being refused on the same costs where shares are issued under an employee share scheme, on the grounds that the costs relate to an exempt supply, namely the issue of shares to the employee, despite the fact that rights to the shares are part of the employment contract, and that the employee may be wholly engaged in making taxable supplies.

Failing correction of the regulations (which we regard as the better solution) we *propose* that the law should be amended to render recoverable the VAT on all the expenses of the issue of shares and debentures.

5 Due and prompt payment of taxes

Where there is delay in accounting for taxes but no fraudulent intention, the correct remedy is to charge interest at a commercial rate on the tax outstanding in restitution of any loss suffered, rather than to impose penalties or surcharges. Such an approach has been proven effective in operation by the Revenue for many years. It is simple, inexpensive, readily understood and preserves as far as possible good relations between the public and the taxing authorities.

The system of more or less automatic penalties, surcharges and Tribunal appearances now in operation, on the other hand, reduces good relations to an irrelevance. It is incomprehensible to the majority of taxpayers, inexplicable in its complexity, and arbitrary and capricious in its incidence.

We understand that Customs are inhibited from calculating interest by problems in computer programming. If that is so, it is not acceptable and the highest priority should be given to resolving these problems. If necessary, the system should be extended by the use of private contractors.

There is concern that repayment aspects of VAT are not being treated equitably. Where a firm is in a constant repayment position there is often an inspection of its books by Customs to verify entitlement to repayment, with consequent delay in making payment. We *propose* that Customs should aim wherever possible to use existing information to avoid unnecessary verification visits. This would save Customs' resources and accelerate repayments.

6 Repayment supplement – error in return

Where a repayment of VAT is delayed by more than 30 days Section 20, FA 1985, entitles the taxpayer to have the repayment increased by a supplement. However, the supplement is not due if the amount initially claimed as repayment exceeds the amount ultimately established as correct by both 5% and £250.

This is too drastic and undiscriminating. Where large values are involved an inadvertent error in one item could lead to the cancellation of the whole of the supplement. Unless the claim is fraudulent, this is unfair.

7 Inward processing relief

Regulation 44, SI 1985, No.886, gives relief from the charge to VAT if goods are imported solely for repair or other treatment, do not become the property of a person in the UK and, when re-exported, are identifiably the same goods. We consider that this relief should be extended to bring it in line with the provisions of inward processing relief available for other duties. As we have said before, the relief would benefit UK exports and we are not aware that it would harm UK producers, since it is a basic requirement for the purpose of Inward Processing Relief that comparable and suitable goods are not available from within the EC.

8 Donations of equipment to educational establishments

If a trader registered for VAT donates equipment or items from his stock-in-trade to an educational establishment in the UK he must pay VAT thereon, calculated on the cost of the goods supplied. In some circumstances, for example, where the educational establishment makes public recognition of the donation in some way, the VAT may become payable on the open market value of the goods supplied.

In any case, the trader concerned is likely to have a budget figure for his charitable donations, with the result that the benefits accruing to donees will be reduced by the amount of the VAT which has to be paid away to Customs.

We *propose* that this unfortunate deterrent to the making of donations of equipment should be removed, by deeming that for VAT purposes the equipment was disposed of for nil consideration.

9 VAT on buildings and land

Paragraph 6, Schedule 3, FA 1989, adds a new Section 35A and a new Schedule 6A to the VAT Act 1983, and the Section empowers the Treasury to amend the Schedule by Order.

Before any Order is made it should be published in draft form for public consultation; the time allowed for comment on the draft should be adequate, and there should also be enough time between the deadline for comments and the making of the Order for the views expressed to be discussed with Customs.

We are replying separately to Customs' consultation on the self-supply provisions, paragraphs 5 and 6, in new Schedule 6A, VATA 1983.

Appendix I

Appendix I examines two of the issues on which the Revenue or Customs have indicated there is little immediate prospect of change. The CBI considers these issues, which create burdens and need to be kept under review, should remain on the table.

1 The schedular system

Many of the cases where the British tax system imposes anomalies and unnecessary burdens on business arise from the continuance of the schedular system. The continued use of this system seems unnecessary wherever audited accounts are available and form the basis for the tax computation.

We have addressed ourselves to this subject on many occasions, notably in our reply to the Green Paper on Corporation Tax (CBI, October 1982). What we *propose* is legislation which will permit all bona fide business expenses to be deductible in computing business profits.

Typical items of expenditure which concern us are the costs of raising equity capital (referred to earlier in our representations), the cost of abortive capital projects or feasibility studies, payments to terminate onerous contracts, relief for capital expenditure on intangibles such as franchises, publishing rights and computer software licences, and the business expenditure of investment and certain insurance companies which may at present fall foul of Section 75, TA 1988.

One important problem is that some expenditure, although clearly for legitimate business purposes, is not relieved as a business expense, a cost for capital gains purposes, or as being available for capital allowances. We refer elsewhere in these representations to the difficulty in establishing that certain expenditure is 'enhancement expenditure' on shares for capital gains purposes. We believe that it is anomalous that what is clearly business expenditure should not be relieved, either as a revenue or as a capital outgoing.

The archaic distinction between interest which is a business expense and interest which is a charge on income, and between trading income and interest or rental income, should be brought to an end. Also, capital losses should be made available for off-set against trading income, or for group relief.

2 VAT on imports – repayments

Repayment returns are on occasion subject to verification by visits from Customs prior to making the repayment. This procedure causes a delay in making that repayment and affects the cash-flow of businesses.

Obviously, we accept that there must be cases which warrant a visit from Customs prior to the repayment being made. However, in circumstances where the repayment claim relates primarily to VAT on imports already paid to Customs, and of which they have adequate records, the delay in repayment as a consequence of a visit to the trader's premises cannot be justified.

As we have said above in relation to repayments generally, we *propose* that Customs verify such repayments from their own records and not by the examination of traders' books. This may require changes in their computer systems.

Appendix II

The following items are the subject of separate discussions or representations with:

1 The Revenue

Exchange rate fluctuations
The exchange fluctuations on all foreign currency borrowings should be recognised for tax purposes.

Surplus ACT
The cost of economic double taxation presently suffered by companies in a Surplus ACT situation should be relieved.

Capital injected by way of capital contribution
Contributions of a capital nature should be taken into account in calculating the capital gain or loss on disposal of the share capital of the company concerned.

The Pay and File Scheme and the Keith Report
A number of aspects of the implementation of the scheme for filing returns for, and making payments of, corporation tax are creating concern for business.

Also under discussion are new rules for time limits and claims to capital allowances, group relief, the carry forward or back of losses, and the treatment of discovery assessments.

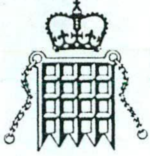
2 Customs

VAT: Civil penalties for dishonesty
A review of the system of civil penalties introduced by the Finance Acts 1985 and 1986.

VAT: repayment supplement
Appeals to a tribunal.

VAT: capital goods
Relief for input tax on land and computers.

VAT: repayment of VAT overpaid
Right to be repaid VAT paid in error.



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Mr Paisley's annual visit.

Paymaster General

FROM: D A GAW
REVENUE DUTIES DIVISION A

DATE: 25 October 1989

BUDGET REPRESENTATIONS: TOBACCO PRODUCTS

Earlier this year Dr Ian Paisley MP led a deputation of Northern Ireland trade unionists from Gallahers' tobacco factory, which is located in his constituency, to make representations about taxation of tobacco. The company is one of the largest private sector employees in Northern Ireland and much business activity in that part of the Province is dependent on the continued success of the tobacco factory near Ballymena. Similar visits were made in 1985, 1987 and 1988. On each occasion the deputation was seen at Deputy Chairman level and the representations reported to Ministers.

Circulation:

PS/Chancellor
Mr Michie
Mr Call

CPS
Mr Strachan
Mr Wilmott
Mr Parker
Mr Craske
Mr Cleaver

2. On the first two occasions, Dr Paisley sought a meeting with Ministers but subsequently asked to see our Deputy Chairman. A similar request has been received seeking a meeting here in February 1990. It is of course very unusual for a deputation led by an MP to be seen other than by a Minister, but the Deputy Chairman's role would be simply to listen and report. I would be grateful to know whether the Paymaster General is content that past practice continues and that Mrs Strachan should see this deputation.

D A GAW