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BUDGET PAPERS 1989

1/2

FILE BEGINS 06/02/1989

ENDS 14/02/1989

NOTE OF A MEETING HELD IN THE CHANCELLOR'S ROOM, HM TREASURY AT 10.30AM ON WEDNESDAY 19 OCTOBER

Present: Chancellor
Chief Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Phillips
Mr Luce
Mr Odling-Smee
Miss Peirson
Mr Sedgwick
Mr Turnbull
Mrs Butler
Mr Gieve
Mr Hibberd
Mr MacAuslan
Mr Pickford
Miss Simpson
Miss Walker
Mr Call

AUTUMN STATEMENT: INDUSTRY ACT FORECAST, ECONOMIC ASSUMPTIONS FOR PUBLIC EXPENDITURE, AND TIMING

The meeting first discussed the key figures for the Industry and Forecast, and the public expenditure assumptions for the Autumn Statement, on the basis of Mr Sedgwick's minute of 18 October.

Assumptions underlying the forecast

2. The Chancellor said that he was content for the Autumn Statement to state explicitly that the forecast for the year ahead assumed the same PSBR as forecast for the current financial year. He was also content for the IAF to assume an oil price "close to recent levels", in line with practice in previous published forecasts.

Real GDP

3. The Chancellor said that he was not keen to break precedent and publish figures for real GDP growth rounded to the nearest quarter. He thought this had an air of spurious accuracy. He also queried the apparent narrowing of the differential between oil and non-oil growth: he would be interested to know what the unrounded figures were, and if there was a significant change what the explanation was. The question then arose of which way rounding to one-half would tip the numbers. Sir T Burns said that he would wish to look again at the unrounded figures, and at the profile of half yearly figures, which we would also publish in the Autumn Statement. He would also want to consider what account needed to be taken of likely discrepancies between different measures of GDP. The Chancellor wondered whether, if we discounted the likely under-recording of GDP(E), a figure of 4½ per cent for the whole economy in 1988 would be more appropriate. It was noted that likely under-recording of GDP(E) had been explicitly taken into account in the figures published in last year's Autumn Statement: in principle it was agreed that a similar footnote should be included in this year version. Sir T Burns would provide further advice on the options.

Current Account

4. In discussion of the proposed current account path, it was noted that a deficit of £14 billion for 1988 was towards the top of the range of market expectations; as far as 1989 was concerned, the markets would be expecting some downward sloping stylised path, and a flat path would arouse suspicion that in fact we expected some deterioration in 1989. The margin of error on the forecast for 1989 was huge. Provisionally, it was agreed that the IAF should show a deficit of £14 billion for 1988, and £12 billion for 1989, but we would want to consider the September trade figures before finalising the 1989 figure.

The RPI

5. It was agreed that the IAF should assume an RPI less MIPs inflation rate of 5 per cent at end-1989, but that it should show the all items RPI coming back to 5 per cent by 1989Q4. This implied some falling back of interest rates by end-1989, but this was plausible, and consistent with what outside forecasters would be expecting.

6. The Chancellor said he was not attracted by the idea of including in the Autumn Statement a series of figures for the RPI excluding MIPs for future years. But he was attracted to Mr Sedgwick's suggestion that we should publish a chart showing the path of both RPI and RPI excluding MIPs for past years: it was for consideration whether this should cover the future as well as past figures.

7. In line with the assumptions for calendar year RPI, it was agreed that the assumption for the RPI to September 1989 should be 5½ per cent; the equivalent assumption for RPI less housing (Rossi) should remain at 5 for September 1989.

GDP Deflator

8. There were differences of view between GDP and the forecasters about the proposed assumptions for the GDP deflator. After discussion, a compromise of 6¼ in 1988-89 and 5 in 1989-90 was agreed.

Money GDP

9. It was noted that the money GDP projection would need to be revised in line with decisions on real growth and inflation.

PSBR/PSDR

10. The Chancellor said he thought it right to publish a number rounded to the nearest £1 billion, with some safety margin; the choice lay between £10 and £11 billion. He was inclined to the lower figure, and this was provisionally agreed, unless there were any surprises in the next CGBR figures, which caused us to revise our internal forecasts.

Unemployment

11. It was agreed that 1.9 million was provisionally the preferred assumption. This should be given to relevant departments when appropriate. However, we should hold open the prospect, internally, that the assumption might be trimmed to 1.85 million.

Average Earnings

12. The proposed path of $8^3/_4$ /7½/6/5 was agreed.

Interest Rates

13. It was agreed that the assumption for three month sterling interbank in 1989-90 should be revised down for consistency with the new RPI assumptions. The choice would probably be between 11 and 11¼ per cent. Initially departments should be asked to rework their figures using 11 per cent.

Debt Interest

14. Mr Sedgwick noted that there were a number of possible approaches to the figures of debt interest in future years. Either it could be calculated on the basis of assumptions about interest rates and the PSDR, eg. that it returns to zero as in the

MTFS, or on the basis of a stylised path for debt interest which did not involve assumptions about the path of the PSDR. On any of these approaches, we would be pressed about the assumptions we had made. It was agreed that a further submission was required, setting out possible paths for debt interest, how the assumptions used could be defended, and their effect on the survey figuring.

Timing of the Autumn Statement

15. The Chancellor and the Chief Secretary were agreed that, if the latest view of progress in the survey was correct, it would not make sense to stick to the original Autumn Statement timetable with a public expenditure cabinet on 10 November. The choice was therefore between options (i) and (ii) in Miss Simpson's minute of 18 October. The Chief Secretary said that if we went to Cabinet on 2 November but delayed the Oral Statement until 8 November it seemed very likely that news would leak out, and presentational advantage would be lost: he therefore favoured planning to do the Oral Statement on the afternoon of 2 November. There were risks in this strategy, in particular the danger that some Ministers would seek to reopen settlements at Cabinet. The Chancellor said he very much hoped it would be possible to limit the number of programmes reopened because of revised deflators. The Chief Secretary agreed that we should attempt to limit this as far as possible, although he saw difficulties on health, student awards, and overseas aid.

16. The Chancellor also commented that given the likelihood that the timetable would be accelerated, it was essential that DSS be told to produce their NIC proposals without delay. It was not acceptable that this should be allowed to jeopardise the whole timetable. Miss Peirson agreed to take this forward. The other next steps were for the Chancellor to discuss timing with the Prime Minister, and for officials to consider how much departments should be told, and when. It would be necessary to look back at

the handling of the 1986 operation. However, in the meantime the working assumption internally should be that the Public Expenditure Cabinet would be on Wednesday 2 November with an Oral Statement that afternoon. Informing Departments on whether the Oral Statement would be immediately after Cabinet could be deferred, but a final decision would be required by Tuesday 25 October, if departments were to have enough time to prepare press notices and clear them with the Treasury.

MOIRA WALLACE
19 October 1988

<u>Distribution</u>

Those present

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FROM: A C S ALLAN
DATE: 9 JANUARY 1989

CHANCELLOR
CHIEF SECRETARY
FINANCIAL SECRETARY
PAYMASTER GENERAL
ECONOMIC SECRETARY
SIR P MIDDLETON
SIR T BURNS
MR ANSON
MR WICKS
MR SCHOLAR
MR CULPIN
MRS CHAPLIN
MR TYRIE
MR CALL
SIR A BATTISHILL - IR
MR UNWIN - C&E

DORNEYWOOD: 7 JANUARY 1989

... I attach a note of the main conclusions reached during Saturday's discussions at Dorneywood. As in previous years, it is primarily confined to the decisions reached, and does not aim to be a blow-by-blow account of the discussions.

2. Disclosure of the decisions reached at Dorneywood is subject to the rules set out in the Budget security instructions which were circulated recently.

ACSA

A C S ALLAN

DORNEYWOOD: 7 JANUARY 1989

This minute records the main points emerging from Saturday's discussions.

POLICY BACKGROUND

Stance of Policy

2. Sir T Burns noted that non-oil growth in 1988 had been about 2 per cent above the rate we now thought was consistent with steady inflation. To get inflation down, we now needed to see a period when output grew below trend. We had already seen substantial tightening which he believed would have a significant effect on money GDP, though there were considerable uncertainties: over the past two years output growth had been much stronger than expected given the policy stance adopted. A continued tight policy stance was needed to restore credibility following a year when money GDP has overshot its MTFS path very substantially. In discussion the following points were made:

(i) We should be very cautious of taking too much notice of a forecast slow-down in the economy, and should watch current indicators, especially M0, closely.

(ii) We should not overdo things, and focus so much attention on maintaining a tight policy stance that we induced a recession.

It was agreed that the priority was to have a policy stance sufficiently tight to get inflation down. That might imply output markedly below trend, and possibly rising unemployment. The tight stance must be maintained for a further period until we are absolutely confident that it was right to relax it.

Savings

3. Sir T Burns noted that the decline in private savings and the rising investment ratio meant that the private sector could not finance its investment out of its own savings. It was too early to say whether this was a long term problem. There were cyclical elements to both savings and investment, though it was possible we were moving into a period when we would continue to see higher investment ratios. In his view, the imbalance between savings and investment was likely to persist into the medium term, though not on the current scale. In discussion, the following points were made:

(i) The problems of too much savings were much easier to deal with than the problems of too little savings.

(ii) There were no problems financing the current account deficit provided the market maintained confidence in the Government's policies; but a rising deficit could create difficulties.

(iii) The fall in net private savings had largely reflected an increase in borrowing, and tax incentives for saving were unlikely to have a marked effect on that.

(iv) The stance of policy had important consequences for private savings, but it was not an independent objective of policy to increase private savings.

(v) There was a risk that attempting to offset the decline in private savings by raising public sector savings would be self defeating.

It was agreed that, for the present, the main focus should be on anti-inflationary policies. That would mean high interest rates for some time, and that in turn would affect the pattern of private sector net savings. There were no major implications for the Budget judgement, apart from the general need for prudence.

But it would be important that the Budget gave appropriate signals that savings were a good thing.

PSDR and the Budget

4. It was agreed that we should keep the medium-term objective of a balanced Budget, and should not chase the PSDR up in response to the fall in private savings - any more than we had done the reverse in 1981-82. But the speed with which we should get back to a balanced Budget did depend in part on private sector behaviour. There was no need to take decisions now, but it would be desirable to maintain the sequence of tax reductions, even if they were modest. It would be undesirable to set a PSDR for next year larger than the outcome for this year. There was also a case, on grounds of prudence, for saying that it should not be set significantly lower. It looked as if tax reductions of about £1 billion relative to an indexed base would leave the tax burden broadly unchanged.

TAX PACKAGE

Excise duties

5. Because of the particular problems of the impact of mortgage interest payments on the RPI over the next few months, there was a very strong case for not revalorising the excise duties. There was, however, a case for increasing the differential between leaded and unleaded petrol, probably by a 5p increase in the duty differential (which should produce a doubling of the price differential between 4-star petrol and unleaded petrol). This might be done either by not changing leaded petrol duty and cutting unleaded duty by 5p; or by leaving unleaded duty unchanged and increasing the duty on leaded petrol by 5p. The second option would bring in additional revenue of about £$^1/_4$ billion. Customs would produce a note on these two options, for discussion at an overview meeting.

VED

6. The increases for coaches were agreed.

7. The increases for rigid heavy goods vehicles would widen the differential with articulated vehicles. It was in principle very strange to have different rates for these two types of vehicles. The Economic Secretary would consider this further.

VAT

8. The proposals for implementing the European Court Ruling that VAT must be extended to non-domestic construction and other services were agreed. The politically sensitive issues arose on charities, where we could exempt most but not all of their non-business activities. It was agreed that draft clauses should be published by end January.

9. It was agreed that the proposals to extend VAT to domestic passenger transport should be dropped.

10. It was agreed that the VAT threshold should be revalorised.

VAT deregulation package

11. The three proposals, on bad debt relief, on simplifying registration, and on the default surcharge, were all sensible. But they were expensive. They should all be included in the provisional tax package, but might need to be dropped if the total cost of the package looked like coming out too high.

Income tax

12. There was a case for further reductions in income tax this year if that looked at all possible: it would reinforce the message that lower taxes brought important supply side benefits. But given the need for caution it did not seem right at this stage to plan for a cut in the basic rate. It was agreed that the working assumption should be no change in the basic rate, but the

option of a 1p cut should not be ruled out, and should be reconsidered when final decisions on income tax were taken.

13. On personal allowances, there were some attractions in over-indexation: we could adjust the amount so as to produce a desired revenue cost, whereas cutting the basic rate was much more expensive and less flexible; presentation of an increase in allowances might be easier than presentation of a cut in the basic rate; and it would reduce the number of tax payers relative to simple indexation (which would increase taxpayer numbers by 200,000 relative to the 1988-89 regime). But, on the other hand, increased allowances were very quickly forgotten, and it would be better to save the revenue for a cut in the basic rate when that seemed possible. It was agreed that the package should contain simple revalorisation of allowances only.

14. It was agreed that the basic rate limit should be revalorised.

15. On concessions for pensioners, it was agreed that the package should provisionally contain an increase of 10 per cent in the age allowances for the over 80s, and a reduction in the withdrawal rate for age allowances, so that £1 of allowance was withdrawn for every £2 of additional income. An increase in the over 65 age allowance, while very effective in taking people out of tax, was too expensive.

Cars

16. While there were arguments for a larger increase, it was agreed that there should be a 20 per cent increase in car scales. The Revenue would provide a note on revenue yield and the distributional effects.

Corporation tax

17. It was agreed that the main rate of corporation tax should remain at 35 per cent.

18. It was agreed that the threshold for the small companies rate of corporation tax should be raised to £150,000, and the band over which the small companies rate was tapered out should be extended to an upper limit £750,000. The Revenue would provide a note on the effects of these.

Savings

19. The main effect of any tax changes was likely to be to shift savings between different instruments, and in particular into instruments we thought desirable. This meant share ownership in particular. At the same time it would be desirable to have a sensible tax reform package, which must, on balance, look favourable to savings.

Pensions

20. It was agreed that the new limits on pensions which can be paid from a tax privilege fund should be £40,000 for the pension itself (equivalent to a £60,000 earnings limit) and £90,000 for the lump sum. The earnings limit should be indexed to prices, and the lump sum linked to that. Nothing should be said about the possibility of under-indexing the lump sum in future: that, or other structural reforms, might be reconsidered once the reform had bedded in.

21. The Revenue will provide a note on the position of an employee who changed jobs but remained in his original pension fund.

22. Further work was needed on the implications of the reform package for the public sector, for both contributory and non-contributory schemes and for both funded and non-funded schemes, and on how the proposals would affect non-contributory schemes in the private sector. In particular, the Revenue would provide a note on the treatment of pensions or lump sums above the limits.

23. There was general agreement that earnings indexation for early leavers was a desirable change. But to do it in the Budget would increase the pressure for earnings indexation of the new limits we were introducing. It was agreed that the Chancellor would propose this to the Secretary of State for Social Security, but not until after the new pensions provisions had been enacted.

Life assurance

24. After some discussion, it was agreed that the ring-fencing of life offices' pensions business was a priority for early action, though the revenue yield needed to be examined further. The elimination of stamp duty on life assurance policies was also agreed. It was also noted that when stamp duty on shares was abolished, there would be considerable benefits to life offices.

25. It was agreed that the Revenue and the Treasury should work up costings, setting out both the impact and longer-term effects, and including an indication of the differential effect on different life offices, of a package which included:

(i) Cutting the tax rate on both income and gains to 25 per cent; and

(ii) spreading acquisition expenses against both income and gains over a period of years: the options covered should be 3/5/7/10 years;

(iii) possibly phasing in the changes, though varying the period over which acqusition expenses were spread was a more attractive way of fine-tuning the costs/yields.

Other options could be considered if appropriate. The objective should be to secure a yield of up to about £$^1/_4$ billion, net of the various offsets, from the package as a whole, (ie including the changes in paragraph 24).

Stamp Duty

26. It was agreed that stamp duty should be abolished. The start date would depend on further information about the likely implementation of Taurus. The provisional date should be 1 January 1990. But if it looked as if the Stock Exchange would be able to get Taurus in place for alpha stocks and new issues by 1 November 1989, that should be the start date. Abolition would be presented as part of the savings package, and early thought was needed on how this was best done.

PEPs

27. After extensive discussion it was agreed that two proposals should be examined further:

(i) To change from the present system to one of full front-end relief with a full exit charge. The limit should not be greater than £3.000, but might be less.

(ii) A scheme similar to the present one (with the agreed simplifications). The limits for unit trusts and investment trusts, provided they were 80 per cent invested in British equities, should be raised substantially, probably to £2,400. In those circumstances, there was a case for raising the overall limit to £4,800.

Some considerable doubts were expressed about the first option, in particular whether the PSBR costs - which could be substantial - were justified when there was no net benefit to the individual investor.

28. It was agreed that PEP treatment should not be extended to any other forms of savings. Letters of allotment should be able to be transferred straight into PEPs. The Revenue would provide a note on whether it would be possible to allow individuals the tax advantages of PEPs without going through a plan manager.

Employee Share Ownership Plans (ESOPs)

29. It was agreed that the Budget should contain a package to facilitate ESOPs.

Unit Trusts

30. It was agreed that the rate of corporation tax for unit trusts should be cut from 35 per cent to 25 per cent.

100 per cent business relief for IHT

31. This was being considered again by the Financial Secretary.

Tax relief for pensioners' health insurance

32. This would be announced in the Health White Paper, but would be scored as a Budget measure. The Chancellor asked for advice about whether an authoritative explanation of the proposal should be given at the time the White Paper was published, or should be held back for the Budget.

PRP

33. The proposals on PRP (abolishing the 5 per cent rule; increasing the amount which can attract relief from £3,000 a year to £4,000; and relaxing of the rules on headquarters etc) were agreed; the additional options of raising the tax-free proportion and of giving incentives for employers were not attractive. After some discussion, it was agreed that it would be better, on balance, not to announce that PRP would be a permanent scheme.

CGT

34. It was agreed that the £5,000 annual exemption from CGT should be frozen.

35. It was agreed that CGT rollover relief for gifts should be abolished.

Revenue Confidentiality

36. The Revenue and Customs would be providing full advice on this, reflecting discussions with other Departments. It was important to consider carefully the issues of a "harm" test, and what should be done about "purported" information. The precedents in the Banking Act and Financial Services Act on criminal sanctions for unauthorised disclosure were helpful. It was important to keep in close touch with what other Departments, particularly DSS, were planning. It would be worth considering whether the need for action in this sphere should be trailed in the Standing Committee discussions of the Official Secrets Bill.

Charities

37. The administrative costs of allowing one-off gifts to charities were high. Although this was an attractive option, it was agreed that it should not be pursued. It was agreed that the Financial Secretary, in consultation with the Paymaster General and the Economic Secretary, should consider a package for charities as a partial counter to the impact of the VAT changes arising from the ECJ ruling. This should include:

(i) Increases in the payroll giving limit either to £360 or £480;

(ii) relief for one-off gifts to charities by close companies; and

(iii) relaxation of the lotteries and fund-raising provisions.

(iv) any other appropriate lollipops.

Residence

38. It was provisionally agreed that action on the definition of residence should be included in the 1989 Budget; the Financial

Secretary was also considering what could be said in the Budget about strengthening the receipts' basis, and what the scope was for introducing a minimum tax.

Schedule E receipts basis

39. This would be a significant simplification, and would save 175 Revenue staff by 1992-93. But it carried a transitional cost. It should be included in the package provisionally, but further consideration would be needed on whether it could be afforded.

Subcontractors scheme

40. The proposals were agreed.

Close company apportionment

41. There was scope for major simplification here. A 35 per cent rate seemed attractive, and it was hard to see how the cost could be as a high as £100 million. A separate meeting on this was to be held.

Oil taxation

42. It was agreed that there should be nothing on North Sea abandonment in the Budget this year. The proposals for incremental projects should be included in the Budget this year.

EC tax approximation

43. It was agreed that our line that EC tax approximation was something best left to market forces must apply to the taxation of financial services as well as to indirect taxes. Otherwise our arguments did not stand up. We might, however, want to agree some harmonised level of taxation.

Overviews

44. It was noted that many of the issues for further discussion were highly technical and might be better discussed in the first instance in smaller groups before being taken to full overview Meetings.

Presentation

45. There was a need for early consideration of the presentation of the package. In general, the package should be presented as modest but sensible tax reform, which encouraged investment in equities and wider share ownership. It was not attractive to refer to levelling bumps in the playing field, or to give hostages to fortune by asserting publicly that the tax system was broadly neutral between consumption and savings.

A C S ALLAN

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1/89

FROM: N I MACPHERSON
DATE: 2 February 1989

MR GILHOOLY

cc Mr Culpin
Miss Hay
Mr Michie
Mr Flanagan
Miss Wallace Copy 2a

CHAPTER 4 AND TOPICS TO BE COVERED IN THE BUDGET SPEECH

I attach a first draft of Chapter 4 of the FSBR. This needs to be sent to the Revenue Departments tomorrow so that they can get down to the nitty-gritty of the tables and notes. I would appreciate comments of substance by midday (tomorrow). We have more than three weeks to get the drafting right.

2. We should include all the items in Chapter 4 in the Budget Speech with the exception of codgers' medical insurance.

3. Measures not currently in Chapter 4 which will probably merit a mention in the Budget Speech are:

? 1) Relocation Costs.
[2) VAT: minor property changes.] ?
? 3) VAT: Charities (Starter 32).
~~4) VAT: input tax on capital goods.~~
? 5) Duty and tax relief for diplomats and visiting forces.
[? 6) Prosecution time limits.] ?
[7) Unauthorised disclosure of information. O.S. act?]
✓ 8) Taxation of employee priority in company flotation.
? 9) Trusts - tidying up for Independent taxation.
? 10) Capital allowances at sports grounds.
✓ 11) Extension of pre-trading expenditure relief.
✓ 12) CGT: Chattels exemption.
? 13) [Lloyds CGT treatment].
✓ 14) CGT: Sterling non-qualifying bonds.
? 15) [IHT: Instruments of variation]. to be dropped
✓ 16) Residence.

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BUDGET

17) Deep discounted bonds.
18) VED: rigids.
19) VED: grass cutting machines.
20) National Savings: abolition of minimum interest rate provision.
21) Tax charge on switching investments in off-shore funds (umbrella funds).

4. There is a case for putting (1) and (18) in Chapter 4.

5. (2), (3) and (4) will fit in with the section on ECJ. This will no doubt be brief since it is yesterday's news.

6. (5), (6) (12) and (19) are lollipops. (5) fits into this category by virtue of the fact that nobody has ever got unpopular being nasty to foreigners - especially diplomats.

7. (6) and (7) fit into the law and order/Keith section. (14) and (17) are dull, but fit in with the COBO theme. (9) could follow on from the Independent Taxation section. (8) is not obligatory but could be tacked on to the wider share ownership section. Nor is (11) - the Alastair Morton Starter; this could be tacked on to the business section. (21) fits in with Unit Trusts.

8. (16) has to be mentioned, to explain why we are not doing anything in the 1988 Finance Bill.

9. (20) is bad news for the small saver and could be omitted if we can get away with it. However, it ties in with the anti-institutional saving/M4 theme.

Maybe can't

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10. NICs on mortgages, rent-a-room and CGT: unincorporated businesses' trading losses would all need to be in the Speech if they go ahead. The first two (and possibly the third) would also go into Chapter 4.

11. Any views?

Nick Macpherson

N I MACPHERSON

SECRET

B.L.O.

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4 The Budget tax proposals

4.01 The main tax changes proposed in the Budget are summarised below. A full list of changes is given in Table 4.1.

Income tax

4.02 The main income tax personal allowances will be increased in line with the statutory indexation provisions (based on the increase of 6.8 per cent in the RPI in the year to December 1988). This will mean that:

the single person's and wife's earned income allowances will rise by £180 from £2,605 to £2,785;

the married allowance will rise by £280 from £4,095 to £4,375;

the additional personal allowance and widow's bereavement allowance will rise by £100 from £1,490 to £1,590;

the age allowance for those aged 65 to 79 will rise by £220 from £3,180 to £3,400 (single) and by £350 from £5,035 to £5,385 (married);

the income limit for age allowance will rise by £800 from £10,600 to £11,400;

the basic rate limit will rise from £19,300 to £20,700 of taxable income.

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4.03 The age allowance for those aged 80 and over will be increased by 10 per cent, giving a £340 rise from £3,310 to £3,650 in the single allowance and a £530 rise from £5,205 to £5,735 in the married allowance.

4.04 The age allowance withdrawal rate will be reduced from £2 of allowances for each £3 of income to £1 for each £2 of income above the limit of £11,400.

Benefits in kind

4.05 Car benefit scale charges will be increased by 20 per cent from 6 April 1989.

Medical insurance for the elderly

4.06 Income tax relief will be given from April 1990 on private medical insurance paid by or for those aged 60 or over.

Charitable giving

4.07 The limit on charitable donations qualifying for tax relief under the payroll giving scheme will be doubled from £240 to £480 a year from 1989-90.

Profit-related pay

4.08 The cash ceiling on the amount of profit-related pay attracting tax relief will be increased to £4,000. The registration rules for PRP schemes will be simplified by abolishing the rule that PRP must equal 5 per cent of the rest of total pay, if profits are unchanged.

Employee shares schemes

4.09 The 1978 employee share scheme limit will be increased from £1,250 or 10 per cent of salary to £2,000 or 10 per cent. The 1980 SAYE share scheme limit will be increased from £100 to £150 per month.

[4.10 ESOPs]

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Personal equity plans

4.11 The annual limit on investment in Personal Equity Plans will be increased from £3,000 to £4,800. The annual limit on investment in unit and investment trusts will be increased from £540 or a quarter of the PEP whichever is higher to £2,400.

Stamp Duty

4.12 Stamp duty on share transactions will be abolished from 1 January 1990.

Pensions

4.13 A new tax regime for pensions will be introduced. For 'final salary' schemes, the main features will be:

an earnings limit of £60,000 on which tax-privileged pensions can be paid. This will give maximum privileged pension benefits of £40,000 p.a. and a maximum tax free lump sum of £90,000;

indexation of the earnings limit to prices;

no ceiling on pensions in excess of the limit, but would be fully taxed and, if funded, paid out of a non-privileged fund;

application of the new rules to employees joining or changing pension schemes after 14 March 1989.

4.14 For personal pension schemes, annual contribution limits, as a percentage of earnings, will be increased, but will be subject to a cash limit, also indexed to prices.

from x to y

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[4.15 AVCs,]?

Life assurance

4.16

Unit trusts

4.17 The rate of corporation tax on unfranked income of units trusts will be reduced from 35 per cent to 25 per cent for financial year 1989.

Business taxation

4.18 The profit limit of the small companies' corporation tax rate of 25 per cent for financial year 1989 will be raised from £100,000 to £150,000 and the limit for marginal relief will be raised from £500,000 to £750,000.

4.19 The main rate of corporation tax for the financial year 1989 will be 35 per cent.

4.20 The apportionment rules for close companies will be abolished. A special higher rate of corporation tax of 40 per cent will be introduced for close investment companies which distribute less than 85 per cent of their profits.

Oil taxation

4.21 A new petroleum revenue tax allowance will be introduced for the costs of incremental investment within existing oil fields.

Capital gains tax

4.22 The capital gains tax annual exempt amount will remain at £5,000 in the case of individuals and £2,500 in the case of most trusts.

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4.23 Capital gains tax deferral on life time gifts (excluding business assets) will be abolished.

Inheritance tax

4.24 From Budget Day the threshold for inheritance tax will be increased from £110,000 to [£118,000].

Termination payments

4.25 The £30,000 income tax exemption for termination payments will be withdrawn for payments in excess of £60,000. For payments between £30,000 and £60,000, £1 of exemption will be withdrawn for every £1 in excess of £30,000.

Schedule E assessment

4.26 The basis of assessment under Schedule E will be changed from accruals to receipts.

Excise duties

4.27 The duty on unleaded petrol will be reduced by the equivalent of 3.2p a gallon (inclusive of VAT). The duty on 2 star petrol will be raised by 5p a gallon (inclusive of VAT).

Vehicle excise duty

4.28 The number of rates of vehicle excise duty for hackney carriages (buses, coaches, taxis etc.) will be reduced from sixty to six. Rates of duty for buses and coaches will be brought ~~into line with~~ up to a level to cover track costs.

VAT

4.29 The quarterly and annual turnover limits for VAT registration will be replaced by a single limit based on turnover in the previous twelve months.

4.30 From 15 March 1989 the registration limit will become £23,600 per annum.

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4.31 A general VAT bad debt relief will be introduced.

4.32 The maximum default surcharge will be reduced from 30 per cent to 20 per cent.

4.33 To comply with the European Court judgement of 21 June 1988, standard rate VAT will be charged on:

> new non-domestic construction, new building sales and building land from 1 April 1989. Landlords will have option to tax rents and sales of existing non-domestic buildings from 1 August 1989;
>
> supplies to employers of protective boots and helmets from 1 April 1989;
>
> news services ~~other than those supplied direct to the public or for the production of zero-rated items such as newspapers~~ from 1 April 1989;
>
> supplies of fuel and power other than to ~~final~~ domestic consumers from 1 July 1990;
>
> supplies to industry of water and sewerage services from 1 July 1990.

4.34 Supplies of construction and fuel and power to charities for non-business purposes will continue to be zero-rated. All supplies of water to charities will be zero-rated.

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ITV levy

4.35 From 1 January 1990, the additional payments made by ITV programme contractors will be assessed on a mixture of net advertising revenue and profits.

Sale of vehicle registration numbers

4.36 [DTp to provide]

Tax administration

4.37 In the light of recommendations by the Keith Committee, changes will be made to:

the system of monetary penalties for tax offences;

the powers of the Inland Revenue to obtain information;

the regime for collecting, and charging interest on, overdue payments of income tax and national insurance contributions from employers.

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FROM: N I MACPHERSON
DATE: 3 February 1989

MR GILHOOLY

cc: Mr Culpin

BUDGET SPEECH OUTLINE

Attached is a draft outline, which I would quite like to give to Moira Wallace today.

2. The ordering is difficult because there are so few items of excitement. An alternative might be:

Savings
Capital
Business
Income
Spending

3. Keith has no obvious place. We got away without mentioning it last year. Perhaps, we can do so again.

4. Any views?

Nick Macpherson

N I MACPHERSON

JG. think put nastier sub business.

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BUDGET SECRET

Outline of Tax Section of Budget Speech

A. BUSINESS

- Main CT rate
- Small companies profit limit
- PRP (and material interest)
- Oil incrementals
- ITV levy
- Minor business changes: Sports grounds
  Pre-trading expenditure relief
- Simplification/deregulation: Close companies
  VAT registration simplification
  VAT threshold
  Bad debt relief
  Default surcharge

[B. Keith, Confidential Information and other law and order issues. Drop if at all possible]

C. CAPITAL TAXES

- CGT: Limit
  chattels
  gift deferral
  COBO etc [Alternatively in A]
- IHT: Threshold

D. SAVINGS

- rationale
- pension
- life assurance
- Stamp duty
- unit trusts (and umbrella funds)
- Wider share ownership: PEPs
  ESOPs/ESS
  [Employee priority flotation]

E. TAXES ON SPENDING

- VAT ECJ and minor property changes [Diplomats/visiting forces]
- VAT and charities (Tack on payroll giving limit, National Trust Starter)
- VED: buses, rigids, grasscutters etc.
- Number plates
- Excise duties

F. TAXES ON INCOME

- Tidying-up: Residence
  Independent Taxation (and minor trust changes)
  Relocation
  Cars
  NICs on subsidised mortgages
  Lump sum termination payments
  Schedule E receipts
  Rent a room
- Income tax: Allowances
  [rates]

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BUDGET SECRET

FROM: N I MACPHERSON
DATE: 6 February 1989

MISS WALLACE

cc: Mr Culpin
Mr Riley
Mr Gilhooly
Miss Hay
Mr Michie
Miss Simpson

SECRET

BUDGET STATEMENT

I attach an outline of the tax section.

Nick Macpherson

B.L.O.

N I MACPHERSON

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Outline of Tax Section of Budget Speech

A. BUSINESS

- Main CT rate
- Small companies profit limit
- PRP (and material interest)
- Oil incrementals
- ITV levy
- Minor business changes: Sports grounds
  Pre-trading expenditure relief
- Benefits-in-kind: Cars
  NICs on subsidised mortgages
  Relocation
- Simplification/deregulation: Close companies
  VAT registration simplification
  VAT threshold
  Bad debt relief
  Default surcharge

[B. Keith, Confidential Information and other law and order issues. Drop if at all possible]

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D. SAVINGS

- Rationale
- Pensions
- Life assurance
- Stamp duty
- Unit trusts (and umbrella funds)
- Wider share ownership: PEPs
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  [Employee priority flotation]

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- Tidying-up:
  - Residence
  - Independent Taxation (and minor trust changes)
  - Lump sum termination payments
  - Schedule E receipts
  - Rent a room
- Income tax:
  - Allowances
  - [rates]

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FROM: MISS M P WALLACE
DATE: 10 FEBRUARY 1989

CHANCELLOR

BUDGET STATEMENT: OUTLINE

I attach a still fairly rough outline of the Budget Statement. It is more or less based on drafts from Messrs Sedgwick, Peretz and MacPherson, and I have had comments from various others, notably Alex and Robert. Caveats and questions follow.

Economic background

(i) Do you want to say more about the world economy than at present? Do you, for example, want to lecture the US at all?

(ii) An early problem in the speech is whether you delay the 88 growth figure until you explain the adjustments. The office tends to favour doing so, but it does sound very hesitant and negative. I prefer the formulation at X - Andrew's suggestion, in fact. Do you agree?

(iii) I shall commission another learned paper on definitions of "steady growth," and what we can now say.

MTFS

(iv) This section has been revived, having been dropped in 86. It's fairly short and sweet at the moment, but Chris Riley thought this might be the point at which we could stretch the speech, by adding something on savings, and more on the

current account. It could, he suggested, be renamed simply "The Medium term". I wouldn't oppose a longer renamed section myself - but I don't think we want to devote too much time to either of these themes. What are your views?

Agree with Mr Riley

(v) Another quite attractive way of lengthening the economic section of the speech would be to embroider something around COBO - bonfire of controls etc! Robert suggested this could go between the MTFS and public finances sections, and although I'm not sure quite how we lead in and out of it, that seems about the right time.

Agree - we could have a small section on COBO, & still have a "credits" ...

Tax

(vi) At this stage, this is really just a list. A lot depends on decisions still to be made, and we can shuffle postcards around when things are clearer. At the moment there are one or two sections that hang together fairly obviously, although others look a bit sorry for themselves. There is also a pool of things which could go in a number of sections, depending on the overall balance: CGT (Robert has abolished the capital taxes section - "No such thing"); an explanation of where we stand on residence; and various business/personal borderline areas such as cars and other perks, and PRP.

Next Steps

(vii) I ought to circulate this round the top brass as a formal BLO paper, and I propose to do this on Monday. This could incorporate first thoughts from you, if you wish. Or I can send it round as something I have put to you, and this will allow the experts to look at it and point out all the tax measures I have left out etc. If you think it would be helpful to have a small meeting, we can fix one for early in

the week. Either way, I aim to put a first full draft to you next Friday (17th) for your first reactions. I have commissioned some of the tax bits and pieces from FP, but otherwise I shall try and draft myself and get comments from others.

MPW.

MOIRA WALLACE

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BLO

BUDGET-SECRET

COPY NO 1 OF 31 COPIES

FROM: MISS M P WALLACE
DATE: 13 February 1989

MR RILEY

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr A C S Allen
Mr Gilhooly
Mr S W Matthews
Mr Pickford
Mr Macpherson
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill - IR
Mr Isaac -IR
Mr Painter - IR
Mr Beighton

Mr Unwin - C&E
Mr Jefferson-Smith - C&E

BUDGET STATEMENT: OUTLINE

... I attach the outline of the Budget statement which I put to the Chancellor on Friday evening.

2. The ordering of the various sections will no doubt change, when we have the Chancellor's comments, and as we write it up. In particular, some of the tax measures could just as well go in one section as another (eg perks, or PRP): we can think further about this depending on the overall balance of the speech, as it develops.

BLO

BUDGET-SECRET

3. I shall be putting a first full draft of the speech to the Chancellor this Friday, 17 February. In the meantime, I should be grateful for any comments you or others may have on the overall structure.

MPW.

MOIRA WALLACE

OUTLINE

A. INTRODUCTION

Vigorous growth, employment/unemployment, unprecedented strength of public finances. Reaffirm policies that brought success, crucially determination on inflation.

B. ECONOMIC BACKGROUND

2. 88 activity much stronger than expected worldwide. Figures.

3. UK maintains place at top of growth league cf main European competitors, with another year of vigorous growth.

4. Judge that in 88 output growth [4½ per cent] in line with income and output measures but higher than unreliable expenditure measure.

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with economic stats, of concern to Govt, TCSC, outside commentators - launched Review, conclusions announced/expected shortly.

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6. Present our best estimates in FSBR. Which also sets out unadjusted figures. Full press notice on methodology. Not gone whole way (why). In some cases adjustment makes little difference. In some cases figures less favourable. But believe that adjusted figures nearer accurate picture of what is happening to demand and output, and it is these shall be using in setting out background.

7. 4½ per cent means xth year of [steady growth/ growth above y]. Within this <u>manufacturing</u> esp strong in 88 at [6 3/4 per cent] (past previous peak)

8. Productivity.

9. <u>Employment</u> : new figs and falls in unemployment

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12. But with stronger growth of domestic demand also some resurgence of inflationary pressures. Have had no hesitation in acting, and interest rates taking effect. But in short term perversely caused rise in recorded inflation.

13. For 89, already signs of desirable deceleration of demand. (Evidence) Expect to continue. Forecast investment to remain high (reasons). More marked effect on consumer spending. (Reasons). GDP growth forecast to be correspondingly slower than in recent years at x.

14. With mortgage rate increases coming into RPI early in year, (and reductions from early 88 dropping out of the annual figures) recorded inflation will peak at around x% [next month] before falling back to y% by end of year.

15. Current account may take longer to improve. Same in 89 as 88. Improve later. Import growth to slow with domestic demand. Trade performance should improve as capacity constraints wear off. No sign of any financing problems [as long as seen to maintain prudent policies].

16. [Manifestly no loss of confidence in £. Ended yr slightly firmer, but generally period of welcome stability. Risks / prospects internationally]

17. Risk at home ... pay. If employers fail to control, Govt will not bail them out, jobs will be lost.

THE MEDIUM TERM

18. Have shown that will take necessary action - however unpalatable - to bring the economy back on

to track set out in MTFS. Now entering 10th year: MTFS remains central framework of policy.

19. Determined to maintain steady downward pressure on inflation, downward path for money GDP.

20. Critics of early versions argued that aims could only be achieved at expense of lost output; but record proves otherwise.

21. This year, however, some resurgence of inflationary pressure. Action taken to restrain demand, bring money GDP growth and inflation back down; path set out in MTFS.

22. [Something on savings]

23. [More on current account]

Monetary Policy

24. Within MTFS central role in bringing inflation down belongs to monetary policy, buttressed by prudent fiscal stance.

25. Inflation a monetary phenomenon: monetary policy key to fight against inflation. Means interest rates. Alternatives don't work. [Credit controls]

26. Shall therefore continue to ensure that interest rates are at the level necessary to ensure downward pressure on inflation. MO and other evidence suggests domestic inflationary pressures now easing as predicted in response to tightening of monetary stance. [It may however be necessary to maintain the current level of short-term interest rates for some time yet.]

27. Decisions on the appropriate monetary stance will continue to take full account of role of exchange rate. Have made clear increases in domestic costs will not be accommodated either by monetary expansion or by exchange rate depreciation. Appropriate that exchange rate strengthened slightly in light of emerging inflationary pressures. [[Objective-stability subject to overriding need to bear down on inflation.]]

28. [Ultimate objective stable prices] No government could be proof against short-term fluctuations along the way. But can guarantee the will to ensure that they <u>are</u> only short-term.

29. Accordingly confirm 1989-90 <u>target for MO</u> growth of 1-5 per cent, set last year. Measured on twelve month basis will start the next financial year above top of this range reflecting high growth figures in spring and summer of 88. But growth of M0 over latest 6 months very low - equivalent to X at an annual rate - so twelve month growth will fall below 5 per cent within a few months.

[Here, or somewhere else, a <u>section on COBO</u>, benefits of liberalisation generally?]

Public Sector Finances

30. Prudent fiscal policy always part of MTFS: need to limit burden of debt and public sector's claim on savings and inflows of capital. Needs to be set in medium term context. Not short-term "demand management" tool, but key element of

successful supply side policies [expand]: pattern of taxes and expenditure, and impact on supply side.

31. Last year provided for PSDR of X in 1988-89. Public finances have turned out to be even stronger (give figures). Reflects buoyant economy, so revenues up sharply, public expenditure down as a share of GDP. 1988-89 Public Expenditure outturn and reasons. Also higher privatisation proceeds.

32. Strong position enables Government to repay debt, and reduce the public expenditure burden of debt servicing on present and future generations. [Illustrate with some figures.]

33. This makes room for further debt repayment, tax reductions, or increased expenditure elsewhere on priority services. Already seen latter (cf Autumn Statement).

34. Implications for funding. Restructuring. New techniques etc. [Finance Bill powers to enable government to buy gilts from Issue Department and cancel them.]

35. Factors bearing on PSDR in 1989-90:

- as always prudent and cautious approach essential;

- must not undo all the progress of recent years, and the strong position that we have built up.

  -present strong position partially reflects cyclical influences which will tend to unwind as economy reverts to more sustainable path;

[- gradualist approach essential, to avoid sharp changes in fiscal stance and disruption of the economy;]

36. Conclude that should provide for PSDR in 1989-90 of X.

37. Beyond 1989-90, expect to see PSDR revert [gradually/eventually] to zero - a balanced budget. Illustrative path [for medium term] set out in

MTFS. Though precise path may vary, should permit continuation of steady process of tax reform. To which we now turn.

chex.mw/docs/bs.taxout

TAXATION SECTION

~~Mat~~ Wilson to produce thoughts (discretionary)

1. BUSINESS

but pps on s.c. profits limit

M | Main CT rate. International comparisons? Businesses doing fine, so no major change. But small companies profits limit

X | Pre-trading expenditure relief (plus any other minor business changes) ↖ Mary Hay.

| Oil incrementals ↖ may be dropped. Leave 4 now

| ITV levy Case to produce by Wed, perhaps Thurs.

(me) | Perks: cars
~~subsidised mortgages~~
relocation

(Me) | PRP

Simplification/deregulation:

| close companies Mary
VAT package George
me | Schedule E receipts basis

2. SAVINGS

Thoughts – SWM

Rationale. Discrimination in tax treatment of different kinds of savings. Redress in favour of ownership.

Mace

[N.B. Independent taxation and savings]

Matthews to sort out 10 pr

Stamp Duty

Ford

Unit trusts [Europe]

John G

Life Assurance

Nick

Pensions .

Wider share ownership

Neilson →

PEPs
ESOPs / ESS

3. TAXES ON SPENDING

mention VAT ECJ stuff in passing
already announced VAT deregulation
GM — VAT on charities

charities generally:

me

PRG
× [National Trust starter]

GM. VED:
equity (get coaches and rigids up to track costs)
simplification (reduce number of rates)

SF ≷ number plates

(Wed) C+E excise duties: rationale for unleaded petrol
+ stuff from George

4. CGT:

?

Nick wr - continuous prose

limit
gift deferral
block avoidance - cobo tax changes, etc

Cayley

5. INCOME TAX

allowances (age allowance)'

rates

~~Codgers~~

~~McI. — Earnings rule~~
~~Age allowances~~
~~[Health].~~

Mace — I. taxation
Gilhooly — Ex. gains & losses.

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COPY NO 31 OF 31 COPIES

FROM: MISS M P WALLACE
DATE: 13 February 1989

MR RILEY

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr A C S Allen
Mr Gilhooly
Mr S W Matthews
Mr Pickford
Mr Macpherson
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

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Mr Painter - IR

Mr Unwin - C&E
Mr Jefferson-Smith - C&E

VERSION OF 13/2

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MOIRA WALLACE

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B.L.O.

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14. With mortgage rate increases coming into RPI early in year, (and reductions from early 88 dropping out of the annual figures) recorded inflation will peak at around x% [next month] before falling back to y% by end of year.

15. Current account may take longer to improve. Same in 89 as 88. Improve later. Import growth to slow with domestic demand. Trade performance should improve as capacity constraints wear off. No sign of any financing problems [as long as seen to maintain prudent policies].

16. [Manifestly no loss of confidence in £. Ended yr slightly firmer, but generally period of welcome stability. Risks / prospects internationally]

17. Risk at home ... pay. If employers fail to control, Govt will not bail them out, jobs will be lost.

THE MEDIUM TERM

18. Have shown that will take necessary action - however unpalatable - to bring the economy back on

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to track set out in MTFS. Now entering 10th year: MTFS remains central framework of policy.

19. Determined to maintain steady downward pressure on inflation, downward path for money GDP.

20. Critics of early versions argued that aims could only be achieved at expense of lost output; but record proves otherwise.

21. This year, however, some resurgence of inflationary pressure. Action taken to restrain demand, bring money GDP growth and inflation back down; path set out in MTFS.

22. [Something on savings]

23. [More on current account]

Monetary Policy

24. Within MTFS central role in bringing inflation down belongs to monetary policy, buttressed by prudent fiscal stance.

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25. Inflation a monetary phenomenon: monetary policy key to fight against inflation. Means interest rates. Alternatives don't work. [Credit controls]

26. Shall therefore continue to ensure that interest rates are at the level necessary to ensure downward pressure on inflation. MO and other evidence suggests domestic inflationary pressures now easing as predicted in response to tightening of monetary stance. [It may however be necessary to maintain the current level of short-term interest rates for some time yet.]

27. Decisions on the appropriate monetary stance will continue to take full account of role of exchange rate. Have made clear increases in domestic costs will not be accommodated either by monetary expansion or by exchange rate depreciation. Appropriate that exchange rate strengthened slightly in light of emerging inflationary pressures. [[Objective-stability subject to overriding need to bear down on inflation.]]

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28. [Ultimate objective stable prices] No government could be proof against short-term fluctuations along the way. But can guarantee the will to ensure that they are only short-term.

29. Accordingly confirm 1989-90 target for MO growth of 1-5 per cent, set last year. Measured on twelve month basis will start the next financial year above top of this range reflecting high growth figures in spring and summer of 88. But growth of MO over latest 6 months very low - equivalent to X at an annual rate - so twelve month growth will fall below 5 per cent within a few months.

[Here, or somewhere else, a section on COBO, benefits of liberalisation generally?]

Public Sector Finances

30. Prudent fiscal policy always part of MTFS: need to limit burden of debt and public sector's claim on savings and inflows of capital. Needs to be set in medium term context. Not short-term "demand management" tool, but key element of

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successful supply side policies [expand]: pattern of taxes and expenditure, and impact on supply side.

31. Last year provided for PSDR of X in 1988-89. Public finances have turned out to be even stronger (give figures). Reflects buoyant economy, so revenues up sharply, public expenditure down as a share of GDP. 1988-89 Public Expenditure outturn and reasons. Also higher privatisation proceeds.

32. Strong position enables Government to repay debt, and reduce the public expenditure burden of debt servicing on present and future generations. [Illustrate with some figures.]

33. This makes room for further debt repayment, tax reductions, or increased expenditure elsewhere on priority services. Already seen latter (cf Autumn Statement).

34. Implications for funding. Restructuring. New techniques etc. [Finance Bill powers to enable government to buy gilts from Issue Department and cancel them.]

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35. Factors bearing on PSDR in 1989-90:

- as always prudent and cautious approach essential;

- must not undo all the progress of recent years, and the strong position that we have built up.

-present strong position partially reflects cyclical influences which will tend to unwind as economy reverts to more sustainable path;

[- gradualist approach essential, to avoid sharp changes in fiscal stance and disruption of the economy;]

36. Conclude that should provide for PSDR in 1989-90 of X.

37. Beyond 1989-90, expect to see PSDR revert [gradually/eventually] to zero - a balanced budget. Illustrative path [for medium term] set out in

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MTFS. Though precise path may vary, should permit continuation of steady process of tax reform. To which we now turn.

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TAXATION SECTION

1. BUSINESS

Main CT rate. International comparisons? Businesses doing fine, so no major change. But small companies profits limit

Pre-trading expenditure relief (plus any other minor business changes)

Oil incrementals

ITV levy

Perks: cars
subsidised mortgages
relocation

PRP

Simplification/deregulation:

close companies
VAT package
Schedule E receipts basis

2. SAVINGS

Rationale. Discrimination in tax treatment of different kinds of savings. Redress in favour of ownership.

[N.B. Independent taxation and savings]

Stamp Duty

Unit trusts

Life Assurance

Pensions .

Wider share ownership

PEPs
ESOPs / ESS

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3. TAXES ON SPENDING

mention VAT ECJ stuff in passing
already announced VAT deregulation
VAT on charities

charities generally:

PRG
[National Trust starter]

VED:
equity (get coaches and rigids up to track costs)
simplification (reduce number of rates)

number plates

excise duties: rationale for unleaded petrol

4. CGT:

limit
gift deferral
block avoidance - cobo tax changes, etc

5. INCOME TAX

allowances (age allowance)'

rates

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RA 85/89

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Copy no. 1 of 26

H.M. CUSTOMS AND EXCISE
DEPARTMENTAL PLANNING UNIT
NEW KING'S BEAM HOUSE, 22 UPPER GROUND
LONDON SG1 9PJ
01-620 1313 Ext 5023

FROM: P R H ALLEN
Departmental Planning Unit

DATE: 13 February 1989

CHANCELLOR

BUDGET DAY PRESS NOTICES

The following is in response to your Principal Private Secretary's note of 9 February asking for a provisional list of the press notices we expect to issue on Budget Day.

A. Measures to promote unleaded petrol.

B. Restriction of duty paid blending of made wine.

C. Determination of original gravity of beer.

D. Changes in VAT registration and deregistration thresholds.

E. Simplification of VAT registration requirements.

F. Changes in arrangements for bad debt relief.

G. Review of default surcharge.

H. Recovery of VAT and Excise duty overpaid in error

I. Charities and the handicapped.

J. Research and development cars.

Circulation: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Riley
Mr Gilhooly
Mr Matthews
Mr Pickford
Mr Macpherson
Miss Simpson
Miss Wallace
CPS
Mr Jefferson Smith
Mr Wilmott
Mr Finlinson
Mr Vernon
Ms French
Mr Warr
Miss Davenport
Mr Broyd

This year's Customs Budget package has a strong deregulatory and pro-business flavour. We intend to consider whether an additional omnibus press notice encapsulating the pro-business elements (items D to H above) might better provide maximum publicity for the package.

On the assumption that, following exposure of the ECJ items on 6 February, the budget approach will be low key, we do not recommend any further Budget Day publicity.

RA.

P R H ALLEN

chex.ps/aa/17

RESTRICTED

FROM: A C S ALLAN

DATE: 9 February 1989

PS/INLAND REVENUE
PS/CUSTOMS & EXCISE

cc PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Riley
Mr Gilhooly
Mr Matthews
Mr Pickford
Mr Macpherson
Miss Simpson
Miss Wallace

BUDGET DAY PRESS NOTICES

The Chancellor would be grateful if you could circulate a provisional list of all the press notices you expect to issue on Budget Day. He would be grateful if this could be copied to all Treasury Ministers and be circulated by next Wednesday, 15 February.

2. He would then be grateful for a package of first drafts by Thursday 23 February, for discussion at the Overview on Monday 27 February. He accepts that drafts will inevitably be incomplete, and will require a fair amount of square bracketing.

ACSA

A C S ALLAN

est.ld/james/15 Feb/PS CHX

BUDGET CONFIDENTIAL

FROM: S M A JAMES
DATE: 14 February 1989

PS/CHANCELLOR

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Riley
Mr Gilhooly
Mr Matthews
Mr Pickford
Mr MacPherson
Miss Simpson
Miss Wallace

PS/C&E
Mr Jefferson-Smith - C&E
Mr Wilmott - C&E
Mr Finlinson - C&E
Mr P R H Allen - C&E

BUDGET DAY PRESS NOTICES

/behind

The Economic Secretary has seen Mr Allen's minute of 13 February.

2. He would favour on omnibus press notice on items D to H in Mr Allen's provisional list. Presumably an ECJ press release would be necessary if there are any significant changes in the clauses due to consultation (which the Economic Secretary hopes will not be the case).

S M A JAMES
Private Secretary

fp.ac.gilhooly/199

BUDGET CONFIDENTIAL

FROM: J F GILHOOLY

DATE: 15 February 1989

1 Alex to see

MR ODLING SMEE

2 pmp

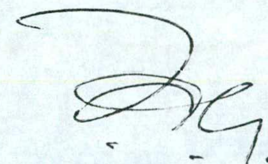
cc PS/Chancellor
PS/Economic Secretary
Mr Scholar
Mr Peretz
Mr Culpin
Miss O'Mara
Miss Simpson

BUDGET DAY PRESS NOTICES

We spoke. The Chancellor has asked the Revenue departments for a provisional list of the press releases planned for Budget Day. I have been asked to do a quick check for any Treasury press releases (over and above the usual Budget set).

2. When we spoke, you identified COBO, on which the Bank rather than the Treasury would be doing a press notice. Margaret O'Mara is checking whether anything might be expected from DNS or from the Bank on other issues related to the Budget in content or simply in timing: but it seems that both are unlikely.

3. The Chancellor has asked for drafts, however incomplete, to go to him on 23 February. Could I please ask you to winkle the Bank's draft out of them and let me have it by **close on 22 February** (ditto Margaret O'Mara if, against expectation, something turns up on her side)?



J F GILHOOLY

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

Copy No 1 of 31

FROM: D DENTON
EXT: 6302
DATE: 15 FEBRUARY 1989

Seems fine @ 1st glance. I await PNs. PS. [illegible]

MR A C S ALLAN

BUDGET DAY PRESS NOTICES

1. You asked (your note of 9 February) for a provisional list of all the press notices we expect to issue on Budget Day.

2. I attach a list (not necessarily in order of importance). For the moment, a marker has been included on the point about unauthorised disclosure of information, although I gather an announcement may be made before Budget Day. Whenever the announcement, the press notice will presumably be a joint one covering Customs' interest as well. Other items in square brackets are provisional pending decisions.

D Denton

D DENTON

---

cc. PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Riley
Mr Gilhooly
Mr Matthews
Mr Pickford
Mr Macpherson
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call
PS/Customs (cover note only)
Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Bush
Mr McManus
Mr McNicol
Miss McFarlane
Mr Denton
Mr Shaw (Rm 44, New)
Mr Willmer
PS/IR

INLAND REVENUE BUDGET DAY PRESS NOTICES

The Budget 1989: Income tax

Income tax rates and personal allowances for 1989/90: PAYE

[Reduction in basic rate of income tax: consequentials]

New basis of assessment for earnings

Income tax: company cars

Relocation costs: reform of tax reliefs

Income tax: gifts between husband and wife and other settlements

Charities: payroll giving limit increased

[Heritage charities: membership covenants to qualify for tax relief]

Personal Equity Plans improved

Pensions: tax rules simplified

Higher tax free limits for Approved Employee Share Schemes

[Employee Share Ownership Plans]

Profit-Related Pay

Employees' material interest tests

[Easements of Employee share and other participation arrangements]

[Electricity Privatisation]

Abolition of Stamp Duty on shares

Life Assurance

Unit trusts: [introduction of new tax regime for unit trusts within the UCITS directive]

Corporation Tax rates

Business Expansion Scheme

Advance Corporation Tax

Abolition of close company apportionment

Capital allowances

Tax treatment of foreign exchange gains and losses: consultative document

Extension of relief for pre-trading expenditure

Set-off of trading losses against capital gains

Sub-contractor Tax Scheme: consultation on reduced voucher requirements

Petroleum Revenue Tax: incremental investment allowance

Lloyd's: change in CGT rules to facilitate stock lending to market makers by Lloyd's underwriters

Capital [gains] [taxes]: miscellaneous changes

Capital gains tax and gifts

Capital gains: branches and agencies of overseas businesses

Gifts to Housing Associations

[Inheritance tax]

Taxes Management: measures to modernise the compliance system

[New criminal penalties for wrongful disclosure of taxpayer information]

European Economic Interest Groupings

Swaps: consultative document and extra-statutory concession

Deep discounted and index linked bonds; changes in the tax rules

eb.ph/sjp/2.27 CONFIDENTIAL

FROM: S J PICKFORD
DATE: 28 FEBRUARY 1989

MISS WALLACE

cc Mr Scholar
Mr Culpin
Mr Gieve
Mr A C S Allan
Mr Flitton
Mr Lind
Mrs Chaplin

BUDGET BROADCAST

You asked for quick reactions to the first draft script.

2. In general I think it will work well. In particular I like the idea of "the tide". I think it is right to recognise straightaway that will have been receiving "bad news" messages from the media.

3. On the structure of the script, it may be better to re-jig the order slightly. At the moment it concentrates on various aspects of economic success - getting down inflation, steady growth, spending on priority programmes, unemployment, real take home pay, investment, league tables. Sandwiched in the middle is the paragraph on repayment of Government debt. I do not think there is any particular rationale for its present location, and it might well fit better at the end of the section. It could then lead in naturally to a "prudent and cautious Budget".

4. On specifics, the paragraph on inflation may be a little complacent. I think it needs to say explicitly that raising interest rates will work, and inflation will be coming down later in the year. (Two small points: I doubt if the average viewer knows what "a couple of points" is; and "letting it rip" implies that there was a possibility that it would do so.)

S J PICKFORD

rc 1989/10.3.01

BUDGET SECRET

COPY NO 1 OF 17

FROM: ROBERT CULPIN
DATE: 10 March 1989

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Scholar
Mr Riley
Mr McIntyre
Mr Pickford
Mr Gilhooly
Miss Wallace
Mr Macpherson
Mr Ford
Mrs Chaplin
Mr Tyrie

Many thanks. Most helpful & in Budget presentation. 2 - per return ...

FACTS

This note pulls together a few figures which might come in useful when you are finalising the Budget presentation. **It does not call for you to change anything.** I have sent you a separate note about life assurance.

with speech.

Income tax

2. Last year you said that the top 5 per cent of taxpayers were expected to bear 28 per cent of the income tax burden in 1988-89, compared with 24 per cent in 1978-79. The Revenue revised that estimate recently, in the light of the latest survey of personal incomes (for 1986-87). The top 5 per cent are now expected to shoulder 29 per cent of the income tax burden in 1988-89 and 29½ per cent in 1989-90, still compared with 24 per cent in 1978-79.

3. I understand from the Revenue that the new estimates are not yet in the public domain, for the simple reason that no one has asked for them. They are there to be used whenever you like: I attach the full table. You might, for example, want to engineer a PQ at some stage.

National insurance stamp

4. So far as I can see, our modern-day equivalent of the old national insurance stamp, which you will be introducing in the Budget, will be the lowest ever in real terms. It will be much less of a burden than the 5 shillings of the great Beveridge reform. I attach a manuscript history table by Mr Macpherson. It would need checking if you want to use any of it in public.

5. The stamp itself was not abolished until 1975. Strictly speaking, it is only since then that, as the speech puts it:

> It has long been a feature of the National Insurance system that, once people earn more than the lower earnings limit... they have to pay National Insurance contributions at the same rate on the whole of their earnings up to the upper earnings limit.

6. We had a stamp plus a single rate in the early sixties (when, I think, the Prime Minister was at the MPNI). The stamp was then large - bigger for men than the rate times the LEL. In the late sixties, there was a two-rate structure. The system reverted to a stamp plus a single rate in the early seventies. I suppose this format could just about be said to have a good historical pedigree.

Steps and marginal rates

7. The GAD say the numbers earning up to £5 below the steps are as follows:

£	thousands
38 - 43	600
70 - 75	250
110 - 115	300

8. The numbers in the 5 and 7 per cent bands, for whom marginal rates will in principle rise are:

£	millions	% of all employees
43 - 75	1.85	9.4
75 - 115	2.05	10.5

These figures include those within £5 of the steps, for whom marginal rates may in practice fall.

9. Putting these figures together, marginal rates might rise for about 3¼ million employees above the LEL. But of course average rates will fall; and the pattern of average tax-and-NIC rates will look very much more sensible - I attach a chart.

Distributional effects of NIC reform

10. You will not want to make a meal of distributional effects. We shall present the changes primarily as a reform to dismantle the steps. But others are bound to see them as something for the lower end to balance last year's reductions at the higher end. So it would be sensible to clarify which distributional claims are true.

11. As you know, about 70 per cent of the benefit goes to people earning less than average male full-time earnings. To put that in perspective:

- just over 70 per cent of all national insurance contributors earn less than this average

- but only about 50 per cent (very roughly) of the benefit of a basic rate reduction would go to this group - strictly, to households whose head earns less than average male full-time earnings.

12. About 60 per cent of the benefit of the NIC reform goes to people earning less than average all-employee full-time earnings.

13. It is not the case that the national insurance changes are either targeted on the lowest paid or of special benefit to the lowest paid. Nor, of course, are the changes any help to pensioners or savers (as such).

14. However, for people on very low earnings (but above the LEL), the NIC reform is more help than anything you could do on income tax, for the simple reason that people start paying NICs before they start paying income tax.

15. For people between about half and about average earnings, the NIC reform is also better than either a reduction in the basic rate or an increase in allowances with a roughly equal cost for people under retirement age.

16. Needless to say, I do not suggest for a moment that you dwell on these points in public, for the obvious reason that we shall soon be back (I trust) to what you have called "the key priority" of reducing marginal rates, and "the number one priority" of reducing the basic rate of income tax. But so long as we do not overdo it, there is a simple common-man story here, which looks fair enough. The last NIC reform in 1985 was of special benefit to the low paid. Since then, you have reduced taxes for the people in the middle by reducing the basic rate in three Budgets in a row; and you have abolished the top rates of tax in your last Budget. This year's NIC reform lightens the load for everyone, and will be of particular help to people a bit below average.

ROBERT CULPIN

QUANTILE SHARES OF INCOME TAX, 1973-74 TO 1989-90

Per Cent

Year	Quantile group of tax units (1) (per cent)															Total tax liability (£million)	Number of tax units ('000s)
	Top 1	Top 2	Top 3	Top 4	Top 5	Top 10	10-20	20-30	30-40	40-50	50-60	60-70	70-80	80-90	Bottom 10		
1973-74	15.6	20.4	23.6	26.4	28.6	37.8	-	-	-	-	-	-	-	-	-	7137	-
1974-75	13.9	18.6	21.8	24.5	26.9	36.7	-	-	-	-	-	-	-	-	-	10271	-
1975-76	11.9	16.3	19.5	22.3	24.7	34.5	-	-	-	-	-	-	-	-	-	15041	-
1976-77	11.4	15.9	19.2	21.9	24.6	34.6	-	-	-	-	-	-	-	-	-	17014	-
1977-78	11.9	16.3	19.6	22.3	24.9	35.0	15.0	12.0	10.0	8.1	7.2	5.1	4.4	2.5	0.8	17420	-
1978-79	11.2	15.4	18.8	21.6	24.0	34.5	15.7	12.3	9.9	8.8	6.7	5.4	4.0	2.0	0.7	18748	21472
1979-80	10.4	14.7	18.0	20.8	23.4	33.8	15.7	12.4	10.4	8.6	6.8	5.6	3.7	2.3	0.7	20599	21645
1980-81	10.9	15.4	18.9	21.6	24.4	34.8	16.1	12.3	10.2	8.5	7.1	5.2	3.3	1.8	0.7	24295	20969
1981-82	11.3	15.8	19.3	23.4	24.8	35.4	15.6	12.1	9.9	8.1	6.7	5.3	3.8	2.4	0.7	28720	20786
1982-83	11.7	16.4	19.9	22.8	25.4	35.9	15.5	12.1	9.9	8.2	6.6	5.2	3.7	2.2	0.7	30361	20770
1983-84	11.4	16.0	19.7	22.7	25.4	36.2	16.2	12.5	10.1	8.1	6.4	4.9	3.5	1.9	0.6	31108	20459
1984-85 (2)	11.8	16.7	20.5	23.6	26.4	37.5	15.7	11.9	9.6	7.8	6.3	4.9	3.6	2.0	0.7	35420	20214
1985-86 (2)	12.9	17.9	21.5	24.6	27.3	38.0	15.3	11.7	9.5	7.7	6.2	4.9	3.6	2.3	0.8	38932	20211
1986-87 (2)	14.2	19.5	23.4	26.6	29.3	39.8	15.2	11.4	9.3	7.6	6.0	4.6	3.3	2.1	0.7	43334	20199
1987-88 (3)	15.0	20.5	24.5	28.0	31.0	41.5	15.0	11.5	9.0	7.5	6.0	4.5	3.0	2.0	0.5	45579	20826
1988-89 (3)	13.0	18.5	23.0	26.0	29.0	40.0	15.5	11.5	9.5	7.5	6.0	4.5	3.0	2.0	0.5	46369	21193
1989-90 (3) (6.8% indexation)	13.0	18.5	23.0	26.5	29.5	40.5	15.5	11.5	9.0	7.5	5.5	4.5	3.0	2.0	0.5	51474	21301

1. Counting married couples as one and combining their incomes.
2. Including MIRAS/investment imputation.
3. Projection from 1986-87 S.P.I, including population adjustments and MIRAS/investment income imputation.

N.B. Percentages for last three years to nearest 0.5% .

Source 289 series : 5 March 1989

Stamp / Entry fee to N I System since 1948-49 (average for year; contracted-in employees; adult males)

	£ current prices	1989-90 prices	% Average earnings
1948-49	.25	3.61	2.7
1949-50	.25	3.51	2.6
1950-51	.25	3.39	2.6
1951-52	.25	3.06	2.3
1952-53	.27	3.08	2.3
1953-54	.29	3.23	2.4
1954-55	.29	3.16	2.3
1955-56	.33	3.42	2.4
1956-57	.34	3.38	2.4
1957-58	.37	3.54	2.4
1958-59	.49	4.57	3.1
1959-60	.50	4.66	3.1
1960-61	.50	4.59	3.0
1961-62	.52	4.58	3.0
1962-63	.53	4.51	3.0
1963-64	.57	4.78	3.1
1964-65	.58	4.66	2.9
1965-66	.68	5.22	3.2
1966-67	.68	5.03	3.0
1967-68	.73	5.29	3.1
1968-69	.76	5.21	3.0
1969-70	.85	5.55	3.1
1970-71	.88	5.35	2.9
1971-72	.88	4.90	2.6
1972-73	.88	4.57	2.3
1973-74	.86	4.05	2.0
1974-75	.78	3.12	1.5
1975-76	.61	1.95	0.9
1976-77	.75	2.08	1.0
1977-78	.86	2.10	1.1
1978-79	1.14	2.57	1.2
1979-80	1.27	2.47	1.2
1980-81	1.55	2.59	1.2
1981-82	2.09	3.13	1.4
1982-83	2.58	3.61	1.6
1983-84	2.93	3.92	1.7
1984-85	3.06	3.90	1.7
1985-86 pre Oct	3.20	3.85	1.6

	£ current prices	1989-90 prices	% Average earnings
1985-86 post Oct	1.78	2.14	0.9
1986-87	1.90	2.21	0.9
1987-88	1.95	2.18	0.8
1988-89	2.05	2.17	0.8
1989-90 pre Oct	2.15	2.15	0.8
post Oct	.86	.86	0.3

pmp or (D) if you can

BUDGET SECRET

COPY NO 12 OF 17

FROM: ROBERT CULPIN
DATE: 10 March 1989

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Scholar
Mr Riley
Mr McIntyre
Mr Pickford
Mr Gilhooly
Miss Wallace
Mr Macpherson
Mr Ford
Mrs Chaplin
Mr Tyrie

FACTS

This note pulls together a few figures which might come in useful when you are finalising the Budget presentation. It **does not call for you to change anything.** I have sent you a separate note about life assurance.

Income tax

2. Last year you said that the top 5 per cent of taxpayers were expected to bear 28 per cent of the income tax burden in 1988-89, compared with 24 per cent in 1978-79. The Revenue revised that estimate recently, in the light of the latest survey of personal incomes (for 1986-87). The top 5 per cent are now expected to shoulder 29 per cent of the income tax burden in 1988-89 and 29½ per cent in 1989-90, still compared with 24 per cent in 1978-79.

3. I understand from the Revenue that the new estimates are not yet in the public domain, for the simple reason that no one has asked for them. They are there to be used whenever you like: I attach the full table. You might, for example, want to engineer a PQ at some stage.

National insurance stamp

4. So far as I can see, our modern-day equivalent of the old national insurance stamp, which you will be introducing in the Budget, will be the lowest ever in real terms. It will be much less of a burden than the 5 shillings of the great Beveridge reform. I attach a manuscript history table by Mr Macpherson. It would need checking if you want to use any of it in public.

5. The stamp itself was not abolished until 1975. Strictly speaking, it is only since then that, as the speech puts it:

> It has long been a feature of the National Insurance system that, once people earn more than the lower earnings limit... they have to pay National Insurance contributions at the same rate on the whole of their earnings up to the upper earnings limit.

6. We had a stamp plus a single rate in the early sixties (when, I think, the Prime Minister was at the MPNI). The stamp was then large - bigger for men than the rate times the LEL. In the late sixties, there was a two-rate structure. The system reverted to a stamp plus a single rate in the early seventies. I suppose this format could just about be said to have a good historical pedigree.

Steps and marginal rates

7. The GAD say the numbers earning up to £5 below the steps are as follows:

£	thousands
38 - 43	600
70 - 75	250
110 - 115	300

8. The numbers in the 5 and 7 per cent bands, for whom marginal rates will in principle rise are:

£	millions	% of all employees
43 - 75	1.85	9.4
75 - 115	2.05	10.5

These figures <u>include</u> those within £5 of the steps, for whom marginal rates may in practice fall.

9. Putting these figures together, marginal rates might rise for about 3¾ million employees above the LEL. But of course average rates will fall; and the pattern of average tax-and-NIC rates will look very much more sensible - I attach a chart.

Distributional effects of NIC reform

10. You will not want to make a meal of distributional effects. We shall present the changes primarily as a reform to dismantle the steps. But others are bound to see them as something for the lower end to balance last year's reductions at the higher end. So it would be sensible to clarify which distributional claims are true.

11. As you know, about 70 per cent of the benefit goes to people earning less than average male full-time earnings. To put that in perspective:

- just over 70 per cent of all national insurance contributors earn less than this average
- but only about 50 per cent (very roughly) of the benefit of a basic rate reduction would go to this group - strictly, to households whose head earns less than average male full-time earnings.

12. About 60 per cent of the benefit of the NIC reform goes to people earning less than average all-employee full-time earnings.

13. It is not the case that the national insurance changes are either targeted on the lowest paid or of special benefit to the lowest paid. Nor, of course, are the changes any help to pensioners or savers (as such).

14. However, for people on very low earnings (but above the LEL), the NIC reform is more help than anything you could do on income tax, for the simple reason that people start paying NICs before they start paying income tax.

15. For people between <u>about</u> half and <u>about</u> average earnings, the NIC reform is also better than either a reduction in the basic rate or an increase in allowances with a roughly equal cost for people under retirement age.

16. Needless to say, I do not suggest for a moment that you dwell on these points in public, for the obvious reason that we shall soon be back (I trust) to what you have called "the key priority" of reducing marginal rates, and "the number one priority" of reducing the basic rate of income tax. But so long as we do not overdo it, there is a simple common-man story here, which looks fair enough. The last NIC reform in 1985 was of special benefit to the low paid. Since then, you have reduced taxes for the people in the middle by reducing the basic rate in three Budgets in a row; and you have abolished the top rates of tax in your last Budget. This year's NIC reform lightens the load for everyone, and will be of particular help to people a bit below average.

ROBERT CULPIN

QUANTILE SHARES OF INCOME TAX, 1973-74 TO 1989-90

Per Cent

Year	Quantile group of tax units (1) (per cent)															Total tax liability (£million)	Number of tax units ('000s)
	Top 1	Top 2	Top 3	Top 4	Top 5	Top 10	10-20	20-30	30-40	40-50	50-60	60-70	70-80	80-90	Bottom 10		
1973-74	15.6	20.4	23.6	26.4	28.6	37.8	-	-	-	-	-	-	-	-	-	7137	-
1974-75	13.9	18.6	21.8	24.5	26.9	36.7	-	-	-	-	-	-	-	-	-	10271	-
1975-76	11.9	16.3	19.5	22.3	24.7	34.5	-	-	-	-	-	-	-	-	-	15041	-
1976-77	11.4	15.9	19.2	21.9	24.6	34.6	-	-	-	-	-	-	-	-	-	17014	-
1977-78	11.9	16.3	19.6	22.3	24.9	35.0	15.0	12.0	10.0	8.1	7.2	5.1	4.4	2.5	0.8	17420	-
1978-79	11.2	15.4	18.8	21.6	24.0	34.5	15.7	12.3	9.9	8.8	6.7	5.4	4.0	2.0	0.7	18748	21472
1979-80	10.4	14.7	18.0	20.8	23.4	33.8	15.7	12.4	10.4	8.6	6.8	5.6	3.7	2.3	0.7	20599	21645
1980-81	10.9	15.4	18.9	21.6	24.4	34.8	16.1	12.3	10.2	8.5	7.1	5.2	3.3	1.8	0.7	24295	20969
1981-82	11.3	15.8	19.3	23.4	24.8	35.4	15.6	12.1	9.9	8.1	6.7	5.3	3.8	2.4	0.7	28720	20786
1982-83	11.7	16.4	19.9	22.8	25.4	35.9	15.5	12.1	9.9	8.2	6.6	5.2	3.7	2.2	0.7	30361	20770
1983-84	11.4	16.0	19.7	22.7	25.4	36.2	16.2	12.5	10.1	8.1	6.4	4.9	3.5	1.9	0.6	31108	20459
1984-85 (2)	11.8	16.7	20.5	23.6	26.4	37.5	15.7	11.9	9.6	7.8	6.3	4.9	3.6	2.0	0.7	35420	20214
1985-86 (2)	12.9	17.9	21.5	24.6	27.3	38.0	15.3	11.7	9.5	7.7	6.2	4.9	3.6	2.3	0.8	38932	20211
1986-87 (2)	14.2	19.5	23.4	26.6	29.3	39.8	15.2	11.4	9.3	7.6	6.0	4.6	3.3	2.1	0.7	43334	20199
1987-88 (3)	15.0	20.5	24.5	28.0	31.0	41.5	15.0	11.5	9.0	7.5	6.0	4.5	3.0	2.0	0.5	45579	20826
1988-89 (3)	13.0	18.5	23.0	26.0	29.0	40.0	15.5	11.5	9.5	7.5	6.0	4.5	3.0	2.0	0.5	46369	21193
1989-90 (3) (6.8% indexation)	13.0	18.5	23.0	26.5	29.5	40.5	15.5	11.5	9.0	7.5	5.5	4.5	3.0	2.0	0.5	51474	21301

1. Counting married couples as one and combining their incomes.
2. Including MIRAS/investment imputation.
3. Projection from 1986-87 S.P.I, including population adjustments and MIRAS/investment income imputation.

N.B. Percentages for last three years to nearest 0.5% .

Source 289 series : 5 March 1989

Stamp / and Entry fee to NI System since 1948-49 (average for year, contracted-in employees; adult males)

	£ current prices	1989-90 prices	% Average earnings
1948-49	.25	3.61	2.7
1949-50	.25	3.51	2.6
1950-51	.25	3.39	2.6
1951-52	.25	3.06	2.3
1952-53	.27	3.08	2.3
1953-54	.29	3.23	2.4
1954-55	.29	3.16	2.3
1955-56	.33	3.42	2.4
1956-57	.34	3.38	2.4
1957-58	.37	3.54	2.4
1958-59	.49	4.57	3.1
1959-60	.50	4.66	3.1
1960-61	.50	4.59	3.0
1961-62	.52	4.58	3.0
1962-63	.53	4.51	3.0
1963-64	.57	4.78	3.1
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1967-68	.73	5.29	3.1
1968-69	.76	5.21	3.0
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1972-73	.88	4.57	2.3
1973-74	.86	4.05	2.0
1974-75	.78	3.12	1.5
1975-76	.61	1.95	0.9
1976-77	.75	2.08	1.0
1977-78	.86	2.10	1.1
1978-79	1.14	2.57	1.2
1979-80	1.27	2.47	1.2
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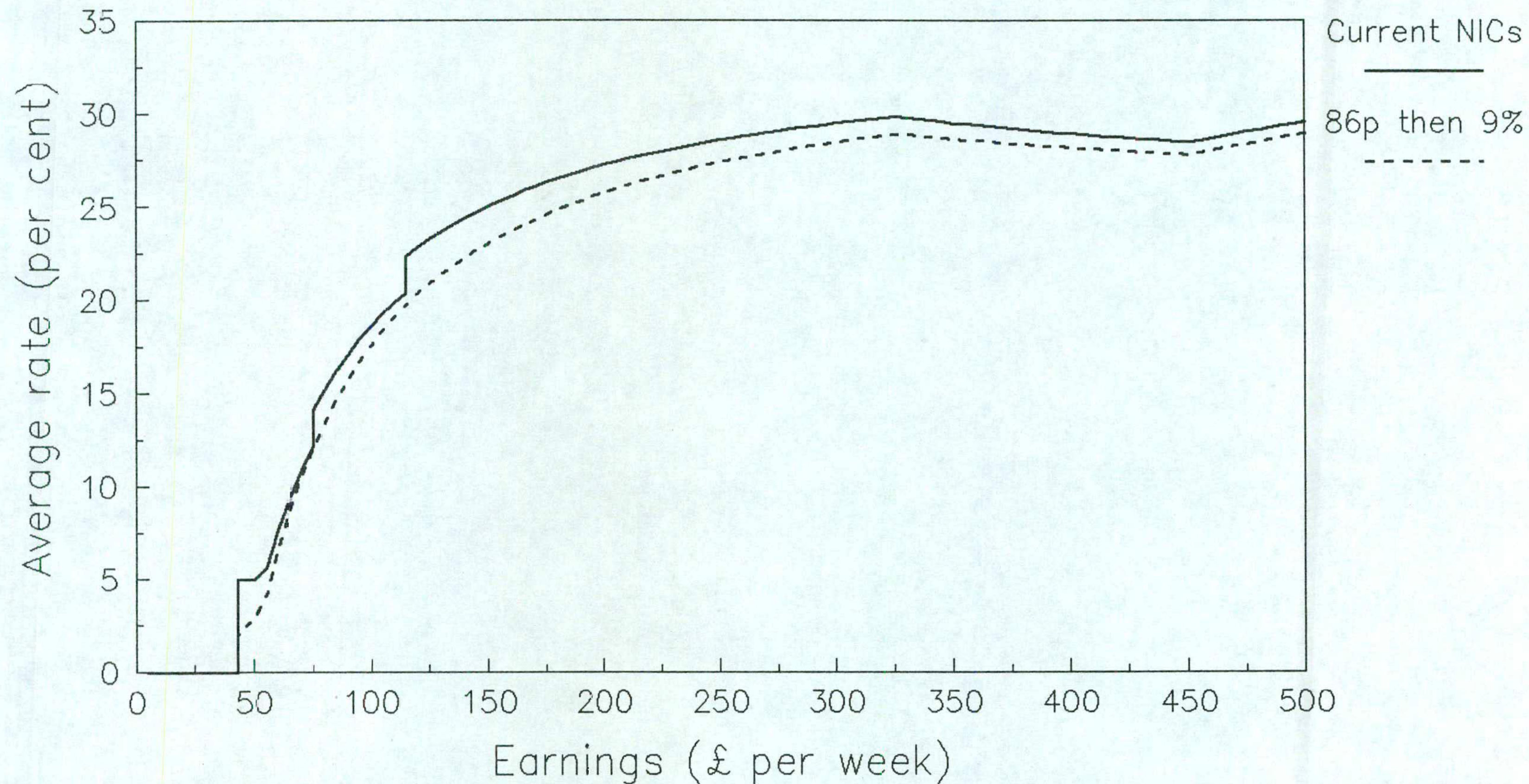
1989-90 pre Oct	2.15	2.15	0.8
post Oct	.86	.86	0.3



Assumes no allowances or reliefs other than the personal allowances

SECRET

PAY

INLAND REVENUE

Press Release

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

[3x] 14 March 1989

INCOME TAX RATES AND ALLOWANCES FOR 1989-90: PAY AS YOU EARN

The Chancellor proposes in his Budget

- to increase the main income tax allowances and the basic rate limit by about 6.8 per cent in line with the statutory indexation requirement;

- to extend to those aged 75 and over the higher level of age allowance currently given to those aged 80 and over;

- to reduce the rate at which the age allowance is withdrawn when a taxpayer's income exceeds the income limit;

- to make no change in the basic and higher rates of income tax.

This Press Release gives details of the changes and explains how these and other proposals will be implemented through PAYE.

/DETAILS OF CHANGES

SECRET

DETAILS OF CHANGES

1. Income tax allowances

	1988-89	Proposed for 1989-90 £	PAYE Code Normally ends in letter £	Increase in Code (x 10 = Increase in Allowances)
(i) Basic allowances				
Single allowance or wife's earned income allowance	2,605	2,785	L	18
Married allowance or single allowance plus additional personal allowance (APA) (a)	4,095 (or 2,605 + 1,490)	4,375 (or 2,785 + 1,590)	H	28
Widow's bereavement allowance	1,490	1,590	-	-
(ii) Age allowances				
Full single age allowance (age 65-74)	3,180	3,400	P	22
Full single age allowance (age 75-79) (b)	3,180	3,540	(c)	36
Full single age allowance (age 80 and over)	3,310	3,540	T	23
Full married age allowance (age 65-74)	5,035	5,385	V	35
Full married age allowance (age 75-79) (b)	5,035	5,565	(c)	53
Full married age allowance (age 80 and over)	5,205	5,565	T	36
Age allowance income limit	10,600	11,400	-	-

(a) The APA is an allowance for a single person who has responsibility for a child. The single allowance and the APA together are equivalent to the married allowance.

(b) See paragraph 2 for further information about the age allowance for those aged 75 and over.

(c) See paragraph 6(c) for an explanation of how the increase in allowances for these taxpayers will be implemented under PAYE.

/Age allowance

2. Age allowance for those aged 75 and over

It is proposed to extend to those aged 75 and over the higher level of age allowance currently given to those aged 80 and over . For single people aged 75 to 79 the age allowance will rise from £3,180 in 1988-89 to £3,540 in 1989-90; for a married couple where at least one partner is aged 75 to 79 and the other is not aged over 79 the age allowance will rise from £5,035 in 1988-89 to £5,565 in 1989-90. The allowance will be subject to the same income limit as the existing age allowances. Taxpayers will qualify for the new allowance for 1989-90 if they are already aged between 75-79 or if they will reach the age of 75 between 6 April 1989 and 5 April 1990.

3. Reduction in rate of age allowance withdrawal

Where a taxpayer or his wife is over 65 but their total income is above a certain limit, the age allowance is progressively withdrawn until it is reduced to the level of the basic single or married allowance. It is proposed to reduce this rate of withdrawal from £2 of allowances for every additional £3 of income above the limit to £1 of allowances for every additional £2 of income. This means that the effective rate of tax on income in the withdrawal band will fall from 41.67 per cent for 1988-89 to 37.5 per cent for 1989-90.

4. Rates and bands

	Taxable Income Bands	
	1988-89	Proposed for 1989-90
	£	£
Basic rate at 25 per cent	1 - 19,300	1 - 20,700
Higher rate at 40 per cent	Over 19,300	Over 20,700

IMPLEMENTING THE CHANGES THROUGH PAYE

5. Increase in basic rate limit

New tax tables reflecting the change in the basic rate limit described at paragraph 4 will be used by employers on the first pay day after [17 May].

/6. Changes in income tax allowances

6. Changes in income tax allowances and car scale benefits

a. Tax offices will be sending employers instructions to increase codes ending in L, H, P or V by the appropriate amounts shown in paragraph 1. The new increased codes will take effect on the first pay day after [17 May]. Revised coding notices are not sent to employees when codes are increased automatically in this way.

b. The codes of the taxpayers listed below will be reviewed individually by the tax office who will notify both the employee and the employer of the revised code where a change is due. The revised codes will take effect on the first pay day after [17 May].

i. employees whose codes begin with D or F or end in T;

ii. employees whose codes include adjustments for car benefits (see separate Press Release "Income Tax: Company Cars" for details of proposed changes to the car benefit scale charges for 1989-90).

c. Tax offices will be reviewing their records to identify, so far as possible from the information already available, those taxpayers aged 75-79 who qualify for the new level of age allowance in 1989-90. Where they can identify such cases and a change in allowance is due, the tax office will notify both the taxpayer and the employer (or the person paying the taxpayer's occupational pension). The revised codes will generally take effect on the first pay day after [17 May]. Any taxpayer who:

i. expects to qualify for the higher age allowance for those aged 75-79 in 1989-90 and

ii. has not been notified individually by the end of May of a changed PAYE code to take account of the new allowance levels

should write to their tax office giving their date of birth. A married man should give his wife's date of birth if he qualifies for the allowance on the basis of her age (see paragraph 2. above).

7. Employers

Tax offices will

- issue to employers codes which have been changed as a result of the reviews under paragraph 6(b) and 6(c): these revised codes will either begin with D or F or end in T.

- instruct them to increase, by the appropriate amount, all remaining codes ending in L, H, P or V.

/New codes

New codes and tax tables will generally be issued by [ ] to be used on the first pay day after [17 May]. Some of the new codes issued by the tax office will be lower than those already in operation. Tax offices will therefore advise employers that it is important to use the new codes and the new tax tables for the first time on the same pay day.

8. Increase in income limit and reduction in withdrawal rate for age allowance

It is proposed to raise the age allowance income limit - below which age allowance is due in full - from £10,600 to £11,400. This means that, in the tax year starting 6 April 1989, after taking account of the reduction in the rate of withdrawal of age allowance described in paragraph 3, the benefit of the married age allowance for those aged 65-74 will not run out until the taxpayer has income of £13,420; for a single person the corresponding figure of income is £12,630. For taxpayers qualifying for the higher level of age allowance for those aged 75 and over, the benefit of the allowance will not run out until the taxpayer has income of £13,780 (married) or £12,910 (single).

Tax offices will amend codes which at present include a reduced amount of age allowance, to take account of the increase in the income limit and reduction in withdrawal rate. Where the size of a taxpayer's income means that no allowance was given for 1988-89 but age allowance is now due, the tax office will revise the code where necessary in the course of examining 1989-90 tax returns from April onwards.

Any taxpayer who is not getting age allowance at present but

a. expects to be entitled to age allowance following the proposed increase in the income limit and reduction in withdrawal rate, and

b. has not been asked by the middle of April to complete a 1989-90 tax return,

should write to their tax office giving details of income and date of birth.

9. Maintenance payments

The limit on maintenance payments qualifying for tax relief under the new rules introduced by the Finance Act 1988 is linked to the difference between the married and single person's allowances (£1,490 for 1988-89). The limit for 1989-90 will therefore be £1,590. [Details of the rules are in leaflet IR77, which is available from local tax offices and Tax Enquiry Centres.]

10. Wife's earnings election

In certain circumstances a married couple may find it to their advantage to elect for the wife's earnings to be taxed separately. For 1989-90 an election will normally be worthwhile only if the couple's combined income before deduction of allowances and reliefs is at least £30,511 including wife's earned income of at least £7,025. (The corresponding figures for 1988-89 are £28,484 and £6,579.) Inland Revenue leaflet IR13 gives further details of the election.

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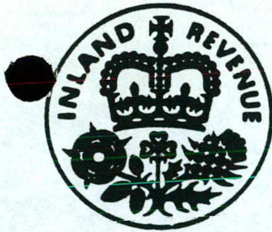

INLAND REVENUE

Press Release

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

[3X]

14 March 1989

SIMPLER SYSTEM OF ASSESSMENT FOR EARNINGS

The Chancellor proposes in his Budget changing the basis on which the earnings of employees and directors are assessed. From 6 April 1989 income tax will no longer be assessed on the amount earned for the tax year but on the amount received in the tax year.

The change will not affect the great majority of employees who are already taxed on earnings received in the tax year. But for the half million or so directors and others who regularly receive pay some time after the year for which it was earned it will

- bring the system of collection (PAYE) and assessment into line
- greatly simplify their tax affairs.

DETAILS

1. Most employees do not get an income tax assessment. The tax deducted under PAYE is near enough the correct amount payable for the year to warrant no further action. And most employees who do get an assessment are assessed on what they receive in the year because it is virtually the same as the amount earned for the year. So the vast majority of employees will not be affected by this proposal.

2. But it will simplify the tax position of directors, or employees receiving bonuses or commission, who often receive pay some time after the year for which it was earned. In these cases it will no longer be necessary to apportion the income of an accounting period to the appropriate tax year. Instead earnings will be assessed for the year in which they are received.

/3. This proposal will

3. This proposal will result in an important simplification of the tax system. From 1989-90,

- earnings from which tax should be deducted under PAYE during the tax year will be assessable for the same year;
- what is currently in practice the position for the majority of employees will now apply to all employees and directors;
- earnings of an employee for a companys' accounting period which does not coincide with the income tax year will no longer need to be apportioned;
- the non-statutory "accounts basis" of assessment (see below) will no longer be needed after 1988-89.

4. The new system will eliminate major disadvantages in the present system, which is characterised by:-

Delay in settling tax bills: The need to apportion the earnings of two company accounting periods to arrive at the income earned for a tax year means that at present the amount to be assessed for any tax year cannot be determined until long after the end of it.

Complexity: To reduce this delay, some cases are, by agreement with the tax office, assessed on a non-statutory "accounts basis" under which the earnings of an accounting period ending in a tax year are taken as the earnings for that year. But the accounts basis necessitates special rules at commencement and cessation which introduce many of the complexities of the Schedule D "preceding year" rules which apply to the self-employed.

Incomprehensibility: Taxpayers find assessments under the present system are difficult to understand because there is no link between the amount of income assessed (the earnings for the tax year) and the tax paid (the tax deducted under PAYE from earnings received in the tax year). A taxpayer whose affairs are right up to date may nevertheless receive an assessment showing a large underpayment of tax, simply because income has been earned for the year which was not paid during the year - and consequently the corresponding tax had not yet been deducted under PAYE.

5. The compliance savings from the simpler system for taxpayers and their advisers will also be reflected in staff savings in the Inland Revenue. During the transitional period when the old system is being phased out and the new one introduced - when work under both systems will be necessary - there will be some extra staff costs. But when the new system has settled down - from 1992/93 onwards - there will be savings of about 175 staff.

/6. Over the transitional

6. Over the transitional period there is also an Exchequer cost (£60 million in 1989/90, £80 million in 1990/91) relating mainly to switching existing cases now on the "accounts basis" to the new receipts basis. In the longer term, however, there will be a yield of about £50 million. This is because at present the accounts basis does not always tax the full earnings over the life of the source of the income (ie. a particular employment or directorship). This will no longer happen with the receipts basis.

7. Legislation in the Finance Bill will define when earnings are received. Because the basis of assessment and the basis of collection under PAYE are being brought into line, the legislation will also clarify when payment, for PAYE purposes, occurs. The new definition will apply from 6 April 1989.

8. The legislation will also include transitional provisions to prevent income earned before the change being taxed twice (once when earned before 6 April 1989, and again when received after 5 April 1989), as well as necessary anti-avoidance measures.

Notes for Editors

1. At present earnings are assessed for income tax on the amount due for the year irrespective of when the earnings are received. For most employees paying tax under PAYE on their earnings received weekly or monthly there is little difference between what is earned and what is received in the year. But for some, such as directors who may receive remuneration when it is voted some time after the year for which it was earned, or for people receiving significant commission or bonuses relating to work done in previous years, it is necessary to sort out what income relates to which year. As the information is often not available until long after the tax year has ended, assessments are often substantially in arrear.

2. To reduce this delay many directors have opted to be assessed on the long-standing non-statutory "accounts basis" of assessment. Under this arrangement the remuneration for the company's accounting period ending in the tax year is normally taken to be the earnings for that year.

3. But whichever of these bases is used, the assessment is often complicated and difficult for the taxpayer to understand. It may include earnings which were not paid in that tax year and in respect of which no PAYE tax has yet been paid. The assessment then shows tax underpaid, some or all of which will be collected automatically under PAYE as soon as the unpaid remuneration is paid. But, with variations, the whole process is repeated from one year to another making it difficult to establish at any point whether there is a "real" underpayment which needs to be collected separately or simply a "notional" underpayment which will automatically be collected as soon as unpaid remuneration is paid.

/4. The proposal will

4. The proposal will mean that earnings will only be included in assessments when paid. This will be simpler for taxpayers and their advisers, will cut out some difficult but not very productive work in tax offices, and enable tax liability to be settled more promptly.

Definition of "payment" for PAYE

5. The Keith Committee, recognising that there were particular problems applying PAYE to directors' remuneration, recommended that certain defined circumstances should be "treated as payment for the purposes of Schedule E and PAYE". Section 92 of the Finance (No 2) Act 1987 provided that this could be done in regulations. But it is important that the definitions of payment for PAYE purposes and receipt for assessment purposes under the Chancellor's proposals for the receipts basis should match. Both definitions will therefore be in the Finance Bill and will be effective from 6 April 1989. They will be on the lines suggested by the Keith Committee.

6. Payment (and therefore receipt) will be treated as occurring on the first of the following events:

a) When actual payment is made of, or on account of, emoluments;

b) when a person becomes entitled to payment of, or on account of, emoluments.

And, in the case of directors:

c) when sums on account of emoluments are credited in the company's accounts or records;

d) at the latest, when the amount of the emoluments for a period of account are determined or voted.

In considering whether c) or d) apply, any fetter on the director's right to draw the emoluments is to be disregarded.

7. As the Keith Committee envisaged, these definitions should ease the task of employers by clarifying when PAYE has to be applied in cases where it may at present be unclear.

DRAFT PRESS RELEASE

PAYROLL GIVING SCHEME FOR CHARITIES
TAX RELIEF LIMIT TO BE DOUBLED

The Chancellor proposes in his Budget to double the limit on charitable donations qualifying for tax relief under the payroll giving scheme. The limit will be increased from £240 a year (£20 a month) to £480 a year (£40 a month).

The increase is designed to:

- encourage new people to join in payroll giving schemes; and

- enable those employees already giving the maximum amount of £240 a year to give more if they wish.

The new limit of £480 a year will apply from 6 April 1989, the start of the 1989-90 income tax year.

Growth of payroll giving

Interest in the payroll giving scheme has been growing steadily since it started two years ago. Over [3400] schemes have been set up by employers, enabling their employees to make tax free gifts to charity direct from their pay; and more than [100,000] employees have joined in.

Joining the scheme

An employee who wishes to join the scheme can ask his employer for a charity choice form on which he can ask for donations to be deducted from his pay and say which charity or charities he wants them to go to.

Alternatively the agency may, if it wishes, allow employee to join the scheme by making a simple telephone call to the agency. The agency then follows this up with the employer and does all the necessary paperwork.

Choice of charity

Employees participating in the scheme can give to any charity or charities they wish.

Some individual charities appeal for funds under the scheme using their own name on "coupons". Employees can also use the "coupons" to show how much they want to give to the particular charity, and the details are transferred onto approved charity choice forms by the agency charities.

Donations under the scheme can also be made to consortia, or groups of charities, usually with a common interest, to be shared out among the charities in proportions which they have agreed in advance. This enables charities to share the cost of this part of their fund-raising.

It is also open to the agency to arrange for people who want to support a particular charitable cause, rather than an individual charity, to do so. The donor can simply specify the cause, leaving it to the agency charities to distribute the money to individual charities in the chosen field.

Converting old schemes into new ones

There were payroll deduction schemes for giving to charity before the 1986 Budget, but employees did not get tax relief for their donations. These old-style schemes can be converted into new-style schemes, giving employees tax relief for their charitable gifts, if the

employer signs a contract with an agency charity which has been approved by the Inland Revenue. This means that charities can receive increases equivalent to the tax previously paid on the donations, at no extra cost to the employee.

Agency charges

Agency charges can be met out of the donations made by employees. But employers who pay the reasonable administration costs of agencies running schemes for their employees, thus enabling the full amount of the donations to go to charity, can, by concession, claim those costs as a deduction from their profits for tax purposes.

NOTES FOR EDITORS

1. The payroll giving scheme was introduced in the 1986 Budget and started on 6 April 1987. It is voluntary for employers and for employees.

2. Briefly the scheme operates as follows -

   - The Inland Revenue approves agencies to run the scheme.

   - Employers who wish to set up a scheme for their employees enter into a contract with an approved agency.

   - Employees who wish to participate in the scheme authorise their employer to deduct the gifts from their pay and nominate the charities which they wish to receive their gifts.

- The employer gives his employees tax relief under a "net pay" arrangement, as happens for superannuation contributions - ie the gifts are deducted from pay before calculating the PAYE tax due.

- The employer pays the gifts over to the agency.

- The agency acts as a clearing house, distributing the gifts to the individual charities which have been nominated by the employees.

3. Charities wishing to be approved as agencies must satisfy the Inland Revenue that they can meet all the requirements laid down in regulations.

Charities which have been approved as agencies are -

Barnardo's
BEN - Motor and Allied Trades Benevolent Fund
Birmingham Council for Voluntary Service
Bristar Foundation
Charities Aid Foundation (Give As You Earn)
Charities Trust
Chest Heart and Stroke Association (Scottish Branch)
Lankro Employee Charity Fund
Lloyd's Charities Trust
Minet Employees' Charitable Trust
Northern Ireland Council for Voluntary Action
"S" Group Charitable Trust
Scottish Council for Voluntary Organisations
South West Charitable Giving
United Way Payroll Giving Service
Wales Council for Voluntary Action

BUDGET CONFIDENTIAL

DRAFT PRESS RELEASE

HERITAGE AND CONSERVATION CHARITIES: MEMBERSHIP SUBSCRIPTIONS PAID BY DEED OF COVENANT TO QUALIFY FOR TAX RELIEF IN CERTAIN CIRCUMSTANCES

The Chancellor proposes in his Budget that, for certain types of charity, the benefit of free or cheap entry for members to view the charity's property should be ignored in deciding whether the charity can claim a tax refund on membership subscriptions paid by deed of covenant.

Details

At present, covenanted membership subscriptions to charities do not qualify for relief if there is a significant benefit to the donor in being a member. The proposal is that for certain charities the benefit of free entry to view the charity's property may be disregarded so that it does not disqualify the covenant payments from relief.

The charities concerned are those where membership is open to the general public and whose sole or main purpose is the preservation of property or conservation of wildlife for the public benefit. This includes heritage and conservation bodies, as well as museums and supporters' organisations (such as "Friends" of museums).

The benefit to be ignored is the entry to view the property or collection by the member, or by those of his family covered by family membership arrangements. The benefit must not be capable of being sold or passed on by the member to someone else.

Other benefits provided by charities for their members will continue to be treated in accordance with existing law.

The proposal applies to covenanted membership payments due on or after today, 14 March 1989.

NOTES FOR EDITORS

1. Where a deed of covenant is used to make donations to charity, the donor deducts basic rate tax from each payment and the charity can usually claim this tax back from the Inland Revenue.

2. But is is not quite so straightforward if the donor gets benefits (goods, services or other facilities) from the charity in return for his payments. When this happens, the question is whether they are so substantial that the charity loses its claim to a refund of the tax deducted.

3. The High Court decided in the case of Taw and Torridge Festival Society (38 TC603) that benefits worth practically 25 per cent of a membership subscription cannot be ignored as insubstantial. Based on this, it has been Inland Revenue practice in general for ordinary small subscription to ignore benefits if they are worth less than 25 per cent; but to refuse tax repayments to charities where the benefits provided for members were worth 25 per cent or more of the ordinary annual subscription. It is the availability of benefits which counts for this purpose, not the actual use made of them by members.

4. An important benefit provided by membership charities for their members is the right to free or cheap entry to view property, museum collections or wildlife. It is this benefit which will no longer be taken into account in deciding whether qualifying charities can claim tax relief on covenanted membership subscriptions. The existing law will continue to apply to other benefits.

BUDGET CONFIDENTIAL: DRAFT BUDGET DAY PRESS RELEASE

INLAND REVENUE

Press Release

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

[3x]

14 March 1989

INCOME TAX: GIFTS BETWEEN HUSBAND AND WIFE AND OTHER SETTLEMENTS

The Chancellor proposes in his Budget some changes in the income tax rules for gifts between husband and wife and other settlements. These follow the personal tax reforms in last year's Budget.

The changes will ensure that when Independent Taxation begins in April 1990:

- simple outright gifts of assets between husband and wife will be recognised for income tax purposes. Income from such gifts will be taxed as the income of the person who receives the gift.

- certain allocations of pension between husband and wife will be taxed as the income of the person to whom the pension is allocated.

There will also be a change in the income tax treatment of some trusts where the person who made the trust, or the husband or wife of that person, is able to benefit from the trust income or capital. Beneficiaries of the trusts affected will no longer be able to claim repayment of the basic rate tax suffered by the trustees. This completes last year's reform of non-charitable covenants. It stops trusts being used to obtain the tax advantages which are no longer available through covenants. The change will take effect immediately for trusts made on or after today. Some existing trusts will be affected when Independent Taxation begins.

DETAIL

1. Under Independent Taxation a gift of an asset between husband and wife will only be recognised for income tax purposes if it is an unconditional gift of both the asset and the income arising from it. The income arising after the transfer will then be treated as the recipient's for tax purposes. The income will generally be treated as the donor's for tax purposes if, for example:-

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- the donor has the right to get the asset back in the future, or to decide what the recipient should do with it; or

- the donor uses a trust to give the income to his or her partner while retaining control over the capital, or passing the capital to a third party.

2. Some statutory pension schemes allow a pensioner to give up part of his or her pension so that a pension can be paid to the pensioner's husband or wife before the death of the pensioner. The proposal ensures that the allocated pension will be treated as the partner's income under Independent Taxation.

3. The proposals on trusts will alter the effect of Section 683 Income and Corporation Taxes Act 1988. Trust income to which that section applies will be treated as the settlor's for all tax purposes. (At present the income is treated as the settlor's for higher rate purposes only).

4. For trusts made on or after today the changes will take effect immediately. Existing trusts will only be affected by the proposals if trust income goes to the husband or wife of the settlor. In those cases the new rules will apply to that income when Independent Taxation is introduced in 1990-91.

NOTES FOR EDITORS

1. During the debates on last year's Finance Bill, the Financial Secretary promised to look at the provisions relating to settlements in the light of the planned introduction of Independent Taxation and the ending of tax relief on most non-charitable covenants. These proposals fulfil that commitment.

2. Section 683 is part of a series of provisions (Sections 660 to 685) which apply to trusts, covenants, gifts and other settlements. In most cases where the person making the settlement (the settlor), or the husband or wife of that person, is able to benefit from the income or capital of the settlement the income from the settlement is already treated as the settlor's for all tax purposes. However, if Section 683 applies the income is at present only treated as the settlor's for higher rate. For basic rate the income continues to be treated as belonging to the beneficiary to whom it is paid. If that beneficiary has unused personal allowances to set against that income, he or she can reclaim basic rate tax suffered by the trustees.

3. Under Independent Taxation a wife's investment income will no longer be treated as her husband's for tax purposes. These proposals ensure that the rules for settlements will operate in a way which is consistent with the Government's objectives for Independent Taxation.

DRAFT BUDGET DAY PRESS RELEASE

[3x] 14 March 1989

IMPROVEMENTS TO THE RELIEF FOR PROFIT-RELATED PAY (PRP)

The Chancellor proposes in his Budget a range of improvements to the tax relief for PRP. These will

- increase the upper limit on PRP which can qualify for tax relief from £3,000 to £4,000;
- enable employers to set up schemes for central (eg headquarters) units with PRP based on the profits of the whole undertaking;
- abolish the requirement for PRP to equal at least 5% of employees' pay if profits remain the same;
- allow certain alterations to be made to registered PRP schemes without loss of tax relief;
- improve the operation and administration of tax relief for PRP.

These changes will have statutory effect from Royal Assent to the Finance Bill, but the increased limit will apply to all PRP payments made in respect of profit periods beginning on or after 1 April 1989.

/DETAILS OF THE PROPOSALS

DETAILS OF THE PROPOSALS

Increase in Tax Relief

1. Since half of PRP payable for any profit period under a registered scheme can be free from income tax, the current limit on the tax relief of the lower of 20% of pay or £3,000 enables PRP up to 10% of pay or £1,500 to be paid tax-free. For any payments made in respect of a full year profit period beginning on or after 1 April the increased cash limit of £4,000 will have the effect that 10% of pay or £2,000 if less can be free of tax. For a basic rate taxpayer this will be worth up to £[ ]; to a higher rate taxpayer it will be up to £[ ].

Headquarters units

2. An employer may choose the employment unit to which a PRP scheme relates. It may be either the whole or part of a business but the unit must be identified, it must be carried on with a view to profit and it has to be able to establish that profit in the form of a profit and loss account.

3. Where an employment unit covers the operation of only a part of a business, and that part is a general or central function, like a Head Office or Research and Development Division, the employer is likely to have to produce special figures for its profit and loss account. These figures may be both difficult and costly to produce and, given the nature of the activities, they may provide little more than a notional measure of profit.

4. The Chancellor now proposes that an employer who registers one or more conventional PRP schemes will be able also to register a separate scheme or schemes for general or central units with PRP based on the profits of the whole undertaking, not the profits of that particular unit. Such schemes will have to satisfy all the usual requirements, but in addition their registration will depend on

/the number of employees

the number of employees covered not exceeding 33% of the number of employees covered by the conventional schemes. These provisions will come into effect on Royal Assent to the Finance Bill.

The 5% test

5. The requirement that a PRP scheme must contain rules ensuring that PRP is at least 5% of employees' pay (if profits remain the same) will be abolished. This was announced on 3 February 1989, and by concession any schemes registered after that date have been able to disregard that requirement.

Alterations to registered schemes

6. The Finance Bill will also contain legislation to allow certain changes to be made in the rules of schemes already registered without jeopardising their registration. This facility has, with Ministerial approval, been operating extra-statutorily since it was announced on 10 October 1988.

Other changes

Death of sole proprietor

7. If the sole proprietor of a business which has a registered PRP scheme dies registration of the scheme has to be cancelled because the present legislation makes no provision for a substitute employer to take his place. The legal personal representatives of the deceased will now be given the option of continuing to run the scheme, to have it cancelled from the date of death, or, as previously, to have it cancelled from the start of the profit period during which death occurred. In the latter case any tax relief already given for that profit period will be clawed back.

/Excluded employees' remuneration

Excluded employees' remuneration

8. Any employee who has a material interest in a company (that is, he owns it or owns a large part of it), is excluded from receiving PRP under a registered scheme, and the remuneration of such an employee may not be deducted in arriving at the profit of the business for PRP purposes. The effect is to place this type of employee in the same position as a sole trader who cannot receive PRP and whose earnings are not deducted from profits before PRP for employees is calculated. The Finance Bill will make it clear that remuneration in this instance includes fees, percentages, any expense allowance which is charged to income tax, pension contributions and the ~~estimated~~ value of any non-cash benefits received.

Employer's National Insurance Contributions

9. To solve the problem of mutual deductibility of employers' National Insurance Contributions - ie the amount of PRP must be known before NIC can be calculated but NIC must also be known to enable PRP to be worked out - employers will be permitted, if they wish, to provide in their schemes for the exclusion of their own NIC liability on PRP payments from the calculation of profits on which PRP is based. This does not affect in any way the present NIC liability arising from payments of PRP.

Tax recovery powers

10. Present legislation places the responsibility for the operation of PRP relief on the scheme employer. If a scheme is cancelled action to claw back any tax relief wrongly given is against the scheme employer, even if that employer is a parent company of a group and it is actually the subsidiaries who are operating the schemes. Where that group scheme employer is or becomes non-resident in the United Kingdom, recovery of any tax relief overpaid may not be possible. In these circumstances there will be a secondary right of recovery against the employer who operates the Pay As You Earn scheme.

Cost

11. The overall cost of the changes affecting PRP is expected to be £10 million in 1989/90 and £15 million in 1990/91.

Guidance

12. Advice on any aspect of PRP can be obtained from:

Profit-Related Pay Office
Inland Revenue
St Mungo's Road
Cumbernauld
GLASGOW
G67 1YZ

Telephone: 0236 736121

NOTES FOR EDITORS

1. Profit-Related Pay is the element in employees' pay which varies in relation to the movement in the profits of the business in which they work. Subject to certain limits, half of an employee's PRP can be exempt from income tax, provided it is paid under a scheme which has been registered by the Inland Revenue.

2. To qualify for tax relief PRP must be paid under a scheme registered by the Inland Revenue before the date on which the scheme is due to start. Application for registration must be made on a prescribed form and accompanied by a report from an independent accountant that the scheme complies with the legislation.

3. Legislation governing the provision of tax relief for PRP is contained in Sections 169 to 184 and Schedule 8 of the Income and Corporation Taxes Act 1988.

4. Announcements concerning alterations to scheme rules and the 5% test were published in Inland Revenue Press Releases dated 10 October 1988 and 3 February 1989 respectively.

BUDGET CONFIDENTIAL

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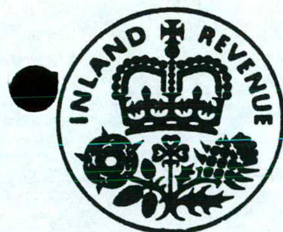

INLAND REVENUE

Press Release

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[3x] 14 March 1989

STAMP DUTY ON SHARES TO BE ABOLISHED

The Chancellor proposes in his Budget to abolish all stamp duties on transactions in shares, together with stamp duty reserve tax, from 1 April 1990.

Abolition of these taxes will give a boost to wider share ownership, enhance London's competitiveness for dealings in United Kingdom securities, and continue the process of simplifying the tax system.

This is the sixth major tax to be abolished since 1983. It fulfils the process of progressive reductions in stamp duty on shares from 2 per cent in 1984 to 0.5 per cent today.

DETAILS

Stamp duties on shares

1. The main duties to be abolished are:

- stamp duty on individual share transfers, which is levied United Kingdom securities at a rate since 1986 of, broadly, 0.5 per cent of the price paid;

- stamp duty of 1.5 per cent, which is payable where United Kingdom shares are converted into depositary receipts or transferred into clearance services;

- stamp duty reserve tax (SDRT), which applies, at the same rates as stamp duty, to some share transactions which are outside the stamp duty net.

2. Transfers of shares on or after 1 April 1990 will be free of duty. Until then, duty continues to apply at existing rates.

Associated charges

3. Also to be abolished are

/- the stamp duty

- the stamp duty charges on bearer shares;
- the fixed duty on share transfers other than sales;
- stamp duty on all transfers of units under a unit trust scheme.

Effects of abolition

4. The Government believes abolition of these taxes will -

a. encourage investment in United Kingdom equities and so foster wider share ownership, by reducing dealing costs;

b. increase the efficiency and liquidity of the London market and reduce the incentive for offshore trading;

c. further simplify the tax system and ease the compliance burden on individual shareholders, the Stock Exchange and company registrars;

d. facilitate the forthcoming introduction of paperless share transactions.

Cost

5. The cost of these proposals is estimated to be about £850 million in 1990/91, the first year of abolition.

Legislation

6. The appropriate legislation will be contained in the 1989 Finance Bill.

Interim measures

7. It is unlikely that the stock market generally will have moved to paperless share transfers (the so-called "dematerialisation") before the duty on shares goes on 1 April 1990. Nonetheless there could be a limited number of such electronic transactions, eg pilot schemes for the Stock Exchange's new transfer system, before then. The forthcoming Finance Bill will therefore include provisions to ensure any early paperless transfers are charged to duty on a par with ordinary transfers made by document.

Life assurance policy duty

8. The Chancellor also proposes in his Budget to abolish life assurance policy duty - another kind of stamp duty - from 1 January 1990. Details of this measure are given in the Inland Revenue press release [ ].

/Stamp duty

Stamp duty on property

9. The Chancellor is not proposing to make any changes to the stamp duty on the transfer of property (including houses).

NOTES FOR EDITORS

Abolition of duties

1. Abolition of stamp duty on shares represents a further significant simplification of the tax system. Within the stamp duty field it follows the removal of stamp duty on gifts in 1985, and the abolition of capital duty and unit trust instrument duty in 1988.

Stamp duty on shares

2. The ad valorem stamp duty on individual transfers of United Kingdom companies' shares is currently charged at the rate of 50p per £100 or part thereof, ie broadly at 0.5 per cent. There are exemptions for purchases by market-makers and charities. Shares in foreign registered companies, and also Government stock and most commercial loan capital, are outside the scope of the charge.

3. A separate head of charge applies to bearer instruments. Broadly speaking bearer instruments are charged at 1.5 per cent on a once and for all basis, either on issue (for instruments issued in the United Kingdom) or on their first transfer in Great Britain.

4. Certain transfers of shares otherwise than on sale can give rise to a fixed 50p charge - for example transfers where there is no change of beneficial ownership.

Stamp duty reserve tax

5. This tax was introduced in 1986 in order to broaden the base of stamp duty on shares, by charging a wider range of transactions. Unlike stamp duty, which is a tax on documents, stamp duty reserve tax applies to agreements - viz most agreements to sell United Kingdom securities. It therefore brings within the scope of the charge:

the purchase and resale of a security within the same Stock Exchange account;

the purchase of renounceable letters of allotment or acceptance;

the purchase of shares registered in the name of a nominee acting for seller and purchaser;

the purchase of shares which are resold before they are taken into the purchaser's name.

6. SDRT is charged at the same rate, 0.5 per cent, as stamp duty on shares.

/Depositary receipts

Depositary receipts and clearance services - the higher rate charges

7. Where shares are transferred into depositary receipt form or into a clearance service, the higher rate of 1.5 per cent stamp duty or stamp duty reserve tax applies on the initial transfer. This charge is in the nature of a "season ticket" - subsequent transfers of depositary receipts, or of shares within a clearance service, then take place free of stamp duty or stamp duty reserve tax.

Unit trusts

8. Stamp duty arises on the purchase of units by one unit holder from another, and in the more common situation of a surrender for cash of units to the managers. The rates are broadly the same as the ad valorem charge on shares, but special reliefs apply.

DRAFT

[3x]

14 March 1989

APPROVED ALL-EMPLOYEE SHARE SCHEMES : LIMITS TO GO UP

In his Budget the Chancellor proposes to increase limits for tax relief for employees in approved all-employee share schemes.

Approved profit-sharing schemes

Under an all-employee profit-sharing scheme approved by the Inland Revenue shares may be given to employees up to an annual limit of £1,250 or 10% of salary, subject to a £5,000 ceiling.

This limit is to be raised to £2,000 or 10% of salary, subject to a £6,000 ceiling, from 6 April 1989.

Approved SAYE-related share option schemes

Two improvements are proposed to the approved all-employee savings-related share option scheme legislation:

i. Share options may be granted to employees involving monthly SAYE savings of up to £150 (compared with the present limit of £100). This increase will take effect from an early date to be fixed by Treasury Order after Royal Assent.

ii. The price at which options may be offered to employees must, at present, be not less than 90% of the market value of the shares at the time the options are granted. The

/maximum permissible

maximum permissible discount is to be increased from 10% to 20% enabling options to be offered at not less than 80% of market value. This increase will take effect from Royal Assent.

Legislation relating to these changes will be included in the Finance Bill.

Approved employee share schemes : Publicity

Inland Revenue leaflets and booklets on approved employee share schemes are being revised and updated. The new versions will be available later this year.

NOTES FOR EDITORS

1. All-employee share schemes are approved by the Inland Revenue under legislation in the Income and Corporation Taxes Act 1988 which was formerly contained in the Finance Acts of 1978 and 1980. They must be open to any employee who has been employed full-time by the company concerned for at least 5 years. Other employees may be included in the scheme if the company wishes, but all employees who take part must do so on similar terms. Under these schemes an employee is exempt from income tax on the value of the shares he receives, or on option gains, if certain conditions are met.

2. The number of all-employee schemes approved by the Inland Revenue up to the end of February 1989 was [ ] (compared with less than 30 in 1979).

3. It is estimated that by the end of the year to March 1988 about 1.75 million employees had benefited under these schemes, and that they had received shares or interests in shares with an initial market value of over £4 billion.

DRAFT BUDGET DAY PRESS RELEASE

[3x] 14 March 1989

IMPROVED TAX RELIEFS FOR EMPLOYEE PARTICIPATION

A major theme of the Chancellor's Budget Statement was the further encouragement of participation by employees in the ownership and prosperity of the businesses in which they work.

Tax reliefs have already played an important role. More than 1.75 million employees have benefited from approved all-employee share schemes, receiving in all shares or options over shares with an initial value of £4 billion. Last year alone, more than £1 billion of shares were allocated under these schemes. The tax relief for profit-related pay, which was introduced only in 1987, already covers more than 120,000 employees.

The proposals the Chancellor announced fall into 4 main groups, each described in detail in separate Press Releases:

- approved all-employee share schemes: increased benefits available

- employee benefit trusts: corporation tax relief for company contributions to a new form of employee benefit trust which distributes shares to employees

/profit-related pay:

- profit-related pay: a wide range of improvements including an increase in the maximum amount of tax relief, and new arrangements, making it easier for headquarters units, research and development divisions etc to participate

- 'material interest' tests: the rules which exclude employees with a significant interest in the employing company from participating in any of these schemes are being substantially relaxed where the interest derives from an employee benefit trust.

NOTES FOR EDITORS

The separate Press Releases issued today, which detail the changes referred to, are:

"Approved All-Employee Share Schemes : Limits to Go Up"

"Tax Relief for Employee Share Ownership Plans"

"Improvements in Profit-Related Pay"

"Relaxation of Employees' Material Interest Tests".

DRAFT BUDGET DAY PRESS RELEASE

RELAXATION OF EMPLOYEES' MATERIAL INTEREST TESTS

The Chancellor proposes in his Budget to relax the material interest tests on an employee's eligibility to participate in a registered Profit-Related Pay scheme or an approved Employee Share Scheme, and thus to benefit from the tax reliefs associated with those schemes.

The relaxation will allow the shareholding of any trust in which an employee has an interest to be disregarded when determining whether he or she has a material interest, provided the trust meets certain conditions. The same changes will be made to the material interest test on individuals eligibility for close company interest relief, and may have the effect (of) denying that relief in particular cases.

The changes will be effective from Royal Assent to the 1989 Finance Bill for Profit-Related Pay and Employee Share Schemes, but the benefit of the changes may be affected by any distribution of shares or other benefits by the trust on or after today. In the case of interest relief the changes will apply to loans made after Royal Assent, and the distribution by the trust of shares or other benefits after Royal Assent may affect the operation of the changes.

DETAILS

Background

1. Employees who have a material interest in a company may not participate in that company's registered Profit-Related Pay scheme or approved Employee Share Scheme. Individuals with a material interest in a close company may have interest relief on loans to purchase shares in that company.

2. A person has a material interest if he or she together with his or her associates owns, or is able to control, more than a specified percentage of the company's ordinary share capital. Associates include the trustees of a trust in which the employee has an interest. So, if shares in the company are held by a trust set up for the benefit of employees, each employee is at present regarded as being interested in all the shares in the trust because of his or her association with the trustees. The effect can be to give an employee a material interest in the company, although in practice he or she neither owns nor controls any shares of the company.

Proposed changes

3. The trustees of a trust set up for the benefit of employees will be excluded from the definition of associate provided certain conditions are met. This change will enable some companies who have been unable to introduce Profit-Related Pay or Employee Share Schemes because of employee benefit trusts to do so in the future.

4. In order for the trustees to be excluded from the definition of associate

- the trust must be one under which all or most employees are eligible to benefit

- the trust may also benefit former employees, the relatives and dependents of employees or former employees and charitable organisations

- the trust will be acceptable for this purpose if it is capable of benefiting non-individuals, provided no benefits are actually distributed to non-individuals other than charitable organisations and approved profit sharing scheme trusts. If a distribution is made to an unacceptable non-individual the trustees will become associates from then on of all the employees with an interest in the trust.

5. These trustees will be excluded from the definition of associate; but once an employee together with his or her associates other than the trustees

- owns or is able to control more than the specified percentage of the company's ordinary share capital

- or enjoys benefits (eg dividends, bonuses) from more than the specified percentage of the company's ordinary share capital

the trustees will become associates of that employee from then on. They will not, however, thereby become the associates of other employees with an interest in the trust.

6. If the trust holds other investments as well as ordinary shares in the company, a distribution made by the trustees in the form of dividends, bonuses etc will be deemed to have come first from the dividends declared on the shares in the company in the current financial year, then, if necessary, from such dividends in the previous financial year, and then, finally, from dividends declared in the financial year before the previous financial year.

7. The changes will be included in the Finance Bill and take effect from Royal Assent. For the purposes of registered Profit-Related Pay schemes and approved Employee Share Schemes, however, in deciding whether an employee has a material interest under the revised tests account will be taken of

- the shareholding on 14 March 1989 of that employee and his or her associates (other than the trustees of an acceptable trust)

- any distributions made by the trustees on or after 14 March 1989.

8. The same changes will be made to the material interest test on an individual's eligibility for interest relief on a loan to purchase shares in a close company. The changes will have effect in the case of loans made after Royal Assent. For this purpose, however, in deciding whether an individual has an interest under the revised test account will be taken of

- the shareholding at the time of Royal Assent of that individual and his or her associates (other than the trustees of an acceptable trust)

- any distributions made by the trustees after Royal Assent.

Cost of the proposed changes

9. The revenue cost of the proposed changes is estimated as negligible in 1989/90 and up to £m5 in each of 1990/91 and 1991/92.

NOTES FOR EDITORS

1. Legislation governing the provision of tax relief for Profit-Related Pay is contained in Sections 169 to 184 and Schedule 8 of the Income and Corporation Taxes Act 1988. The Employee Share Scheme legislation is contained in Sections 185 to 187 and Schedules 8 and 9 of the Act. The close company interest relief legislation is in Section 360 of the Act.

2. The material interest test for eligibility to participate in Profit-Related Pay applies to employees of all companies and unincorporated associations; any with an interest in excess of 25 per cent may not participate. For approved Employee Share Schemes it applies to employees and directors of close companies only. The specified limit is 25 per cent for all-employee profit sharing ~~schemes~~ and savings-related share option schemes, and 10 per cent for discretionary share option schemes; and employees may not participate in any such approved scheme while they have a material interest or within 12 months of having had such an interest. The material interest test for interest relief applies to close companies only and the specified limit is 5 per cent.

3. Compliance cost assessments

Assessments of the compliance costs of proposals affecting businesses are available. A copy of the Compliance Cost Assessment can be obtained from:

Inland Revenue
Deregulation Unit
Room 77
New Wing
Somerset House
London WC2R 1LB

BUDGET CONFIDENTIAL

DRAFT PRESS RELEASE

DEEP DISCOUNTED SECURITIES : NEW TAX RULES

The Chancellor proposes in his Budget to introduce new rules for the tax treatment of investors in securities issued at a deep discount. These will provide a certain and consistent basis of taxation of such securities and will cover the wider range of institutions which will be able to issue such securities following the abolition of the queue by a general consent under the Control of Borrowing Order 1958.

The Budget proposals cover three types of securities:-

I. NON-VARIABLE DEEP DISCOUNTED SECURITIES

1. Where securities are issued by companies with a discount of more than ½ point a year, or more than 15 points overall, the discount accruing during the period of ownership by an investor is taxed under existing law as income in the year of disposal or redemption. Any difference between the acquisition cost and disposal or redemption proceeds which is greater or less than the accrued income is normally taxed as a capital gain or loss (except in circumstances where the security is exempt from capital gains tax).

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

II. VARIABLE DEEP DISCOUNTED SECURITIES

3. Where securities are issued with variable features (for example where the date of redemption can vary or the return is index-linked) it is not possible to calculate in advance the precise amount of accruing discount. For such securities, issued by either corporate or non-corporate borrowers, where it is possible for the accrued discount to exceed ½ point per year or 15 points overall, the whole of the difference between acquisition cost and disposal or redemption proceeds will be taxed as income (subject to III. below). Liability to capital gains tax will not arise.

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

BUDGET CONFIDENTIAL

III. INDEX LINKED BONDS

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

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

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

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

d. The securities are issued for a period of more than 3 years and are not capable of redemption at any earlier date.

6. The new rules will apply to all disposals on or after Budget Day.

[3x] 14 March 1989

CORPORATION TAX RATES

The Chancellor proposes in his Budget to set in advance the rates of Corporation Tax for the Financial Year 1989. The main rate of Corporation Tax and the rate of Corporation Tax for small companies will remain unchanged at 35 per cent and 25 per cent respectively.

There will be an increase in the profits limits for the rate of small companies and the associated marginal relief. For the Financial Year 1989, the limit for the rate for small companies will be increased from £100,000 to £150,000. The limit for the marginal relief from the main rate of Corporation Tax will increase from £500,000 to £750,000. The marginal relief fraction will remain unchanged at 1/40th.

NOTES FOR EDITORS

1. If a company has "associated companies" its profits limits for the rate for small companies, and for the marginal relief, are reduced proportionately. So if it has three associated companies each limit is reduced to a quarter of the full amount. Two companies are "associated" if one controls the other or both are under the control of the same person or persons.

2. The effect of the marginal relief will be as follows. A company with profits of £150,000 will pay tax of £37,500 (an average tax rate of 25 per cent - the small companies rate). One with profits of £750,000 will pay £262,500 (an average tax rate of 35 per cent - the main rate). A company with profits between these amounts pays at the main rate of Corporation Tax less the marginal relief on the difference between its profits and £500,000. So if its profits are £450,000 the tax liability will be £157,500 (35 per cent of £450,000) less £7,500 (1/40th of (£750,000 - £450,000)), which is £150,000. This represents an average tax rate of 33.3 per cent.

[3x] 14 March 1989

ABOLITION OF CLOSE COMPANY APPORTIONMENT

The Chancellor proposes in his Budget to abolish close company apportionment. (This involves taxing individuals on the undistributed income of close companies in which they have an interest.) Instead there will be a 40 per cent Corporation Tax charge on close investment companies which retain a substantial part of their profits.

The change will simplify the way in which undistributed profits are taxed while still ensuring that non-trading companies are not used by higher rate taxpayers to avoid tax. It will apply for accounting periods starting after 31 March 1989.

DETAILS

Close investment companies (CICs)

1. A close company is one under the control of, usually, five or fewer people.

2. The proposal will apply to "close investment companies" (CICs). These will be all close companies other than those:

- whose business consists mainly (over 50 per cent) of trading and whose investment income does not exceed its other income; or

- which exists mainly to co-ordinate the administration of trading subsidiaries or for the purpose of trades carried on by fellow subsidiaries.

Dealing in land, shares or securities will not be treated as a trade. To protect a trading company which pays out its income as directors' remuneration, any remuneration paid to employees will be added to the company's "other income".

/Distribution test

Distribution test

3. A CIC will be liable to Corporation Tax at 40 per cent unless it distributes a certain proportion of its profits (the "distribution test"). CICs whose income comes mainly from property or trading must distribute 70 per cent of their profits; others must distribute 85 per cent. The test will apply separately to each accounting period.

4. Only dividends paid on ordinary share capital will count as distributions. Dividends paid in the six months following an accounting period may be treated as paid during the period.

5. The distribution test will not be satisfied if the dividends paid do not reflect the underlying ownership of the company (eg, if someone waives a dividend). And the recipients of the dividends will not be entitled to a tax credit. This will discourage anyone from using a CIC which they control to divert income to others (eg children) who have unused tax allowances.

6. For the distribution test "profits" of the CIC will include

- net income and capital gains; and
- dividends etc received from other UK resident companies (there are not normally chargeable to Corporation Tax).

Special rate of Corporation Tax

7. If a CIC fails the distribution test for an accounting period it will be liable to Corporation Tax at a rate of 40 per cent on all its profits as defined for the "distribution test".

8. Any dividends paid by the CIC which count as distributions for the purposes of the distribution test will be deductible from the dividends etc received by the CIC (but not from its normal taxable profits). The excess, if any, of the distributions received over the deductible dividends is called the "relevant investment income" ("RII"). This will be treated as carrying a tax credit at the basic rate of income tax which will be set against the Corporation Tax liability (so the effect will be the same as where an individual liable at the higher rate of income tax receives a dividend carrying a tax credit). It will not be possible to set any reliefs (eg losses) against RII (except where this is already allowed under Sections 242 or 243, ICTA 1988) nor will it be possible to set Advance Corporation Tax against Corporation Tax on RII.

9. Under existing law, a member of a group of companies can surrender trading losses and certain other reliefs to another member of the group, so as to reduce its taxable profits. This will be modified so that a company which is not a CIC will not be able to make a surrender to a CIC. Similarly, Section 273, ICTA 1970 (which prevents a capital gain or loss arising on a transfer of an asset between members of a group of companies) will not

/apply to any transfer

apply to any transfer between a CIC and a company which is not a CIC. The purpose of these rules is to prevent the special tax rate of 40 per cent being avoided when a CIC forms part of a trading group (although, as paragraph 2 explains, a company will not be a CIC if it exists mainly for the purpose of the trades being carried on elsewhere in the group).

Deductions for interest etc

10. Under existing law, companies can get tax deductions for interest and other payments in circumstances where an individual could not. At present, the apportionment provisions can counteract this advantage. The apportionment provisions will be abolished but will be replaced by some restrictions on the tax deductions available to a CIC. These restrictions will apply whether or not the CIC passes the distribution test.

11. A CIC will not get a deduction for any interest payments or annual payments which would not be deductible if made by an individual. This restriction on the deductibility of annual payments, other than interest, will also apply to a close company which is not a CIC (as does the present apportionment provision concerning annual payments). This will not prevent a company getting tax relief for a covenant to charity in circumstances where an individual would get tax relief.

12. At present, an investment company can get tax relief for its management expenses and it can also get capital allowances on its plant and machinery. An individual investor cannot get tax relief for similar expenditure. There will be a provision to prevent a CIC getting tax relief for such expenditure.

Definition of close company

13. The present definition of 'close company' depends partly on the existence of apportionment (Section 414(2) and (3), ICTA 1988). With the abolition of apportionment, these provisions need to be replaced. The replacement will operate by reference to direct or indirect rights to the assets of the company if it were wound up. This definition applies from 1 April 1989.

Cost

14. The abolition and replacement of close company apportionment is not expected to make a significant change to total tax receipts.

Compliance cost assessments

15. Assessments of the compliance costs of proposals affecting businesses are available. A copy of the Compliance Cost Assessment for this proposal can be obtained from:

Inland Revenue
Deregulation Unit
Room 77
New Wing
Somerset House
London, WC2R 1LB

NOTES FOR EDITORS

1. The forerunner of the present close company apportionment legislation was introduced to prevent avoidance of the historically high rates of tax on income which applied during the 1920s (which could exceed 50 per cent for people with large incomes). Various changes were made over the years but as top tax rates continued to rise the apportionment legislation remained essential to prevent tax avoidance.

2. In 1979 the top rate of tax on earned income was reduced to 60 per cent. The Government decided that apportionment of the trading income of trading companies was no longer necessary and so in 1980 this was abolished. The current apportionment provisions occupy 19 pages of legislation but the main features are as follows.

Apportionment of undistributed income

3. Apportionment is a process by which the undistributed income of a close company can be attributed to the participators, who are then charged to income tax if they are liable at the higher rate (but only at the excess of the higher rate over the basic rate). This usually produces a similar result to what would have happened if the company had instead paid out the amount apportioned as a dividend. The rules for determining the amount to be apportioned are complicated but in principle half of the company's trading income or income from property and the whole of its other income can be apportioned. But any amount which the company requires for the purpose of its trade (if any) or to repair or improve any investment properties which it owns is excluded.

4. This apportionment applies only to the extent that the company does not distribute (for example, through a dividend) the amount which is apportionable.

Apportionment of distributed income

5. The income of a non-trading company can be apportioned even where it has been distributed. This power, which is seldom used in practice, prevents tax avoidance by the distributions being made disproportionately to people not liable at the higher rate of income tax. For example, a higher rate taxpayer who controlled a company might waive a dividend so that only his or her children (who were not higher rate taxpayers) received any dividends.

Apportionment of interest paid by a close company

6. The amount of any interest paid by a close company can be apportioned to its shareholders and taxed as their income (but only at the excess of the higher rate of income tax over the basic rate). The purpose of this is to reduce the tax advantage someone gets by borrowing through a company (which normally gets tax relief on the interest) instead of doing so directly (when tax relief is usually not available). The effect is, normally,

to apportion to the participator the amount of the company's income which was sheltered from corporation tax by the payment of interest.

7. This apportionment does not apply to trading companies and certain other companies which are largely concerned with trading activities or property investment.

Apportionment of annual payments

8. If a close company makes an annual payment which would not have been deductible if made by an individual (for example, a covenanted payment to a non-charity) the amount of this can be apportioned to the participators. This apportionment has the same purpose, and works in the same way, as the apportionment of interest.

[3X] 14 March 1989

TRADING LOSSES AND CAPITAL GAINS - NEW RELIEF

The Chancellor proposes in his Budget to allow proprietors of unincorporated businesses to set trading losses against capital gains. The new relief is to apply to trading losses and capital gains in years of assessment from 1989/90 onwards.

The purpose of this new relief is to bring unincorporated traders broadly into line with companies, which can already set trading losses against both income and capital gains. It will also help unincorporated businesses going through temporary difficulties. The proprietors of such businesses may have to sell capital assets - either business assets or personal investments - to tide them over. The relief will enable people in this position to reduce their capital gains to the extent that there are trading losses in the same or the previous year.

DETAILS

1. Under the proposed new relief, someone engaged in a trade, profession or vocation who makes a loss and does not have enough income in the year to offset that loss in full will be able to elect to set the unused loss against capital gains of the same year. In addition, if unused trading losses of a year are carried forward to the following year and there is insufficient income in that year to offset the loss, the trader may elect for the excess of loss to be set against capital gains of that following year. Any trading loss which is not set against income or gains of the same or the following year will, as now, be available against future trading profits.

2. Where an election is made in relation to gains of a year, unused trading losses will be set against gains of the year concerned up to a maximum of the gains on disposals in the year less any losses on disposals in the year. The new relief will be given in priority to relief for capital losses carried forward from previous years.

/3. The relief will not apply

3. The relief will not apply to traders whose losses do not qualify for sideways relief against other income, because they are not in business on a commercial basis, for example, "hobby farmers".

NOTES FOR EDITORS

1. The general rule in the UK tax system is that losses can only be relieved against income from the same source as gave rise to the loss.

2. But - as an exception to this rule - traders and professional people who incur losses can, under Section 380 of the Income and Corporation Taxes Act 1988, set those losses against other income (but not capital gains) for the year in which they make the loss or against other income of the following year. (Any excess losses can then be carried forward and set against future profits from the same trade.)

3. This exception recognises that traders may have to fund their losses out of income from other sources. It is equally true that they may have to fund losses out of capital gains, and the Chancellor's proposal recognises this.

[3X] 14 March 1989

EXTENDED RELIEF FOR PRE-TRADING EXPENDITURE

The Chancellor proposes in his Budget to extend the period for which businesses can claim relief for certain pre-trading expenditure from 3 to 5 years.

The proposal recognises that the existing 3 year period may not be long enough to cater for the long lead times needed for some businesses.

The new five year period will apply to individuals, partnerships or companies who start to trade on or after 1 April 1989.

DETAILS

1. At present, a business can claim tax relief for revenue expenditure incurred in the three years before the start of a trade, profession or vocation, provided the expenditure would be allowable as a business expense if the trade had actually started. The relief is given when trading begins, and is available for example, for the cost of taking on employees, or rent or rates.

2. A time limit on the expenditure qualifying for relief is necessary to make sure that relief is restricted to expenditure directly related to the setting up of a trade.

/ NOTES FOR EDITORS

NOTES FOR EDITORS

1. Expenditure incurred before the start of a trade does not satisfy the normal business expenses rules. However, Section 401 of the Income and Corporation Taxes Act 1988 allows businesses to claim relief for pre-trading revenue expenditure. When this relief was first introduced in 1980, it was restricted to expenditure incurred by traders in the year before trading started. In 1982 this was extended to 3 years because the one year limit was thought to be insufficient to cater for some pre-trading research, especially in high technology areas.

2. The proposal only applies to revenue expenditure. Pre-trading capital expenditure has to be dealt with under the capital allowances code, which provides that capital expenditure incurred by a person about to carry on a trade is to be treated as incurred on the first day of trading.

[3x] 14 March 1989

ADVANCE CORPORATION TAX

The Chancellor proposes in his Budget to amend the advance corporation tax rules. The changes will

- make it easier for groups of companies to reorganise, but
- strengthen the safeguards against tax avoidance.

DETAILS

1. The main features are:

Group reorganisations

2. A company which pays advance corporation tax (ACT) can surrender it to a subsidiary company to be set against its liability to corporation tax (CT). If the subsidiary company cannot immediately use all of the surrendered ACT it is carried forward to be set against its future CT liabilities. But if the company ceases to be a subsidiary of the other company, any unused balance of the surrendered ACT cannot be carried forward beyond that point (and so will be lost). The purpose of this rule is to prevent a company selling ACT by surrendering it to a subsidiary and then selling the shares in the subsidiary.

3. However, the rule also deters commercially desirable group reorganisations under which one company may cease to be a subsidiary of another although both will remain under the ownership of a third company. The rule will be amended to allow surrendered ACT to be carried forward in these circumstances.

Change of ownership of a company

4. Where a company has paid ACT, the ACT is lost if

- the ownership of the company changes, and

/- there is either

- there is <u>either</u> a major change in the company's business within 3 years, <u>or</u>

- the company becomes largely dormant before the change of ownership.

This provision prevents a company with unused ACT being sold to another company which would transfer its existing profitable activities to the purchased company to make use of ACT. A similar provision applies where there are unused trading losses.

5. The rules for determining whether there has been a change of ownership are the same for ACT and trading losses (Section 769 of the Income and Corporation Taxes Act 1988). Two of these rules do not always work satisfactorily. These will be amended.

6. The first is in subsection (5). This disregards a change of ownership if before and after the change the company is a "75 per cent subsidiary" of another company. This is intended to prevent the loss of ACT or trading losses where there is a group reorganisation under which the ultimate ownership of the company does not change. But the definition takes account only of the ownership of the company's ordinary share capital and this does not always reflect the economic ownership of the company. The definition will be changed to ensure that a company will be treated as being a 75 per cent subsidiary of another company only if that company is entitled to at least 75 per cent of its profits and to 75 per cent of its assets if it is wound up. The detailed rules will be based on the rules that already apply for group relief (Schedule 18 of the Income and Corporation Taxes Act 1988).

7. The second rule that does not always work satisfactorily is in subsection (6). This says that if there is a change of ownership of a company any 75 per cent subsidiary of that company should also be treated as having had a change of ownership. This rule reflects the fact that the ultimate ownership of the subsidiary will have altered even though its direct ownership is unchanged. But the rule has no effect on a company which is not a 75 per cent subsidiary. For example, the parent company may own 70 per cent of the shares and another company in the group may own the remaining 30 per cent. The shares in the parent company may be sold to another company together with the 30 per cent shareholding. The purchaser will therefore directly or indirectly own all the shares of the subsidiary company. But under the existing rules, that company is not treated as having had a change of ownership. In order to reflect more closely the realities of ownership, subsection (6) will be amended so that when there is a change of ownership of a company any shares (or rights or powers) possessed by the company will be treated as having changed ownership.

8. One further change will be made to the provision concerning the loss of ACT where there is a change of ownership. It will apply where a company surrenders ACT to a subsidiary and both companies pass into the same new ownership (for example, the

/parent company may be

parent company may be sold to another company and the provision described in the previous paragraph will cause there to be a change of ownership of the subsidiary). In future, if within three years of the change of ownership there is a major change in the business of the company which surrendered the ACT this will prevent the subsidiary making use of the surrendered ACT after the change of ownership. In other words, if the ACT would have been lost if it had not been surrendered then it will be lost even if there has not been a major change in the business of the company to which it has been surrendered. The purpose of this is to prevent the indirect sale of ACT by surrendering it to a subsidiary which has been set up to carry on activities which would fit into the business of the purchaser.

Dividends and interest paid between members of a group

9. A parent and subsidiary may elect that any dividend paid by the latter to the former should not be liable to ACT. The companies may also elect that any interest paid from one to the other may be paid without deducting income tax. (Similar elections can be made by a company owned by a consortium and a member of the consortium.) These provisions allow a group of companies (or a consortium) to conduct its internal affairs without encountering unnecessary tax obstacles.

10. The provisions work satisfactorily where the companies concerned are in a genuine group (or consortium) relationship. But the test of ownership of one company by another (or by a consortium) operates by reference to the ownership of the ordinary share capital. This does not always reflect economic ownership. So it is possible to devise arrangements under which one company avoids paying ACT on a dividend payable to another company which is in reality under separate ownership.

11. The test of ownership of a company by another company will be amended in a similar way to that described in paragraph 6 above. The test of ownership by a consortium will also be brought closer to the test which applies for group relief. Under the test (in Section 402(3) of the Income and Corporation Taxes Act 1988) group relief is not available if the company owned by the consortium is a 75 per cent subsidiary of any company - in other words, it is really a subsidiary of a single company rather than being owned collectively by the members of a consortium. A similar exclusion will apply for this relief.

Interest on overdue tax

12. A company can surrender ACT to another company at any time within six years of the end of the accounting period in which the ACT was paid. Where ACT is surrendered and set against a subsidiary's CT liability it will receive a tax repayment if it has already paid its CT liability. This repayment may carry a repayment supplement.

13. The company which surrenders the ACT will of course lose the use of it. If the ACT has already been set against its own CT liability the CT liability will increase as a result of the

/surrender and so the

surrender and so the company may have to pay more tax. But unless the CT liability is under appeal when the claim to surrender ACT is made the increased CT liability will bear interest only from 30 days after it is assessed.

14. The combined effect of these provisions allows a parent and subsidiary to gain an unjustified advantage by making an ACT surrender, which results in no change to their total tax liabilities, but produces a net payment to the subsidiary of repayment supplment.

15. This advantage will be removed by charging interest on the corresponding increased CT liability of the parent. Interest will also be charged where the increased CT liability is offset by a carry-back of surplus ACT from a later accounting period. (This is consistent with the existing provision in Section 825(4) of the Income and Corporation Taxes Act 1988 which prevents repayment supplement being paid on a repayment of CT arising out of a carry-back of ACT).

17. The new provision will apply until the new arrangements for CT Pay and File come into force (not before 31 March 1992). This tax advantage cannot arise under CT Pay and File.

Commencement

18. The changes will come into force as follows.

(i) Group reorganisations - Accounting periods ending after 14 March 1989.

(ii) Change of ownership - Changes of ownership occurring after 14 March 1989.

(iii) Payments between members of a group - Dividends or interest received after 14 March 1989.

(iv) Interest on overdue tax - Surrender claims made after 14 March 1989.

NOTES FOR EDITORS

1. ACT is normally payable when a company pays a dividend or distributes its profits in some other way. The rate of ACT is linked to the basic rate of income tax.

2. The ACT payable on dividends or other distributions paid during a company's accounting period is set against its CT liability on the profits of that period (subject to certain restrictions). Any ACT which cannot be set off in this way can be carried forward to set against future CT liabilities.

/Alternatively, it can

Alternatively, it can be carried back for up to six years and set against the company's CT liabilities for earlier accounting periods.

3. A company may claim to surrender some or all of its ACT to a subsidiary company to be set against its CT liability. A company can surrender ACT even if it could otherwise have set the ACT against its own CT liability.

DRAFT

[3x] 14 March 1989

BUSINESS EXPANSION SCHEME

The Chancellor proposes in his Budget to stop tax relief for interest payments on loans raised to buy shares under the Business Expansion Scheme.

[It has previously been possible for an individual to get tax relief on both the investment and the interest on the loan raised to pay for it. But this has only recently begun to happen on a large scale.] The Chancellor considers that two sets of relief are excessive.

The change will apply to shares issued on or after today.

NOTES FOR EDITORS

[1. In the last six months tens of £millions have been invested in BES shares financed by loans which attract interest relief.]

General description of the BES

2. The Business Expansion Scheme (BES), which was introduced in the Finance Act 1983, offers income tax relief at the marginal rate to individuals investing up to £40,000 per year in new, full-risk, equity of unquoted UK companies with which the investor is not otherwise connected. The company must not be under the control of any other company. It must exist either for the purpose of carrying on a trade or for the purpose

of letting residential property on new-style assured tenancy terms. Originally set to run until April 1987, the life of the Scheme was extended indefinitely by the Finance Act 1986, when among other changes BES shares issued after 18 March 1986 were exempted from capital gains tax.

3. BES is for <u>outside</u> investors, rather than for people putting money into their own business. An investor does not qualify if he or she (together with his or her close relatives, business partners and certain other "associates") has more than 30 per cent of the shares or the voting power in the company. And the investor must not be a paid director or an employee of the company. But the investor may be an <u>unpaid</u> director, and may receive fees for professional and similar services to the company <u>other</u> than as a director or employee.

4. The investment must be in new ordinary shares which have no special rights. The shares must be held for at least five years to ensure that full tax relief is retained. If the shares are disposed of earlier, some or all of the relief may be withdrawn.

5. An individual does not qualify for relief if he or she comes to a mutual agreement with someone else to invest in each other's companies. And there is a general provision preventing relief being given unless the share issue is for bona fide commercial purposes and is not part of an arrangement meant to avoid tax.

Interest relief for purchasing shares in a close company

6. Subject to certain conditions, an individual can obtain tax relief on the interest paid on loans to acquire shares in a closely-controlled company. At present, this relief is available even if the shares qualify for tax relief under the BES.

DRAFT

INLAND REVENUE
Press Release

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[3x]

14 March 1989

CAPITAL ALLOWANCES

The Chancellor proposes in his Budget certain minor changes to the capital allowance rules. These changes will correct defects and anomalies in advance of consolidation of the capital allowance legislation into a single Act. They will also extend the existing relief for safety expenditure on certain sports grounds to regulated stands at what are known as undesignated grounds.

The necessary provisions will be included in the Finance Bill 1989.

DETAILS OF THE PROPOSALS

1. <u>Pre-consolidation changes</u>

(a) <u>Exclusion of double allowances</u>

The principal change proposed is the replacement of the various existing rules with a simple rule allowing a claimant whose expenditure qualifies under more than one head of the capital allowance code to make an irrevocable choice of the type of capital allowance he prefers.

(b) <u>Contributions to expenditure</u>

The existing rules which govern the treatment for capital allowance purposes of contributions made towards another person's capital expenditure are to be amended. The main effects will be to

i. allow relief for contributions where the contributor or the recipient is engaged in a profession or vocation (at present, a contributor can only claim allowances where a contribution of capital is made for the purpose of a trade carried on by him or his tenant);

/ii. confine the

ii. confine the relief due to the recipient of a contribution to his net expenditure where the contributor can claim the contribution as a trading expense or is exempt from tax.

(c) Patent Rights

It is proposed to adapt the rules which limit the amount of a person's capital expenditure when he acquires patent rights from a connected person to deal with the situation where no disposal value is brought to account by the vendor.

The effect of the changes will be that, where the vendor receives a capital sum on which he is chargeable to tax, that sum will be taken as the purchaser's qualifying expenditure. In any other case, the qualifying expenditure will be the smallest of

i. the purchaser's capital expenditure

ii. the market value of the rights when the purchaser acquired them

iii. where capital expenditure was incurred by the vendor, or a person connected with him, on acquiring the rights, the amount of that expenditure.

(d) Other changes

It is proposed to provide statutory cover for a range of extra-statutory concessions and practices.

A number of other minor changes are also proposed, designed to provide a simpler and more cohesive capital allowance code in advance of consolidation of the capital allowances legislation and to facilitate the task of consolidation.

2. Safety at Sports Grounds

The rules governing capital allowances for safety expenditure at sports grounds are to be extended to take account of changes to the Safety of Sports Grounds Act 1975. They will provide relief for safety expenditure on regulated stands at undesignated sports grounds. This relief will apply to expenditure incurred on and after 1 January 1989 in complying with safety certificate requirements of a local authority.

Exchequer effect

The Exchequer effect of the proposed changes will be negligible.

/NOTES FOR EDITORS

NOTES FOR EDITORS

1. Pre-consolidation amendments

Consolidation of statute law is the responsibility of the Law Commission. Capital allowance legislation was last consolidated in 1968 since when extensive changes to the system have been made in annual Finance Acts. A Consolidation Bill to bring together all the current legislation on capital allowances is expected to be introduced later this year.

2. A consolidating Act does not involve any change in the law; but amendments necessary to tidy up the legislation and so facilitate consolidation may be included in a Finance Act. The capital allowance changes now proposed fall into two main categories. In the first there will be a number of minor changes to close gaps and correct anomalies in existing legislation while also providing cover for a range of existing extra-statutory concessions and practices in the taxpayer's favour. The second will consist of changes to facilitate the consolidation itself.

3. Safety at Sports Grounds

Section 49 Finance (No.2) Act 1975 (as extended by Section 40 Finance Act 1978 and Section 93 Finance Act 1988) provides that, if relief is not otherwise available, a trader may claim capital allowances at 25 per cent (reducing balance basis) on capital expenditure incurred in complying with safety certification requirements for designated sports grounds under the provisions of the Safety of Sports Grounds Act 1975, as amended.

The Fire Safety and Safety at Places of Sports Act 1987 Act provided that safety certification procedures should also apply to "regulated stands" (normally, stands which provide covered accommodation for 500 or more spectators) at undesignated sports grounds. That change came into effect on 1 January 1989.

The existing capital allowance rules are to be extended so that the relief will apply to capital expenditure on safety work on a regulated stand.

TEXT SUBMITTED 22 FEB FOR APPROVAL (BY MR KEITH)

[3X] 14 March 1989

FOREIGN EXCHANGE GAINS AND LOSSES-CONSULTATION ON TAX TREATMENT

The Chancellor has approved publication of a consultative document on the tax treatment of foreign exchange gains and losses.

Increasingly, business is conducted across national boundaries, so that many UK companies are exposed to currency fluctuations. Most of the foreign exchange gains and losses arising from these fluctuations are already taken into account for tax purposes, but significant problems remain in certain areas, particularly in the treatment of borrowings of a capital nature.

The Government recognise the importance which industry and its advisers attach to the need for change in this complex area of the business tax system. The consultative document examines the scope for comprehensive legislative reform, and also identifies a number of individual areas where business has found particular difficulty. In each case the document identifies in some detail options for change, and the practical implications that these would seem likely to entail.

The Government have published this document as a detailed response to the calls for change. The Government would welcome further comment on the practical implications of the options discussed in the document, and on how the particular problems which have been identified might best be approached.

Copies of the document may be obtained by calling at or writing to the Inland Revenue Reference Room, Room 8 New Wing, Somerset House, Strand, London WC2R 1LB. The cost of the document is £4.50 (including postage). Payment should be made by cheque or postal order (payable to "Inland Revenue") or in cash. Postage stamps cannot be accepted in payment.

Representations are invited on the matters discussed in the document, if possible to be received by 30 September 1989. They should be sent to:

The Board of Inland Revenue
Exchange Consultation
Room 69 New Wing
Somerset House
London
WC2R 1LB

/SUMMARY OF DOCUMENT

SUMMARY OF DOCUMENT

Present Tax Treatment

1. Under the present UK tax system, gains and losses resulting from currency fluctuations are not always taken into account for tax purposes in the same way, or even at all. For example, some may be treated as trading profits or losses, and some as capital gains or losses, while others fall outside the tax system altogether so that gains are neither taxed nor losses relieved.

2. This leads to difficulties, in particular:

- the absence of relief for exchange losses on capital borrowings (although, as a corollary, gains are not taxed);

- the hedging of currency exposures may be made ineffective because the hedge is treated differently from the underlying transaction;

- changes in the sterling value of foreign currency denominated share capital are not taken into account for tax purposes.

Main Options

3. The document considers how these problems might best be tackled for the corporate sector within the broad framework of the existing tax system.

4. It considers:

- when exchange differences should be taxed or relieved - perhaps when a transaction is settled by cash payment; or when assets and liabilities are translated into sterling in the annual accounts; or some combination of these;

- how they should be recognised - perhaps as part of the trading profit or loss; or as capital gains or losses; or under new rules within the income tax system.

5. It also considers the kind of rules which would be needed to protect the Exchequer against potentially very high costs from:

- relief for exchange losses which in commercial terms are matched by corresponding untaxed gains so that there is no overall gain or loss within the company or group;

- repayment and renewal of foreign currency loans to crystallise accrued exchange losses while deferring accruing exchange gains;

/. exploitation of timing

- exploitation of timing and other differences on intra-group transactions, especially within multinationals.

6. These problems may be especially difficult to solve because of the complex financing arrangements used by large companies and groups in the normal course of their business. For example, it may not be easy to draft clear and objective rules to establish whether a particular loss is in fact linked with a gain which may have been made elsewhere in the group; or whether a new loan can be said to replace another which has been repaid.

7. If an acceptable basis for comprehensive reform cannot be found, it may be possible to make important but more limited changes to deal with specific problems, for example, the need for symmetrical tax treatment of a hedge or exchange differences on share capital denominated in foreign currency. The document discusses some possible alternative approaches to these problems.

NOTES FOR EDITORS

1. Current Inland Revenue practice on the tax treatment of foreign exchange gains and losses is set out in Statement of Practice SP1/87. When this Statement of Practice was published, the Financial Secretary said:

> "We have certainly not ruled out the possibility of major legislative reform but, before committing itself, the Government would need to be satisfied that a scheme could be devised which could be applied effectively in practice and reflect a broad measure of agreement without entailing an unacceptable cost to the Exchequer."

2. Following publication of the Statement of Practice, proposals for change were made by a group of nine major trade and professional bodies in July 1987. Their report was an important contribution to the debate on the need for a new scheme of relief, but as the group itself recognised, it left unanswered a number of important questions which would need to be tackled in any comprehensive reform.

TEXT SUBMITTED TO FST 21 FEB (MR CAYLEY)

BUDGET CONFIDENTIAL

INLAND REVENUE

Press Release

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

[3x] 14 March 1989

REFORM OF CAPITAL GAINS TAX RULES FOR GIFTS

1. In his Budget, the Chancellor proposes to reform the capital gains tax relief for gifts by individuals and trusts. Under present law, tax on any gain accrued up to the date of gift of an asset can normally be deferred until the donee disposes of the asset.

2. One of the original reasons for introducing this deferral was the existence of a simultaneous charge to capital transfer tax. With no general Inheritance Tax charge on lifetime giving, that rationale no longer applies. In addition, the capital gains tax deferral has come to be widely used not just to postpone gains but also to reduce or eliminate the tax charge on gains up to the date of gift. The reform, by substantially restricting the scope of the deferral, will make it much more difficult to use the relief for tax planning.

3. The main features of the reform are:-

(i) deferral to be restricted to

- gifts of business assets (including unquoted shares in trading companies and holding companies of trading groups)
- gifts of heritage property
- gifts to heritage maintenance funds
- gifts to political parties, and
- gifts on which there is an <u>immediate</u> charge to inheritance tax.

(ii) where deferral is not available, payment of tax by instalments will be allowed for gifts of land, controlling shareholdings, and minority holdings in unquoted companies.

(iii) some technical changes will be made to ensure that deferral does not effectively lead to gains being taken out of the capital gains charge.

/4. These changes

starter.252

4. These changes will apply to gifts and disposals made on or after 14 March 1989. They are expected to yield £m10 in 1990-91, rising to £m40 in a full year.

5. Gifts to charities will be unaffected by these changes. So - apart from one technical change (see paragraph 13 of the detailed description below) - will gifts between husband and wife.

DETAIL

A. GIFTS ON WHICH DEFERRAL WILL REMAIN AVAILABLE

1. The following paragraphs describe the types of gift on which deferral will continue to be available.

(i) <u>Business Assets</u>

2. Business assets will be defined for this purpose to include:-

(a) assets used in a trade, profession or vocation carried on

- by the donor, or
- if the donor is an individual, by his family company or a member of a trading group of which the holding company is his family company (the definitions here will be the same as for retirement relief), or
- if the donor is a trustee, by the trustee or by a beneficiary who has an interest in possession in the settled property.

As now for Schedule 4 of the Capital Gains Tax Act, deferral will be restricted if the asset was either not used in the trade etc throughout the period of ownership or if it is a building only part of which was used in the trade etc.

(b) agricultural property which would attract 50% relief from inheritance tax (the main assets concerned are farmland and associated buildings where the donor has vacant possession).

(c) shares and securities in trading companies, or holding companies of trading groups (defined as for retirement relief), where <u>either</u>

- the shares or securities are neither quoted on a recognised stock exchange nor dealt in on the Unlisted Securities Market,

<u>or</u>

/ - if the donor

- if the donor is an individual, the company concerned is his family company (defined as for retirement relief),

<u>or</u>

- if the donor is a trustee, the trustee can exercise 25% or more of the voting rights.

As now for Schedule 4 of the Capital Gains Tax Act, deferral will be restricted if the trading company or trading group has assets not used in a trade: but this restriction will not apply if, throughout the period of twelve months before the gift, the donor had less than 5% of the voting rights in the trading company or holding company of the trading group.

(ii) <u>Heritage Property and Maintenance Funds</u>

3. The reliefs provided by Section 147 CGTA for certain disposals of works of art, historic buildings, land of scenic, historic or scientific interest, etc, will continue unaltered. The reliefs provided by subsections (1) and (3) of Section 147 are confined to outright gifts (including gifts in settlement): in cases where some consideration (but less than market value) is received, deferral will continue for disposals which attract exemption from inheritance tax.

4. In addition, deferral will continue for gifts to heritage maintenance funds which attract exemption from inheritance tax.

(iii) <u>Political Parties</u>

5. Gifts to political parties and to trusts for political parties will continue to attract deferral if they would be exempt from inheritance tax under Section 24 Inheritance Tax Act 1984.

(iv) <u>An Immediate IHT Charge</u>

6. Deferral will also continue where a gift constitutes a transfer immediately chargeable to inheritance tax. The most common examples will be gifts to discretionary trusts and companies. But deferral will not be available - except in cases falling within (i), or (ii) above - if the gift is a potentially exempt transfer on which inheritance tax in the event becomes chargeable.

7. A gift will be regarded as chargeable to inheritance tax even if it falls within the nil rate band of that tax. It will also be regarded as so chargeable if it would be immediately chargeable but for the fact that it is within the inheritance tax annual exemption (Section 19 of the Inheritance Tax Act 1984).

B. INSTALMENTS

8. Where deferral ceases to be available any capital gains tax may be paid by annual instalments over ten years if the gift is of

/- land, or

- land, or

- a controlling shareholding in a company, or

- minority holdings of shares or securities in a company neither quoted on a recognised stock exchange nor dealt in on the Unlisted Securities Market.

9. The instalments will, if paid on time, be interest free if the gift is of agricultural property (as defined for inheritance tax: the main example is tenanted agricultural land given away by the landlord). Otherwise interest will run from the normal due date for capital gains tax.

10. The first instalment will be due on the normal due date. Taxpayers may pay the tax still outstanding, plus any accrued interest, early if they do not want the instalment arrangements to run their full course. If the gift is to a connected person and the asset is subsequently sold within the ten-year instalment period, any outstanding tax and accrued interest will become payable immediately.

C. TECHNICAL CHANGES

11. Deferral is not available under present law if the gift is to a person neither resident nor ordinarily resident in the United Kingdom. Some donees may be resident for tax purposes in both the United Kingdom and another country: in such circumstances a double taxation agreement may exempt some of their assets ("prescribed assets") from the normal United Kingdom charge on capital gains. In situations where deferral would otherwise continue, it will no longer be available if the gift is of an asset which would be "prescribed" in the hands of the donee. (A rule of this kind already exists if the donee is a dual resident trust.)

12. Where shares or securities within the capital gains charge are exchanged for qualifying corporate bonds (which are exempt from charges on gains), tax on any gain on the original shares or securities is deferred until there is a disposal of the replacement bonds. Further deferral will not be allowed on a gift of the replacement bond. If the bonds become the subject of a no gain/no loss transfer (eg within a group of companies or between husband and wife) the charge on the gain is preserved but due to a technical defect in the rules it is lost if there is more than one such transfer. Legislation will be introduced to correct this defect and will apply where there is a disposal on or after 14 March 1989 which has been preceded by more than one no gain/no loss transfer.

13. The new rules will also deny deferral under the gifts relief provisions for certain arrangements designed to take business assets outside the capital gains charge, for example by transferring business assets to a company the shares in which are owned by a non-resident trust.

TEXT SUBMITTED TO FST 21 FEB (MR GORDON)

DRAFT

BUDGET CONFIDENTIAL

INLAND REVENUE

Press Release

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

[3x] 14 March 1989

CAPITAL TAXES: GIFTS OF LAND TO HOUSING ASSOCIATIONS

The Chancellor proposes in his Budget changes to the capital gains tax and inheritance tax rules for gifts or sales of land below market value to non-charitable Registered Housing Associations. This means

- the transferor will be liable to capital gains tax only in so far as there is a gain by reference to the actual sale proceeds; and

- the transfer will normally be exempt from inheritance tax.

These changes will apply where the transfer to the Registered Housing Association takes place on or after Budget Day.

NOTES FOR EDITORS

1. Under existing law, landowners who donate land (or sell it cheaply) to a non-charitable Housing Association can face a capital gains or inheritance tax charge based on the market value of the land. The person transferring the land may therefore face a capital gains tax liability based on an amount greater than any actual sale proceeds received. There may also be an inheritance tax charge on the decrease in value of the landowner's estate as a result of the transfer.

2. Under the Chancellor's proposals, where land is given or transferred cheaply to a Registered Housing Association the transfer will no longer be treated as taking place at market value. This means that a capital gain - which may be reduced by indexation allowance - will arise only if the actual sale proceeds exceed the amount of the allowable expenditure. If the actual sale proceeds do not exceed the amount of the allowable expenditure, the landowner will be treated as making neither a gain nor a loss after any indexation allowance.

/3. The Chancellor's

3. The Chancellor's proposals also mean that gifts or sales below market value of land to a Registered Housing Association will normally be exempt from inheritance tax.

4. As far as the landowner is concerned, the effect of these changes will be to bring the CGT and IHT treatment of transactions with non-charitable Registered Housing Associations into line with the rules which already apply to transactions with charitable Housing Associations.

5. The estimated cost of these changes is negligible.

TEXT SUBMITTED TO FST 21 FEB (MR GORDON)

DRAFT

INLAND REVENUE

Press Release

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

[3x] 14 March 1989

CAPITAL GAINS TAX: NON-RESIDENTS WITH UK BRANCH OR AGENCY AND DUAL RESIDENT COMPANIES

The Chancellor proposes in his Budget a reform of the capital gains tax rules for non-residents carrying on a business in the UK through branches or agencies. He also proposes to introduce rules dealing with companies which are resident in both the UK and another country for tax purposes. Without these changes there would be a risk of substantial tax loss to the Exchequer, in particular from avoidance of the charge on migrating companies introduced last year.

(A) Non-Residents with UK branch or agency

1. The Chancellor proposes that:

(a) any unrealised gains on assets will be chargeable if

(i) the UK business ceases; or

(ii) the assets are removed from the UK;

(b) the capital gains tax rollover relief will be available only where the replacement asset is within the UK tax charge;

(c) non-residents carrying on professions or vocations in the UK through a branch or agency will be treated in the same way as traders; but in this case only gains accruing from Budget Day will be brought into charge;

(d) if a non-resident company fails to meet its liability on branch or agency gains other companies in the same group or controlling directors may be called upon to meet the liability;

(e) with necessary modifications, the changes will extend to certain non-mobile assets and dedicated mobile assets used in connection with the exploration or exploitation of the UK continental shelf.

/2. The changes

2. The changes will generally apply where the disposal (or cessation or removal of the asset from the UK as the case may be) takes place on or after Budget Day.

Background

3. At present a person who is not resident (and in the case of an individual, not ordinarily resident) in the UK is not normally chargeable to capital gains tax (or corporation tax on capital gains in the case of companies). Such a person is however chargeable on the disposal of an asset which is situated in the UK and which is or has been used for the purpose of a trade carried on in the UK through a branch or agency in the year of assessment in which the disposal takes place.

(B) Dual-resident Companies

4. The Chancellor proposes that where assets of a dual resident company change, under the terms of the double taxation agreement, from being within the UK tax charge to being outside it, the company will be liable to tax on all unrealised gains on those assets.

5. The change will apply where the asset ceases to be within the UK tax charge on or after Budget Day.

6. At the same time the change to the capital gains tax rollover relief rules described in paragraph 1(b) above is extended to dual resident companies.

Background

7. A company which is resident in the UK may at the same time be treated as resident abroad under the terms of a double taxation agreement. The double taxation agreement will specify to what extent assets belonging to the company are within the UK tax charge, and to what extent they are outside. Where a company resident in the UK becomes dual resident then - following changes last year - it has to pay tax on all unrealised gains on assets which, under the relevant double taxation agreement, thereafter fall outside the UK tax charge.

NOTES FOR EDITORS

1. These changes will counter arrangements by which non-residents carrying on a business in the UK through a branch or agency may be able very easily to avoid the intended capital gains tax charge on the disposal of assets situated in the UK and used for that business.

/2. At present

2. At present the charge is generally confined to assets situated in the UK which are sold while the trade is continuing. So if the trade ceases before the asset is sold the charge is normally lost. Similarly if the asset is removed from the UK before being sold the charge is lost. Even where the UK asset is sold while the trade is continuing, capital gains tax rollover relief permits the non-resident vendor to roll the gain into assets which are outside the UK tax net, and so again the charge may be permanently lost.

3. Until recently the scope for, and extent of, abuse was limited. However last year new company residence and migration rules were introduced. Under these, companies wishing to migrate have to pay tax on unrealised gains on migration; but that charge does not apply to assets of a branch or agency which remain in the UK and thus still within the UK tax net. So companies wishing to migrate may very easily be able to arrange things so that their assets remain in the UK in a branch or agency - thus avoiding the emigration charge - and then to exploit the weaknesses in existing law to take gains wholly out of tax. Many millions of tax may be at stake.

4. The measures proposed by the Chancellor will counter these possibilities by ensuring that those carrying on business in the UK through a branch or agency pay tax on all unrealised gains when the business ceases and on any unrealised gain on an asset, if that asset is removed from the UK. At the same time the CGT rollover relief rules (which allow deferral of tax where disposal proceeds are used to acquire certain replacement assets within certain time limits) are being tightened up; and because of the possible difficulty of collecting tax from non-residents extra enforcement powers are being provided on the same lines as those already applying for the gains charge on companies which migrate. With necessary modifications the rules are extended to those involved in the use of certain non-mobile assets and dedicated mobile assets for the exploration or exploitation of the UK continental shelf.

5. Both the existing and the new rules are also extended as appropriate to non-residents carrying on professions or vocations here through a branch or agency. But because these persons have not hitherto been liable to capital gains tax it would be hard to justify catching all gains realised on or after Budget Day; so the change will apply only to gains accruing on or after Budget Day.

6. Finally, rules are being introduced for dual resident companies whose assets cease - under the terms of a double taxation agreement - to be within the UK tax charge. These rules will be in line with those introduced last year for companies whose assets cease to be within the UK tax charge when they become dual resident. As is the case for companies becoming dual resident there will be a charge on any unrealised gains on the relevant assets. As for non-residents carrying on business in the

/UK through a

UK through a branch or agency, the CGT rollover relief rules are being tightened up.

Compliance Cost Assessments

7. Assessments of the compliance costs of proposals affecting business are available. A copy of the Compliance Cost Assessment for this proposal can be obtained from:

Inland Revenue Deregulation Unit,
Room 77
New Wing
Somerset House
London WC2R 1LB.

BUDGET CONFIDENTIAL

TEXT SUBMITTED 22 FEB FOR APPROVAL (BY MISS DYALL)

INLAND REVENUE

Press Release

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

[3x] 14 March 1989

CAPITAL GAINS: MISCELLANEOUS PROPOSALS

In his Budget the Chancellor proposes:-

(i) to increase from £3,000 to £5,000 the exemption for chattels, including chattels used in a trade, with effect from 6 April 1989;

(ii) to maintain the annual exemption at its present level. For 1989/90 (as for 1988/89) an individual will be exempt on the first £5,000, and most trusts on the first £2,500 of gains;

(iii) to extend the exemption from capital gains tax, and corporation tax on gains, for disposals of qualifying corporate bonds to non-convertible sterling bonds generally. The change will apply to disposals made on or after 14 March 1989 of non-convertible sterling bonds, and to options and contracts to acquire or dispose of such bonds.

It is also proposed to make some minor technical amendments to clarify the application of rebasing in some special circumstances. The detailed provisions will be included in the Finance Bill.

NOTES FOR EDITORS

Exemption for chattels

1. A chattel is an item of tangible movable property such as a picture, antique, piece of jewellery etc. Business assets which are chattels include plant and machinery. Under present law the gain accruing on the disposal of a chattel is exempt from capital gains tax if the consideration for the disposal does not exceed £3,000. The charge is tapered where the consideration just exceeds this amount. The new limit of £5,000 will apply to disposals on or after 6 April 1989 in the same way as the present limit.

/Annual exempt

pittsbd.pr

Annual exempt amount

2. At present an individual whose total net gains in a year of assessment do not exceed £5,000 is not liable to capital gains tax. This exemption is also available to the trustees of a mentally disabled person or a person in receipt of attendance allowance, and to personal representatives for gains accruing to them in the year of death and the two following years of assessment. For trustees of other settlements the exempt amount is £2,500.

Qualifying Corporate Bonds

3. Disposals of qualifying corporate bonds have been exempt from capital gains tax since 1984. At present the exemption is limited to non-convertible sterling bonds which

- from the time of issue have been quoted on the UK Stock Exchange or dealt in on the Unlisted Securities Market; or
- issued by a UK company or other body with shares or securities quoted on the UK Stock Exchange or dealt in on the Unlisted Securities Market.

It is proposed to remove this limitation.

Rebasing

4. In the 1988 Finance Act the base date for computing capital gains was brought forward from 1965 to 1982. The Finance Bill will include some minor clarifications of the rebasing rules. Very few people are likely to be affected. The main changes concerned will be designed to ensure that:-

(i) rebasing will eliminate the charge on certain gains deferred before 1982. This change will apply to disposals on or after 6 April 1988 - the start date for the general rebasing provisions; and

(ii) an appropriate adjustment is made to an asset's 1982 value where there has been a small part-disposal between 1982 and 1988 but the consideration received exceeded the allowable expenditure. This will have effect for disposals on or after 6 April 1989.

TEXT SUBMITTED TO FST FOR APPROVAL (MR SHAW)

BUDGET CONFIDENTIAL

INLAND REVENUE

Press Release

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

[3x] 14 March 1989

TAXES MANAGEMENT: MEASURES TO MODERNISE THE COMPLIANCE SYSTEM

The Chancellor proposes in his Budget to introduce measures to

- simplify and update the system of interest and monetary penalties for tax offences, and
- modernise the information and search powers of the Inland Revenue and provide greater safeguards for the taxpayer.

These measures are based on recommendations of the Keith Committee for the reform of the compliance system for income tax, capital gains tax and corporation tax. They take account of extensive consultations with business and professional organisations. Together with measures introduced in the last two Finance Acts, they substantially complete the Government's programme of reform in this area.

Most of these measures will take effect immediately, although some will be introduced gradually over a lengthy transitional period.

MAIN PROPOSALS

1. The proposals are designed to modernise and simplify the administrative structure of the compliance system, to provide a proper balance between taxpayers' rights and obligations, and between the powers of the Revenue and safeguards for taxpayers. The proposals are in the following areas:

- civil penalties for tax offences;
- the compliance regime for employers' PAYE;
- Revenue interest provisions;
- time limits for assessments on tax offenders and claims for further reliefs;
- Revenue information powers, including protection for accountants broadly equivalent to that for lawyers;

/- a new criminal

- a new criminal offence for the intentional falsification or destruction of documents called for under the Revenue's information powers;
- Revenue search powers;
- seizure of goods to meet tax debts.

DETAILS OF MAIN PROPOSALS

Civil penalties for tax offences

2. It is proposed to update, simplify and streamline the system of civil penalties for tax offences. This will result in a simpler structure of penalties which can be applied easily and fairly, so that offences of similar seriousness attract similar penalties.

3. Tax offences can be divided into four groups, each with its own type of penalty. The new proposals bring these penalties up to date, restore limits eroded by inflation, remove obsolete limits and eliminate differences within each group.

4. First, there is the group of fully-mitigable tax-geared penalties for offences that put tax seriously at risk - for instance, omissions from tax returns and very long delays in completing personal tax returns, continuing beyond the end of the tax year following the year in which the return is issued. The penalties for offences in this group are, at present, up to £50 plus 100 per cent, or in some cases 200 per cent, of the tax underpaid or paid late. In practice, the penalties are based on 100 per cent of the tax and further mitigated according to the seriousness of the offence. It is proposed to bring the law into line with practice, and make the penalty 100 per cent of the tax, fully-mitigable, for offences in this group.

5. Second, there is the group of fully-mitigable fixed limit penalties for offences that help to put tax seriously at risk - for instance, where a business omits payments to persons in the black economy from an information return or an accountant helps a taxpayer to prepare a false return. The penalties for offences in this group are, at present, up to £250, or, in certain cases, £500. It is proposed to increase these penalties in line with inflation since they were last set in 1960, and to eliminate the differences. This will give a single penalty of up to £3000, fully-mitigable, for each offence in this group.

6. Third, there is the group of fully-mitigable fixed limit penalties for delay. These arise in the present compliance regimes, where the Revenue can take proceedings before the Appeal Commissioners to force a taxpayer to complete an overdue return - for instance, for a personal tax return or an information return from a business. The penalties for offences in this group are, at present, up to £50 for the initial offence, and up to £10 per day if it continues thereafter. It is proposed to increase these limits in line with inflation since they were last set in 1960, to up to £300 for the initial offence, and up to £60 per day if it continues thereafter, both fully-mitigable.

/7. Offences

7. Offences in this group can be further subdivided into obligations which are imposed at the Revenue's discretion, for instance to complete a tax return, and obligations which are imposed automatically by law, for instance to account to the Revenue for tax deducted at source. It is proposed to add a further safeguard for the taxpayer, for offences within the first category, by providing for a final warning to be given to complete the overdue return before a penalty can be awarded. It would not be appropriate, however, to allow a final warning before penalties can be awarded for offences in the second category.

8. Fourth, there is the group of automatic, that is non-mitigable, penalties for failing to make returns. These arise in the more modern compliance regimes, where the taxpayer is automatically required to complete a return. A modern compliance regime for companies, known as Pay and File, was introduced in Finance (No 2) Act 1987. It is now proposed to introduce a broadly similar, modern compliance regime for employers and this is described further below.

A modern compliance regime for employers

9. At the end of the tax year, the employer is required to make an end of year return providing details of pay, PAYE and NIC deductions for his employees (forms P14, P35 and P38/38A). At present, the end of year return is due on April 19. It is proposed to change the due date to May 19 and to introduce a new system of penalties for late returns. (NB These proposals relate only to the end of year returns. Other employer's returns, including forms P11D, will continue to be dealt with under the present compliance regime.)

10. It is proposed to introduce automatic penalties for late end of year returns. This will be a penalty of £100 for each 50 employees, and for each month the return is late up to 12 months. The automatic penalties will not begin before 1995.

11. It is proposed to tighten up the compliance rules gradually over the transitional period, starting with the 1989/1990 return due on 19 May 1990 and continuing up to the introduction of automatic penalties. Under these proposals, the Revenue will be able to take proceedings before the Appeal Commissioners for late end of year returns. The Commissioners will be able to award an initial penalty of up to £1200 per 50 employees. If the failure continues thereafter, automatic penalties of £100 per 50 employees and per month will be charged for further delays, up to 12 months after the original due date. There would be no final warning before proceedings were taken, but in the first year of operation, proceedings would not be taken for returns that were less than three months overdue, that is that were made by 19 August. This would be reduced progressively over the transitional period, to allow penalty proceedings to be taken for any late return from 1995 onwards.

12. It is proposed also to introduce a separate, fully-mitigable penalty for delays in completing end of year

/returns of more

returns of more than 12 months and for incorrect end of year returns, of up to 100 per cent of the tax underpaid or paid late as a result.

13. These proposals for PAYE deductions apply in the same way to NIC deductions, which are collected with them, and to deductions under the scheme for subcontractors in the construction industry, which are collected under similar rules.

Default interest

14. Where tax is assessed late as a result of an offence by a taxpayer, interest is charged from the date that the tax would have been due if it had been assessed at the correct time. It is proposed to extend this "default" interest more generally, to any tax which is assessed late as a result of an incorrect return. This is to eliminate the advantage that the taxpayer would otherwise enjoy over a taxpayer who completed his return correctly, and to compensate the Exchequer for the delay in payment of the tax.

Determining default interest and penalties

15. It is proposed to introduce a simpler and more streamlined procedure for charging default interest and penalties. Under the new procedure, the Revenue will make a formal determination of the penalty, or that default interest is due. This will be similar to an assessment. It will not alter in any way the taxpayer's rights to challenge whether default interest or a penalty is due, or the amount thereof, before the Appeal Commissioners or the Courts.

16. The new procedure will not apply to the initial penalties in the present compliance regimes (see paragraph 6 above), as these can be awarded only where proceedings are taken before the Appeal Commissioners.

Interest provisions

17. Changes to the interest rates charged on late payments to the Revenue, and paid on repayments by the Revenue, are presently made by statutory instrument. This is a slow and cumbersome procedure which makes it difficult to keep rates closely in line with the market. It is proposed to introduce a more open and streamlined procedure under which formulae by which rates are to be set would be made by statutory instrument, and rate changes would then be made automatically to follow changes in market rates.

18. It is proposed to redraft the rules for charging interest on overdue tax, but without changing the way in which they work. The purpose of the redraft is to make the provision easier to understand and to remove a possible technical defect in the drafting.

19. The main rule is that interest does not start to run on tax in dispute until six months after the normal due date. The rules were amended in 1982 to provide that interest ran in the same way

/where an assessment

where an assessment was increased on appeal. The Revenue have always applied this rule in the way it was intended to work. It now appears that it may be defective in certain exceptional cases where an assessment is first reduced by the Commissioners and then increased by a higher Court. For avoidance of doubt, it is proposed to correct this possible defect. As the purpose of the correction is to confirm the way in which the law has been applied since 1982, the amendment will be retrospective to 1982.

20. All repayments by the Revenue are made by payable order. A wide range of provisions require the Revenue to include interest with the repayment which is calculated up to the day that the payable order is issued. There is now doubt that this is the effect of the wording in some cases. It is, therefore, proposed to amend these provisions to use common wording which puts it beyond doubt that interest is to be calculated up to the day that the order is issued. Here too the purpose of the correction is to confirm the way in which the law has been applied and the changes will therefore be retrospective.

21. It is proposed to introduce a new procedure for companies, to come into effect together with Pay and File (the new system for payment of corporation tax, which will not start earlier than 1992) to allow repayments to be surrendered within groups. Under this procedure, a company would be able to surrender a repayment of corporation tax, income tax, or payment of tax credit, to another company within the same group. The surrendered payment would be treated as if it had originally been made by the receiving company for the same accounting period. The purpose of this provision is to allow groups to rearrange tax liabilities within the group without being subject to the differential that is proposed for Pay and File between the interest rates on overdue tax and on repayments.

Time limits

22. The normal time limit for making an assessment of tax is six years from the end of the period being assessed. This is extended, in some cases indefinitely, for assessments made to recover tax which has not been paid as a result of an offence by the taxpayer. It is proposed to introduce a uniform time limit of 20 years for these "default" assessments. This brings the time limits for direct taxes into line with those for VAT.

23. Taxpayers are allowed extra time to make claims for reliefs against default assessments. It is proposed to introduce a similar extension of time limits for claims to relief where the Revenue discovers that further tax is due but there is no offence by the taxpayer - for instance as a result of an innocent error. The taxpayer will be allowed to make, or vary, claims to reliefs up to one year after the assessable period in which the discovery assessment is made, so as to reduce his tax liabilities by up to the amount charged by the discovery assessment.

Information powers

24. It is proposed to update the Revenue's powers to call for information about a taxpayer whose affairs are under enquiry. At

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present, the Revenue can call only for documents which are already in existence. It is proposed to allow the Revenue to require the taxpayer to give written answers to written questions of fact. This brings the Revenue's information powers into line with the similar powers of the Appeal Commissioners.

25. At present, the working papers of an accountant are protected from disclosure under the Revenue's information powers. It is proposed to replace this by a better focused protection which protects audit papers from disclosure by a company's auditor and tax advice from disclosure by a taxpayer's tax adviser, but allows the Revenue access to facts essential to the understanding of a taxpayer's return and accounts. The new provision will give accountants protection which is broadly equivalent to that given, for tax, to lawyers.

26. Furthermore, it is proposed to give additional safeguards to the taxpayer, in line with police search powers, by protecting personal records and journalistic material from disclosure to the Revenue; and, except in certain serious cases where the notice is given by the Board of Inland Revenue, to allow not less than 30 days for the documents or information to be produced.

Falsification of documents

27. It is proposed to introduce a criminal sanction against the falsification or destruction of documents which the Revenue has called for under its information powers.

28. This will provide that a person who intentionally falsifies or destroys a document which the Revenue has called for under its information powers is guilty of a criminal offence. He is automatically released from this obligation to preserve the document once it has been seen by the Revenue, six months after the initial informal request for access has been made and, unless the Revenue renews its request for access, two years after the formal request. He can also apply to the Revenue or to the Appeal Commissioners to be released from the obligation. A person guilty of an offence under this provision will be liable, on summary conviction, to a fine not exceeding £2000 or, on conviction on indictment, to an unlimited fine and to imprisonment for up to two years.

Search powers

29. It is proposed to update the Revenue's search powers, to restrict them to cases of serious fraud and to provide further safeguards for the public in line with police and VAT search powers.

30. It is proposed to make the search warrant more specific, so that the warrant must show, and the Judge approve, the number of Revenue officers who may carry out the search, the time of day at which it is to be carried out and whether a uniformed police constable should be present.

31. The officer conducting the search will be allowed to take with him other persons whom he considers to be necessary, for

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example a locksmith or an interpreter. Persons on the premises may be searched, but only by a person of the same sex - this can, for instance, be necessary if the taxpayer tries to conceal a bank book in his pocket whilst the search is in progress.

32. It is proposed to introduce detailed rules for the conduct of the search, requiring the officer in charge of the search to give a copy of the warrant, endorsed with his name, to the occupier if he is present or to leave a copy of the warrant prominently displayed on the premises. The officer will be required to leave a list of things seized from the premises. The warrant will be required to be returned to the Court, to be retained there for 12 months and to be available for inspection by the occupier of the premises to which it relates. This last provision, in line with the corresponding provision for police searches, applies to England and Wales only.

33. It is proposed to introduce detailed rules, in line with those for police search powers, to allow the taxpayer access to documents seized in the course of a search. Where a copy of the things seized would be sufficient as evidence or for the investigation, the original will be returned to the taxpayer. The taxpayer will also be given a right of access to the property seized, and to take copies thereof, except where this would be prejudicial to the investigation or criminal proceedings.

Seizure of goods to meet a tax debt

34. It is proposed to update the Revenue's powers to seize goods to meet a tax debt. The main changes are designed to update the wording without changing its meaning. Changes are also proposed to the rules for break-open warrants and priority claims.

35. Break-open warrants, allowing forcible entry to premises, are, very occasionally, needed in order to seize goods to meet a tax debt. At present, the warrant has to be obtained from the General Commissioners. It is proposed to change the level of authority to a Justice of the Peace, so as to provide greater judicial oversight of the power.

36. Where a third-party has seized goods to meet a debt, the Revenue can, in some circumstances, claim up to one year's tax debts from him. It is proposed to restrict the Revenue's priority claim to tax debts for deductions of PAYE and from subcontractors in the construction industry made in the last 12 months. This is in line with the provisions in the 1985 Insolvency Act which reduced the Inland Revenue's preferential claims in an insolvency.

NOTES FOR EDITORS

The Keith Report

1. The Keith Committee on the enforcement powers of the Revenue Departments was set up in July 1980 to

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enquire into the tax enforcement powers of the Board of Inland Revenue and the Board of Customs and Excise. It was chaired by a Law Lord, Lord Keith of Kinkel PC. The Committee took evidence from bodies representing industry, trade, the professions and trade unions, as well as from individuals and from the Revenue Departments.

2. The Committee's Report is in four volumes. Volumes 1 and 2 were published (Cmnd 8822) on 23 March 1983 and covered income tax, corporation tax, capital gains tax and VAT.

3. Since publication, extensive consultations have been held with a number of representative bodies.

4. Proposals in response to the recommendations in Volumes 1 and 2 of the Report were published in a consultative document "The Inland Revenue and the Taxpayer" in December 1986. Measures based on these proposals were included in the Finance (No 2) Act 1987 and in the Finance Act 1988.

5. Further suggestions for implementing the remainder of the recommendations in Volumes 1 and 2 of the Report were published in a consultative paper "Keith: Further Proposals" in July 1988. This year's proposals are based on these further suggestions, modified in the light of responses to the consultative paper.

6. This year's proposals complete the Government's programme of legislation for implementing the recommendations of the Keith Committee for income tax, capital gains tax and corporation tax, except for the recommendations on the administration and conduct of appeals. The Government has announced that proposals for legislation in this area are being considered by the Inland Revenue and the Lord Chancellor's Department and will be the subject of a separate consultative document or documents.

<u>Compliance cost assessments</u>

7. Assessments of the compliance costs of proposals affecting businesses are available. A copy of the compliance cost assessment for this proposal can be obtained from:

Inland Revenue
Deregulation Unit
Room 77
New Wing
Somerset House
LONDON, WC2R 1LB

[3x] 14 March 1989

OFFSHORE UMBRELLA FUNDS

The Chancellor proposes in his Budget that switches made on or after today within offshore "umbrella" funds should be taxable. This will mean that switches within offshore funds and onshore unit trusts will have the same tax treatment.

DETAILS

Currently, where a switch is made from one class of investments in an offshore fund to another, there is no disposal for tax purposes. From today, UK investors will be liable to tax on any gain arising when they switch holdings within an offshore fund or any other "umbrella" collective investment scheme.

For offshore funds, the treatment of switches will follow the existing treatment for disposals of holdings. In the case of offshore funds not certified by the Inland Revenue as "distributing funds" the charge will be to income tax (under Case VI Schedule D). In all other cases the charge will be capital gains tax.

NOTES FOR EDITORS

1. The term "umbrella fund" applies to investment funds whose investments are divided into different sub-funds, the rules of the fund permitting investors to switch their investments from one sub-fund to another. They commonly take the form of "open-ended" investment companies whose share capital can be increased or decreased at will.

2. Switching within offshore funds is at present covered by the share reorganisation provisions in Section 78 CGTA 1979 which effectively exempt the investor from any tax liability. Under the legislation proposed by the Chancellor, Section 78 will be disapplied for such switches. Consequently there will be a disposal for all capital gains tax purposes, including the offshore funds provisions in Chapter V Part XVII ICTA 1988.

3. The charge on switches within UK unit trusts is currently provided for by Section 78 F(No.2)A 1987. The present proposal will cover switches in all umbrella collective investment schemes. This will enable Section 78 (F(No.2)A 1987 to be repealed.

Draft

INLAND REVENUE

Press Release

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

14 March 1989

[3x]

THE BUDGET 1989 : INCOME TAX

1. The Chancellor proposes in his Budget

- to increase the main income tax allowances and the basic rate limit by about 6.8 per cent in line with the statutory indexation requirement;

- to extend to those aged 75 and over the higher level of age allowance currently given to those aged 80 and over;

- to reduce the rate at which the age allowance is withdrawn when a taxpayer's income exceeds the aged income limit;

- to make no change in the basic and higher rates of income tax.

2. The changes will mean that most single taxpayers and married women will pay 87p per week less tax and most married men will pay £1.34 per week less tax. The tax reductions, including any tax overpaid from 6 April, will be in pay packets on the first pay day after 17 May.

3. The increases in allowances are the amounts required under statutory indexation based on the increase in the Retail Price Index of 6.8 per cent in the year to December 1988, rounded in accordance with the statutory provisions. The married man's allowance is increased by £280 to £4,375 and the single person's allowance and wife's earned income allowance are increased by £180 to £2,785. The additional personal allowance (mainly for single parents) and the widow's bereavement allowance - which are automatically equal to the difference between the married and single allowances - increase by £100 to £1,590.

4. Age allowances are also increased: by £220 to £3,400 for single people aged 65 to 74 and by £350 to £5,385 for married couples aged 65 to 74. For those aged 80 and over, the single

/age

age allowance is increased by £230 to £3,540 and the married age allowance is increased by £360 to £5,565. The higher level of age allowance currently given to those aged 80 and over is extended to those aged 75 and over. For those aged 75 to 79, the single age allowance is increased by £360 from £3,180 to £3,540 and the married age allowance by £530 from £5,035 to £5,565.

5. The income limit for age allowances rises to £11,400 and the rate at which age allowance is withdrawn above the income limit is reduced from £2 of allowances for every additional £3 of income to £1 allowances for every additional £2 of income. The effective rate of tax in the withdrawal band will fall from 41.67 per cent in 1988-89 to 37.5 per cent in 1989-90.

6. The Chancellor also proposes to increase the basic rate limit by the amount indicated by the indexation formula, that is by £1,400 to £20,700 of taxable income. The increases in the basic rate limit and the allowances mean that a single person with income of over £23,485 will pay £282 less tax in 1989-90 and a married men with income over £25,075 will pay £322 less tax if they have no other allowances or tax reliefs.

7. The Chancellor's proposals in detail are as follows:

(1) <u>Income Tax Allowances</u>

	1988-89	Proposed increase		1989-90 Proposed level
	£	£	per cent	£
Single person's allowance and wife's earned income allowance	2,605	180	6.9	2,785
Married man's allowance	4,095	280	6.8	4,375
Additional personal allowance and widow's bereavement allowance	1,490	100	6.7	1,590
Single age allowance (age 65-74)	3,180	220	6.9	3,400
Single age allowance (age 74-79)	3,180	360	11.3	3,540
Single age allowance (age 80 and over)	3,310	230	6.9	3,540
Married age allowance (age 65-74)	5,035	350	7.0	5,385
Married age allowance (age 75-79)	5,035	530	10.5	5,565
Married age allowance (age 80 and over)	5,205	360	6.9	5,565
Age allowance income limit	10,600	800	7.9	11,400

/(2)

(2) Rates and Rate bands

Rate of tax	1988-89 taxable income	Proposed increase in starting point		1989-90 Proposed taxable income
per cent	£	£	per cent	£
25	0-19,300	-	-	0-20,700
40	Over 19,300	1,400	7.3	Over 20,700

8. The total direct revenue costs of these proposals will be about £1.5 billion in 1989-90. The changes to the structure of age allowances above the level required for indexation will cost £15 million.

Costs (£ million)	1989-90		1990-91
	total costs	costs above indexation	costs above indexation
Increases in main personal allowances	1,140	-	-
Increases in age allowances and income limit	125	10	15
Reduction in age allowance withdrawal rate	5	5	5
Increase in basic rate limit	210	-	-
Totals	1,480	15	20

9. The Chancellor also proposes in his Budget to reduce the employee's levels of National Insurance Contributions (NIC) from 1 October 1989. The rates will be as follows:-

Weekly Earnings £	NIC Rate %
Under 43	0
43 - 75	5
75 - 358	9
Above 358	0

The rates will be applied in the following manner:

- for those earning less than £43, no NIC is payable;
- for those earning between £43 and below £75, NIC is payable at 5 per cent on the full amount of earnings;
- for those earning £75 or more, NIC is payable at 5 per cent of £75 plus 9 per cent of the earnings above £75 up to total earnings of £358.

/The

The rebate for those contracted out of SERPS is unchanged at 2 per cent. Full details of the changes to NIC rates are given in a Press Notice by the Department of Social Security published today.

Illustrative changes

10. The effects of the changes on individual taxpayers at various levels of income are illustrated in the attached tables, which assume that the taxpayer has no reliefs other than his or her personal allowance. Tables 1 and 2 show the effects of the changes in income tax proposed in the Budget for 1989-90 for single and married taxpayers compared with 1988-89. Tables 3A-3C shows the effects for people aged 65 to 74, 74 to 79 and those aged 80 and over. Tables 4,5A to 5C give information in weekly, instead of annual, terms for levels of income up to £600 a week.

11. Tables 6 and 7 show the effects on the weekly net income of single and married taxpayers and families with two children, after taking account of the new structure of National Insurance Contributions to be introduced in October and child benefit.

12. The remaining tables illustrate the effect of the income tax and National Insurance Contributions changes after taking account of the effects of increases in earnings. For illustration, an increase in earnings of 7.5 per cent has been assumed. This is the rate of increase between 1988-89 and 1989-90 taken by the Government Actuary as a working assumption for his annual review of National Insurance Contributions (see paragraph 3.02 of the Autumn Statement 1988). Table 10 includes the effect of child benefit for a married couple with two children. Finally, Table 11 shows changes in the weekly income after tax of a married couple where both partners are working.

Note for Editors

The indexed figures for allowances and thresholds are set out in an Order made today by the Treasury under Sections 1(6) and 257(11) of the Income and Corporation Taxes Act 1988. Sections 1(4) and 257(9) of this Act require 1988-89 allowances and thresholds to be increased by the same percentage (6.8 per cent) as the percentage increase in the general index of retail prices (RPI) between December 1987 and December 1988; and

i. in the case of the rate bands and age allowance income limit, the result to be rounded up to the nearest multiple of £100; and

ii. otherwise, the increase to be rounded up to the nearest multiple of £10; although

iii. additional personal allowance and widow's bereavement allowance are automatically equal to the difference between the married man's allowance and the single person's allowance.

BUDGET CONFIDENTIAL

INLAND REVENUE

Press Release

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

[3x] 14 March 1989

INCOME TAX: COMPANY CARS

The Chancellor proposes in his Budget to increase the scale charges for taxing employees on the private use of company cars by [20] per cent. This is a further step in reducing the undervaluation of company cars for tax purposes. The changes will take effect from 6 April 1989.

The increase will affect approximately 1.4 million directors and employees. It will yield £90 million in 1989/90 and £110 million in 1990/91.

No increase is proposed in the separate scales for fuel provided for private motoring in company cars.

DETAILS

1. Company cars are provided for directors and employees in a wide variety of circumstances. In some circumstances there is little or no business use and the car is provided essentially as part of the employee's remuneration. In other cases - more commonly - there is some significant business use, and many company cars cover a very large business mileage.

2. The car scales charge directors and employees earning over £8,500 a year on the benefit of having a car provided by their employer available for private use. While the car scales at present take broad account of the number of business miles for which the car is used, they are essentially concerned with the private use of the car, not its business use. They are a means of putting a figure for tax purposes on the value to the employee of having the car available for private use. The need for a car to cover a substantial business mileage does not reduce the value to the employee of its use for private purposes. The average private use of company cars does not vary significantly whether the business mileage is high or low.

Implementation

3. The new rates will take effect from 6 April 1989. The necessary legislation will be included in the Finance Bill. Tax

/ offices will review

offices will review and amend all PAYE codes containing an adjustment for car benefits individually to reflect the proposed scale charges. Employers and employees will be notified of the revised codes which will generally take effect on the first pay day after 17 May 1989, at the same time as the increases in personal allowances and thresholds are implemented.

A CAR BENEFIT SCALE CHARGES AND TAX INCREASES PROPOSED FOR 1989-90 FOR CARS UNDER 4 YEARS OLD

Original Market Value	Engine Size	Standard Scale Charge	Tax Increase for 1989/90 (Basic Rate Taxpayer)		
			High Business Mileage(1)	Average Business Mileage	Low Business Mileage(2)
£	cc	£	£	£	£
Up to 19,250	0-1400	1,260	26.25	52.50	78.75
	1401-2000	1,680	35.00	70.00	105.00
	2001 +	2,640	55.00	110.00	165.00
19,250 to 29,000	All	3,480	72.50	145.00	217.50
Over 29,000	All	5,520	115.00	230.00	345.00

B CAR BENEFIT SCALE CHARGES AND TAX INCREASES PROPOSED FOR 1989-90 FOR CARS OVER 4 YEARS OLD

Original Market Value	Engine Size(1)	Standard Scale Charge	Tax Increase for 1989/90 (Basic Rate Taxpayer)		
			High Business Mileage(2)	Average Business Mileage	Low Business Mileage(3)
£	cc	£	£	£	£
Up to 19,250	0-1400	840	17.50	35.00	52.50
	1401-2000	1,130	23.75	47.50	71.25
	2001+	1,740	36.25	72.50	108.75
19,250-29,000	All	2,330	48.75	97.50	146.25
Over 29,000	All	3,670	76.25	152.50	228.75

/TABLE C

C **CAR FUEL SCALE CHARGES IN 1989-90 (UNCHANGED)**

Engine Size cc	Scale Charge £
0-1400	480
1401-2000	600
2001+	900

(1) The car scale charges and the car fuel scale charge are reduced by half for a car used for 18,000 or more business miles a year.

(2) The car scale charges, but not the fuel scale charges, are increased by half for a second car or a car used for under 2,500 business miles a year.

3. Separate scale charges apply to cars <u>with unconventional engines</u> as follows:-

Original Market Value	Conventional Car Equivalent
less than £6,000	Up to 1400cc
£6,000 to £8,499	1401-2000cc
£8,500 to £19,250	Over 2000cc

/NOTES FOR EDITORS

NOTES FOR EDITORS

1. The Income and Corporation Taxes Act 1988 contains special rules (in Chapter II, Part V) for taxing benefits and expenses payments provided for directors and employees earning at a rate of £8,500 a year or more, including expenses and benefits. Under these rules the value of the benefit (its "cash equivalent") is added to his income and taxed at the taxpayers marginal rate.

2. The car scales give the amounts of the "cash equivalents" - the amount on which the employee will pay tax in respect of the benefit of having a company car available for private use in 1989/90. A typical company motorist (driving a 1600cc car less than 4 years old) will pay about £8.08 a week in tax for the car compared with £6.73 in 1988/89. (A further £2.88 a week will be payable if fuel is provided for private motoring.)

3. Both the car and car fuel scales are <u>halved</u> for the motorist who does 18,000 <u>business</u> miles or more in the tax year. The car scale (but not the fuel scale) is increased by 50 per cent if the car is a second company car or is driven for less than 2,500 business miles in the tax year.

4. The car scales (which were introduced in 1977/78) are reduced pound for pound for contributions which the employee is required to make for the private use of the car. The car fuel scale is reduced to Nil if the employee makes good <u>all</u> the fuel used for private journeys. Journeys between an individual's home and place of work are regarded as private motoring.

5. Since April 1987, the car fuel scale has been used to assess VAT due on fuel provided out of business resources for private motoring by registered traders and their employees as well as to determine the amount on which income tax is payable on free private fuel for company cars. The Chancellor's decision not to increase the car fuel scale charges in 1989-90 means that they will not have been increased since 1986.

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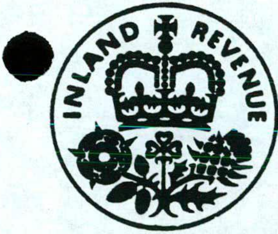

INLAND REVENUE

Press Release

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PHONE: 01-438 6692 OR 6706

[3X]

14 March 1989

NEW TAX RELIEF FOR EMPLOYEE SHARE OWNERSHIP PLANS (ESOPs)

The Chancellor proposes in his Budget a new tax relief to encourage companies wishing to promote employee share ownership through arrangements including specially set-up trusts (commonly known as ESOPs).

Payments by companies to ESOP trusts set up to distribute shares to the company's employees will qualify for corporation tax relief, provided certain conditions are met. Key features of the qualifying conditions will be that shares must be distributed to employees within a maximum of 7 years of their acquisition by the trust, and on an all-employee, similar terms, basis.

"

1. Various tax reliefs are already available in connection with trusts set-up to run approved employee share schemes under legislation introduced in the Finance Act 1978. But some companies wish to encourage employee share ownership through ESOP trusts, which may differ in some important respects from trusts set up under the 1978 legislation. In particular, ESOP trusts

- may borrow to acquire their shares rather than relying entirely on funds provided by the company

/ may need to hold

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- may need to hold shares for a longer period (for example, while repaying borrowings) than the maximum 18 months permitted under the 1978 scheme

- may wish to distribute larger amounts of shares to employees than is possible under 1978 schemes

- in the case of unquoted companies, may wish to provide a market for the company's shares for the benefit of employees.

2. At present there are no tax reliefs expressly directed towards ESOPs. Depending on the particular circumstances, company contributions to ESOP trusts may qualify for relief from corporation tax under the general rules of Schedule D. But there is at best some uncertainty over entitlement to this relief; and it is clear that for ESOPs wishing to operate in some particular circumstances relief would not be available. The Government believes that this uncertainty may discourage companies wishing to set up trusts of this type for the benefit of their employees. The new relief proposed will overcome this obstacle and provide more certainty for companies to distribute their shares to their employees through ESOPs.

3. The Chancellor's aim in introducing this new relief - as with the three existing employee share schemes which qualify for tax reliefs - is to encourage individual employees to own shares in the businesses in which they work. To ensure that this objective is met, the new statutory relief will depend on the trust meeting qualifying conditions. These will include requirements that:

- all employees of the company must benefit on similar terms;

- there are no beneficiaries other than employees of the company;

- shares must be acquired by the trust within a specified time, and must be distributed to employees within 7 years of acquisition;

/ a majority of the

- a majority of the trustees must be independent of the company and of those who have, or have had, a substantial interest in it.

Detailed provisions will be included in the Finance Bill.

4. ESOP trusts which meet the qualifying conditions will not qualify for any other tax relief. Such a trust will therefore be liable to income tax and capital gains in the normal way, and employees receiving shares will be liable to income tax if they pay less than market value for them. An ESOP trust may, however, operate in conjunction with a profit-sharing trust set up under the 1978 legislation, and distribute shares to employees through it. Provided the necessary conditions are met, the employees will then not be liable to income tax on any shares given to them.

/NOTES FOR EDITORS

NOTES FOR EDITORS

1. There are three separate schemes designed to encourage employee share ownership.

2. Under the 1978 all-employee profit sharing scheme, corporation tax relief is given for company contributions to a trust set up to distribute shares to employees. The trust is exempt from additional rate income tax and from capital gains tax, and shares distributed free to employees are exempt from income tax provided they are held at least 5 years. Various limits apply, for example shares must be appropriated to employees within 18 months of acquisition and there are limits on the value of the shares which can be appropriated each year to employees (these are increased in the Budget - see separate Press Release).

3. There are also two share option schemes introduced in 1980 and 1984. Under these employees can be exempt on share option gains where the qualifying conditions are met. The limits for the 1980 all-employee share option scheme are also increased in the Budget.

4. Some of the conditions for relief for a qualifying ESOP trust will be similar to those under the 1978 scheme. For example, under the 1978 scheme benefits must also be made available to all employees on similar terms.

5. As indicated in paragraph 1, a qualifying ESOP trust will be able to undertake a much wider range of activities than a trust set up under the 1978 scheme. For example, such a trust cannot borrow or make a market in shares.

[3x] 14 March 1989

PENSIONS: TAX RULES SIMPLIFIED

The Chancellor proposes in his Budget today important changes in the tax rules for pensions. These will

- simplify the rules for pension schemes, employers and employees;

- permit greater flexibility in pension provision;

- lift the administrative burden on employers and pension schemes; but

- place a limit on the amount of tax relief available.

The changes are:

* New freedom for employers to provide whatever pension they want (but without additional tax relief)

* Simplification of the tax rules for occupational pension schemes, particularly affecting those who leave or retire early

* No tax advantages for pensions which arise from earnings in excess of £60,000

* A new approach to additional voluntary contributions (AVCs), which will greatly reduce the burden on employers, and make it much easier for employees to take out freestanding AVCs

* Better arrangements for personal pensions, including higher contribution limits for those over 35, a better way of calculating lump sum benefits, and greater freedom for members to control the investment of their money.

/The restriction of tax

The restriction of tax advantages for pensions based on earnings above £60,000 a year will affect <u>only</u> those joining a pension scheme on or after today (14 March). Other changes will apply from Royal Assent to the Finance Act.

DETAILS OF THE PROPOSALS

1. The Chancellor is retaining the existing broad framework for the tax treatment of pensions. But within that framework a numbe of significant changes are proposed, with the objective of making the system simpler, fairer and more flexible. And, by limiting the amount of tax relief available to very high earners, the reliefs for pensions will be brought into line with most other tax incentives.

2. The Government recognises that the last few years have involved a major upheaval for the pensions industry, from tax and other changes. The Chancellor therefore intends to make no further changes this Parliament to the tax treatment of pensions.

<u>Occupational Pensions</u>

3. A pension scheme satisfying certain conditions about the bneefits it pays will be approved by the Inland Revenue, in which case various tax reliefs apply to it:

- relief for employer's and employees' contributions
- tax-free build-up of the fund
- lump sum benefits may be paid tax-free.

4. However, it is not possible at present for an employer to set up two schemes, one with tax relief and one without, if the <u>combined</u> benefits exceed the normal limits for tax approval. The result is that the limits on tax relief have come to determine the total pension an employee can receive, and the form it takes. At the same time, since the tax rules tie pensions to final salary, there is no upper limit on the tax relief involved: the higher someone's earnings, the more pension they may receive, and the more tax relief is likely to be involved.

5. The Chancellor proposes two main changes:

- First, employers will in future be able to set up <u>"top-up" schemes</u>, without the usual tax advantages, to provide more generous benefits than the tax rules allow. Thus the Inland Revenue will no longer effectively restrict the total pension provided.

  But, second, there will in future be a <u>limit on the total tax relief available</u>: for new members of pension schemes, earnings in excess of £60,000 will be disregarded for the

/purposes of calculating

purposes of calculating benefits payable from a tax approved scheme. This limit has been set at a level at which the vast majority of pension scheme members will be unaffected.

6. The result will be that, for those joining a scheme from today, the maximum pension payable from tax approved occupational scheme will be £40,000 a year (two-thirds of £60,000). Some of this may be commuted for a tax-free lump sum: the maximum lump sum will be £90,000. The figure of £60,000 will be increased annually in line with inflation.

7. These changes make it possible to introduce a number of simplifications (which also apply to those joining a scheme from today) in the detailed rules for tax approved schemes. In particular:

- a maximum two thirds final salary pension may be paid on retirement between ages 50 and 70, subject to completion of 20 years' service with an employer.

- the maximum tax-free lump sum will be the better of 3/80 of inal salary for each year of service up to 40, or 2.25 times the amount of pension before commutation.

In general these simplifications will be more generous than the present rules.

8. The tax treatment of non tax-relieved "top up" pension schemes will broadly follow from existing legislation. It will be possible to set up such schemes as soon as the Finance Act has received Royal Assent.

9. Most tax-approved pension scheme will need to amend their rules, for new members. The Finance Bill will include legislation to override their present rules, unless they choose to be excluded. This approach, which was used to implement changes made in the 1987 Budget, saves schemes a great deal of work in changing their rules and resubmitting them to the Inland Revenue for approval.

Additional Voluntary Contributions

10. The present rules for additional voluntary contributions (AVCs) to a pension scheme, and in particular those for "freestanding AVCs" (ie paid to a separate pension plan of the member's choice), date from October 1987. They went with social security legislation which gave employees the right to pay AVCs to their own scheme, or to a freestanding scheme.

11. Before an employee can pay contributions to a freestanding AVC provider, the provider has to check with the employer's scheme that maximum benefits are not likely to be exceeded. That requires co-operation from the employer's scheme, and can involve that scheme in a lot of work. Further checks must be carried out at intervals to retirement. If, despite these checks, the total

/benefits payable on

benefits payable on retirement exceed the tax limits, the employer's scheme must cut back the benefits it provides. To that extent, the employee's contributions will have been wasted.

12. The Chancellor proposes a new approach to AVCs:

- Any "excess" at retirement, or on leaving employment, will no longer go to waste. Instead, it will be returned to the employee subject to a tax charge which broadly corresponds to the tax relief received on contributions, and on build-up of funds.

- The procedure on first paying AVCs will be radically simplified. For those making payments less than £2,400 (well above the average contribution) the AVC provider will make a few simple checks: there will be no need for the employer to be involved at all.

- For larger amounts the employer will need to provide some relatively straightforward information.

- There will normally be no need for further checks until retirement (or leaving employment).

13. This new approach will be available from Royal Assent to the Finance Act. It should make it very much easier, and attractive, for employees to pay freestanding AVCs.

Personal Pensions

14. Personal pensions, available to employees and the self-employed since July 1988, may be used:

- by the self-employed

- by employees not covered by a pension scheme

- by employees who would prefer to have their own scheme rather than join their employer's

- by employees in an occupational scheme who wish to contract out of the State Earnings-related Pension Scheme (SERPS).

15. The Chancellor proposes three main changes to personal pensions:

* It will be easier, for those who wish to, to direct where their fund is invested

* The contribution limits for members over 35 will be more generous

* The calculation of the tax-free lump sum will be changed - in most cases the result will be more generous.

/17. At the same time,

16. At the same time, as with occupational pensions, a limit will be placed on tax relief, which will not be available for contributions related to earnings in excess of £60,000. This figure will be increased annually in line with inflation.

17. [Expand on personalised funds. Depends on how far we get with DTI.]

18. The new contribution limits as a percentage of earnings, with the existing limits for comparison, are:

New Limits		Existing limits	
Age	%	Age	%
35 or less	17.5	50 or less	17.5
36-45	20	51-55	20
46-50	25	56-60	22.5
51-55	30	61 or over	27.5
56 and over	35		

19. These very significant increases, which apply from 6 April 1989, are intended to help those who cannot afford to make large contributions until later in their working life, but then wish to "catch up". The changes do not apply to retirement annuity contracts.

20. Finally, the lump sum which may be taken, tax-free, from a personal pension scheme at retirement, is currently calculated as 25 per cent of the total fund built up, including any "preserved rights" (the part of a personal pension corresponding to SERPS for those who have contracted out) but excluding the value of benefits for dependants. This is illogical, since preserved rights cannot be commuted for a lump sum. And it may encourage some people to cut back on their provision for dependants, so as to maximise the tax-free lump sum. In future, therefore, the calculation will exclude preserved rights and include dependants' benefits. For the majority of people the result will be more generous than now.

Cost

21. The overall pensions package will be broadly revenue-neutral. The small yield from the £60,000 earnings limit for tax-approved pension schemes will be offset by the cost of higher contribution limits (below earnings of £60,000) for personal pensions.

/NOTES FOR EDITORS

NOTES FOR EDITORS

1. The Chancellor announced a number of changes to the taxation of pensions in his 1987 Budget, including a limit on tax free lump sums of £150,000. Then, as now, the changes:

- applied to new pension schemes, and new members of existing schemes, from Budget Day; and

- were introduced by Finance Bill legislation overriding pension scheme rules.

Compliance Cost Assessments

2. Assessments of the compliance costs of proposals affecting businesses are available. A copy of the Compliance Cost Assessment for this proposal can be obtained from:

Inland Revenue
Deregulation Unit
Room 77
New Wing
Somerset House
London, WC2R 1LB

BUDGET CONFIDENTIAL

DRAFT PRESS RELEASE

[3X] 14 March 1989

LIFE ASSURANCE: IMPLEMENTING THE REVIEW

The Chancellor of the Exchequer proposes in his budget a two-stage programme of reform of the tax rules for life assurance companies.

The main structural measures to be included in the 1989 Finance Bill are

* a rate cut - income and capital gains attributable to policy holders to be taxed at basic rate ([25]per cent) instead of 35% and 30% respectively

* a broadening of the tax base - relief for the expenses of acquiring new life assurance business to be spread forward over seven years

  - pension and general annuity business expenses to be deductible only from pension and annuity business profits

  - other measures to put onto a more commercial basis the calculation for tax of pension business profits

* a duty abolished - life assurance policy duty to be abolished

The tax treatment of life assurance premiums and policy benefits in the hands of individuals will be unchanged. Consultation will continue on a number of more technical issues for inclusion in the 1990 Finance Bill. The whole package will come into effect from 1 January 1990 subject to special transitional provisions to assist the industry in the process of adjusting to the new regime.

Implementing the review of the taxation of life assurance

1. The proposals announced today carry forward the reform of life assurance taxation foreshadowed in an Inland Revenue consultative document published in June 1988.

2. This document set out the Government's main objectives

* an effective system

/*parity of treatment

* parity of treatment between life offices and other financial institutions

* a fair distribution of the overall tax burden on the industry between one life office and another, and between one policy holder and another

* adaptability, flexibility and simplicity so far as the complications of life assurance permit

* consistency with the obligations of life offices and the expectations of their policy holders

* recognition of freedom of services within the European Community.

3. In line with responses to the document, the Chancellor has decided against a radically new regime. He proposes instead a reform of the current rules which will preserve the existing basic framework but which tackles both the structural weaknesses identified in the consultative document and the important technical weaknesses acknowledged by the industry in its responses. Main structural changes will be implemented in the 1989 Finance Bill, followed by further consultation with the life assurance industry on more technical issues.

The package in detail

A. First stage - the 1989 Finance Bill

4. The proposals announced today for legislation in the 1989 Finance Bill affect only the corporation tax and policy duty paid by companies doing life assurance business. The tax treatment of life assurance premiums and policy benefits in the hands of individuals will be unaffected.

5. The Chancellor proposes from 1 January 1990:

i. abolition of life assurance policy duty, currently at 0.05 per cent of the sum assured;

ii. a reduced tax rate for income and gains attributable to policy holders equal to the basic income tax rate, at present 25 per cent. This will replace the current rates of 35 per cent and 30 per cent on income and gains respectively. A new formula will identify the policy holders' share of total income and gains;

iii. base-broadening changes to the rules for pension business profits, including

- a "ring-fence" around pension and other business expenses

- a consistent treatment of pension business incomings and liabilities, in line with industry accounting practice

/tax deductible

- tax-deductible reserves in line with the industry's accounting practice and regulatory requirements, but with special provision for extra reserves for tax purposes where necessary;

iv. a revised treatment for the expenses of acquiring new life assurance business. These expenses will be relieved as now but spread forward over seven years rather than allowed immediately. Transitional rules will phase in the change over four years so as progressively to reduce the proportion of expenses qualifying for immediate relief, thus -

1990: five sevenths

1991: four sevenths

1992: three sevenths

1993: two sevenths

Unrelieved expenses of 1989 and earlier years will retain their present right to immediate relief; and,

v. a number of more straightforward technical changes acknowledged by the industry in consultation as appropriate for action, including

- bringing into charge to tax miscellaneous income, such as securities underwriting fees,

- changes to limit the availability of loss and (where appropriate) group relief.

B. Second stage - further consultation on specific issues

6. The Chancellor has authorised the Inland Revenue to consult further with the industry on a number of issues identified by the review. This will be followed by legislation in 1990 to bring the whole package into effect from 1 January 1990. Topics for further consultation include:

i. identification of assets: if feasible, to apply the tax rules for different classes of business (life, pension, annuity, foreign) to the assets, income, gains and expenses actually attributable to each type of business, rather than apportioning totals as at present;

ii. the tax treatment of policy holders: to change the current "qualifying policy" and chargeable events rules so as to

- simplify them and minimise compliance and operational costs

- improve the effectiveness of the charge

/reduce

- reduce tax-induced distortions in the design of life assurance products;

iii. international aspects of life assurance: to improve the current rules for

- foreign branches of UK offices

- UK branches of non-resident offices

- cross-border business conducted on a "services" basis between UK offices or policy holders and counterparts in other European Community countries;

iv. the treatment of reassurance business: in particular to minimise the scope for erosion of the tax base and distortion of commercial decisions caused by tax-driven reassurance, cross border as well as domestic.

v. the future of captive investment vehicles: in the light of the new reduced tax rate on capital gains attributable to policy holders, to determine the proper tax treatment of those means currently used to shelter capital gains from a charge to tax.

[vi. investment-linked business: to consider further taxing this business more in line with that of unit trust investment, having regard to the changes announced today in the future tax rules for many unit trusts.]

Costs and yields

7. Estimates of the costs or yield of components of the package are subject to a wide margin of uncertainty. Only the firm proposals for legislation in the 1989 Finance Bill can be costed, and their effect will depend on future developments in the industry and in the markets in which it invests.

8. Subject to that, however, the package is estimated to cost about [£M] and yield about [£M] in 1990-91, assuming the basic rate is unchanged. As the transitional provisions work through, the yield will rise to a peak before falling away. The peak yield, and the ultimate cost or yield of the mature regime will depend on future tax rates as well as on developments in the industry.

NOTES FOR EDITORS

1. A review of life assurance taxation was first announced by the Chief Secretary to the Treasury, the Rt Hon John Major MP, on 8 July 1987. He said that it was intended

"to take a general look at the tax arrangements for life assurance which have developed piecemeal over a long period" (Official Report Vol 119, Col 362).

/In June

In June 1988 the Inland Revenue published a consultative document "The Taxation of Life Assurance".

In response, various representations were made, including a comprehensive submission by the Association of British Insurers (ABI).

2. The proposals announced today for legislation in the 1989 Finance Bill affect only the corporation tax and policy duty paid by companies doing life assurance business. The tax treatment of life assurance premiums and policy benefits in the hands of individuals will be unaffected by these proposals.

The need for a review

3. The current tax rules for life assurance provide in most cases for only one charge to tax, to be made jointly on the profits, income and gains of the life company and its policy holders. The policy holders themselves in the main have no tax to pay on policy benefits received. Life offices pay corporation tax on the investment income and capital gains attributable to their life assurance business and on the profits of pension and annuity business less expenses (including commissions and other expenses of acquiring new business).

4. This unique single tax base is intended to tax both the profits for the office from running the business and the returns earned for policy holders from the investment of their premiums. The premiums themselves are not taxed. Income, whether attributable to policy holders or shareholders is taxed at 35 per cent. Gains attributable to shareholders are taxed at 35 per cent but those attributable to policy holders at 30 per cent.

5. Because the current arrangements for taxing life assurance have developed in a piecemeal fashion over very many years, they contain a large number of weaknesses and uncertainties. Some are structural and of general application; others are more technical and restricted in scope.

6. As a result, the incidence of tax between offices is very uneven. Some policy holders end up effectively bearing an unfair share of the overall tax burden.

7. Life offices may also benefit in ways not available to other forms of saving (whether made directly by individuals or through media such as unit trusts). An example is that given to the expenses incurred by the company in obtaining new business. Tax relief for these expenses is allowed immediately even though the income and gains from the investment of the premiums from the new business obtained in this way will arise only in later years. As a consequence, some companies escape paying tax entirely.

8. Other structural and technical weaknesses resulted in

- the expenses of pension (and annuity) business spilling over and being allowed for tax against the

/investment income

investment income and gains of non-pension life business;

- a depressed measure for tax purposes of the profits of pension and annuity business
- the use by some life offices of "captive unit trusts" to shelter from tax realised gains.
- the use of reassurance arrangements to reduce tax

Government's objectives

9. The Government's aim has been to find a more effective tax regime in terms of the distribution of the tax burden between life offices and its overall yield. It is also concerned that the burden of the tax on policy holders should be fairer. Among other considerations the Government want as simple a system as the complications of life assurance permit, a flexible regime which can respond in the future to changes in life assurance and the reasonable expectations of policy holders. In addition, any solution would have to tie in with the Government's non-tax policies in relation to the financial sector generally and with freedom of services in the European Community.

Options for change

10. The document put forward three main options for change

- option A: for investment-linked business only, to tax income and gains directly on the individual policy holders by reference to their own tax circumstances
- option B: to replace the current regime by a new special tax regime (dubbed in the document Schedule X), specifically designed for life assurance and formulated on actuarial principles
- option C: to reform the current rules by tackling the structural and technical weaknesses identified in the document including action to restrict the current immediate relief for life business selling costs.

11. The document also raised the question as to the tax rates which would be appropriate given the options proposed for modifying the tax base for life assurance.

Representations on the document

12. The responses of the industry and other interested parties disclosed a broad consensus (set out most comprehensively in the submission of the Association of British Insurers in October 1988) that:

i. the document had identified a number of weaknesses in the current regime which merited action or further consideration;

/ii. but these weaknesses

ii. but these weaknesses, and the industry's taxpaying record, did not justify a radical change to the current regime;

iii. and further consultation was essential before any package of reform was implemented;

iv. so option C was the appropriate approach; without, however, any restriction to the current immediate relief for new business acquisition expenses or accelerating the charge on capital gains.

Government's decisions

13. On these main points raised by the industry, the Chancellor's decision, expressed in his Budget announcements, has been

- to choose option C

- to legislate immediately on the structural issues with most impact on the life assurance tax base: in particular, relief for new business acquisition expenses will be spread forward over seven years, (although this change will be phased in gradually); and the expenses of pension ad general annuity business to be set against pension and annuity business profits only

- to put the calculation of for tax pension business profits onto a more commercial basis

- to cut the tax rate on income and gains attributable to policy holders initially to the basic income tax rate.

- to undertake further consultations on specific technical issues, and to defer implementation of the package as a whole until January 1990.

Compliance cost assessments

9. Assessments of the compliance costs of proposals affecting businesses are available. A copy of the Compliance Cost Assessment for this proposal can be obtained from:

Inland Revenue
Deregulation Unit
Room 77
New Wing
Somerset House
London WC2R 1LB

INLAND REVENUE

Press Release

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

[3X] 14 March 1989

CHANGES IN THE TAX TREATMENT OF RELOCATION PAYMENTS TO EMPLOYEES

The Chancellor proposes in his Budget changes to the tax reliefs currently available under two Extra-Statutory Concessions for the expenses of employees who have to move home with their jobs.

These are:

- to provide, on broadly the same basis as the present extra-statutory concession, a statutory relief for removal expenses which employers either pay or reimburse.

- to withdraw relief for additional housing cost payments made by employers for moves to more expensive housing areas.

Subject to certain transitional arrangements, the changes take effect from 6 April 1989.

DETAILS OF THE CHANGES

Background to the Chancellor's proposals

1. The withdrawal of the relief for additional housing cost payments reflects the Chancellor's concern that the relief has tended to reduce market pressures on employers to relocate to areas where housing costs are lower and has contributed to house price increases in already high-priced areas, such as the South East.

2. Tax relief for removal expenses paid by employers for job related moves will, on the other hand, continue to play an important role in encouraging job mobility and job relocation. For this reason the Chancellor believes it should be retained.

/3. The relief for

3. The relief for removal expenses has existed for over 40 years, but many more employees now benefit from it than in earlier years. Consequently, although generally well known, it is no longer appropriate that the relief should continue on an extra-statutory basis. Appropriate provisions will therefore be included in the Finance Bill.

Relief for removal expenses

4. Under the terms of Extra Statutory Concession A5 (a) and (b) employees are not taxed on certain removal expenses which an employer pays or reimburses if they have to change residence either as a result of a job transfer with the existing employer or to take up a new employment. Relief is available only where it would be unreasonable to expect the employee to work at the new location without moving nearer to it and provided the employee has disposed of any interest in the home at the old location.

Finance Bill proposals

5. The Chancellor proposes that these conditions and the reliefs for removal expenses currently available under Extra-Statutory Concession A5 (a) and (b) should be broadly matched in the statutory relief. The detailed provisions in the Finance Bill will take effect in relation to qualifying expenditure paid or reimbursed by employers on or after 6 April 1989.

6. The categories of removal expenses to be covered by the proposed statutory relief are:

- the costs of selling the old, and purchasing the new, home. For example, legal fees, stamp duty, estate agents fees.

- the costs of removing furniture and effects

- travelling and subsistence costs incurred in connection with the move, for example, by employees and their families in finding a home at the new location and the cost of temporary accomodation at the new location before a permanent move.

- bridging loan interest. The relief will remove any beneficial loan charge arising under Section 160 Income and Corporation Taxes Act 1988 in relation to the provision by the employer of cheap or interest free bridging loan finance.

- costs relating to the provision of replacement items such as carpets and curtains which are not suitable for removal to the new home.

/7. In some instances,

7. In some instances, for example in relation to payments in certain limited circumstances for capital losses incurred by employees on their old homes, employers' removal schemes may provide for the reimbursement or payment of costs which tax offices have in the past accepted as within the scope of the concession, but which will not, in future, be covered by the statutory relief. Under transitional arrangements, however, reimbursement of any such costs on or after 6 April 1989 will continue to qualify for extra statutory tax relief provided

- the employee has entered into a commitment to move before 6 April <u>and</u>

- <u>the job</u> in the new location is started before 1 July 1989

8. An employer making payments on or after 6 April 1989 which are not exempt under the proposed statutory relief, or under the transitional arrangements, should deduct tax from them under PAYE. All reimbursed expenses (except those covered by a dispensation) and taxable benefits must continue to be detailed on form P11D after the end of the year. This should include details of any taxable benefits provided indirectly by, for instance, a relocation company.

<u>Withdrawal of relief for additional housing cost payments</u>

9. Extra Statutory Concession A67 exempts from tax certain payments to employees as contributions to the additional housing costs (eg increased mortgage interest or rent) incurred as a result of moving with their jobs to more expensive housing areas. Tax relief is available only when payments are payable for a limited period, reduce year by year and provided that in total they do not exceed a prescribed maximum. The maximum has varied from time to time in line with changes to the amount payable to civil servants under their Additional Housing Costs Allowance. The present maximum, which has applied since 1 February 1989, is £21210.

10. At the Chancellor's request, the Board of Inland Revenue will withdraw this Extra-Statutory Concession for payments made on or after 6 April 1989. Under transitional arrangements, however, tax relief will not be withdrawn from those employees who before 6 April 1989:

- already receive payments qualifying for tax relief under the extra statutory concession.

- have entered into a commitment to move with their jobs to a more expensive housing area provided that <u>the job</u> at the new location is started before 1 July 1989.

11. Payments will only qualify for relief under these transitional arrangements if the conditions of ESC A67, as published in the 1988 edition of the Inland Revenue booklet IR1, are satisfied. However, the limit on the maximum amount payable

/ tax free will no

tax free will no longer be linked to future changes in the maximum payable in the Civil Service. Instead, the tax free limit will be frozen at the limit applying on 6 April 1989. As before, payments to civil servants will be taxed on the same basis as payments to employees generally.

12. Employers should deduct tax under PAYE from payments to employees who commit themselves to moves on or after 6 April 1989, or who do not satisfy the transitional arrangements.

13. Since the present tax relief for additional housing cost payments is an extra-statutory concession, Finance Bill legislation is not required for this change.

Notes for Editors

1. Full details of both Extra-Statutory Concessions A5 and A67 are available in the 1988 edition of the Inland Revenue's booklet IRI - 'Inland Revenue Extra-Statutory Concessions'. Copies of the booklet are available from the Inland Revenue, Public Enquiry Room, West Wing, Somerset House, London WC2R 1LB.

Compliance Cost Assessment

2. Assessments of the compliance costs of proposals affecting businesses are available. A copy of the Compliance Cost Assessment for this proposal can be obtained from:

Inland Revenue
Deregulation Unit
Room 77
New Wing
Somerset House
London WC2R 1LB

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INLAND REVENUE

Press Release

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

[3x] 14 March 1989

INHERITANCE TAX

The Chancellor proposes in his Budget to

- raise the threshold for inheritance tax from £110,000 to £118,000
- limit the circumstances in which redistribution of estates by beneficiaries have retrospective effect for inheritance tax.

DETAILS

Threshold

1. The inheritance tax threshold rises in line with the Retail Prices Index (RPI) increase for the year to the previous December (rounded up to the next £1,000) unless Parliament decides other-wise. Between December 1987 and December 1988 the RPI increased by 6.8% per cent. This raises the present threshold from £110,000 to £118,000.

2. The Treasury are today making a Statutory Instrument setting out the new threshold. It will apply to transfers made on or after 6 April 1989. There is no change to the rate of inherit-ance tax (currently 40%).

3. The estimated cost of indexation is £35 million for 1988-89 and for 1990-91, £70 million.

Instruments of Variation

4 At present, if the parties so elect, retrospective effect for inheritance tax purposes is given to rearrangements of estates made within two years of death by the beneficiaries for any purpose. The provision was introduced originally to enable estates to benefit from the (then) new spouse exemption. It has achieved that purpose and is being increasingly exploited to avoid inheritancee tax.

/ 5. In future

5. In future rearrangements will continue to be effective for inheritance tax only if made by:

- <u>disclaimer of benefits</u> under wills, intestacies or Scottish legal rights; or

- <u>Court Orders</u> making adequate provision for the deceased's dependants; or

- <u>written variations by the beneficiaries themselves</u> making adequate provision for the deceased's dependants that could be ordered by the Court.

The changes will apply to deaths which occur on or after Royal Assent.

The estimated yield from the change is £5 million for 1989-90, and for 1990-91, £15 million.

TEXT SUBMITTED TO FST 20 FEB (MR CALDER)

[3x] 14 March 1989

INTEREST AND CURRENCY SWAPS

As part of the Chancellor's budget proposals, the Inland Revenue is publishing today:

- a consultative document setting out a possible new statutory scheme of relief for swap fees

- an extra statutory concession to apply pending the introduction of new legislation.

The aim is to make it easier for a wider range of firms to take part in the growing market for interest and currency swaps (financial instruments which enable firms to diversify their interest and currency exposures).

Under present practice relief for swap fees is allowed but in some cases relief is conditional upon tax being deducted at source. But there is no requirement to deduct tax where swap fees are paid to or by a recognised UK bank in the course of its trade. Representations have been made that this practice discriminates unfairly against non bank operators in the UK swaps market. It has in any case become clear that the practice is extra statutory.

As a short term measure the Chancellor has authorised the Inland Revenue to continue its existing practice modified so that relief for swap fees paid to or by a UK swaps dealer will be allowed in exactly the same way as for swap fees paid to or by a UK bank. For the longer term, the consultative document sets out a possible new statutory scheme of relief, on which comments from interested parties are invited by 30 June 1989.

/CONSULTATIVE DOCUMENT

CONSULTATIVE DOCUMENT

1. Under the scheme set out in the consultative document relief, with no requirement to deduct tax, would be allowed for all swap fees, by whomever paid, subject to certain restrictions designed to protect the Exchequer from possible abuse. This would not restrict the availability of relief for swap fees paid for genuine commercial purposes which already exists. On the contrary the object of the legislation would be to facilitate use of swaps both by making the tax treatment clearer and by removing the requirement to deduct tax in most cases.

2. As well as recurrent fees, swaps often involve an initial arrangement fee. Where recurrent fees would be deductible, this initial fee would also be deductible under the new scheme, as if it were an incidental cost of obtaining loan finance.

3. Copies of the consultative document may be obtained by calling at or writing to the Inland Revenue Reference Room, Room 8 New Wing, Somerset House, Strand, London WC2R 1LB. The cost of the document is £1.10 (including postage); payment should be made by cheque or postal order (payable to "Inland Revenue") or in cash. Postage stamps cannot be accepted in payment.

EXTRA-STATUTORY CONCESSION

4. The text of the extra-statutory concession is as follows:

"Where annual swap fees are not deductible in the computation of trading income under strict law the net fees paid will be treated as if they were annual payments for the purpose of computing Corporation Tax profits. Where such fees are paid by or to a recognised UK bank or swaps dealer in the ordinary course of its trade, deduction of the fees as a charge will not be conditional upon tax having been deducted and accounted for to the Inland Revenue. A recognised UK bank is a company which is recognised by the Inland Revenue as a bank for the purposes of Section 349 Income and Corporation Taxes Act 1988. A recognised UK swaps dealer is a company which is either listed by the Bank of England as an exempted person under Section 43 Financial Services Act 1986 or authorised as a member of The Securities Association to carry on investment business; and which is confirmed by the Bank of England or The Securities Association to be entering swaps as part of its regular business activity."

5. Companies wishing to be recognised as swap dealers for the purposes of the interim Inland Revenue concession should write to the Bank of England or to The Securities Association along the lines of the specimen letters below.

/Companies lead

Companies lead regulated by the Bank of England

Mr I Bond
Wholesale Markets Supervision Division
Bank of England
Threadneedle Street
London
EC2R 8AH

SWAP FEES - INLAND REVENUE CONCESSION

On behalf of XYZ Limited, I hereby authorise you to certify to the Inland Revenue that XYZ Limit has been listed as an exempt person under Section 43 Financial Services Act 1986 and is known by you to be entering swap agreements as part of its regular business activities.

Companies lead regulated by The Securities Association

Mr C Woodburn
Head of Financial Regulation
The Securities Association Limited
The Stock Exchange Building
London
EC2N 1EQ

SWAP FEES - INLAND REVENUE CONCESSION

On behalf of XYZ Limited, I hereby authorise you to certify to the Inland Revenue that XYZ Limited is authorised as a member of The Securities Association to carry on investment business and is known by The Securities Association to be entering swap agreements as part of its regular business activities.

6. On receipt of the required certificate from the Bank of England or The Securities Association the Inland Revenue will write to the company concerned confirming that it is recognised as a swaps dealer for the purpose of this concession.

/NOTES FOR EDITORS

NOTES FOR EDITORS

1. Swaps are fixed term agreements designed to exploit the different ratings in different financial markets of two counterparties with complementary needs. For example A may be able to raise fixed rate finance at a lower rate than B but may want floating rate finance where he enjoys no such advantage; while B wants fixed rate finance. A will therefore raise a fixed rate loan while B raises a floating rate loan, and the two parties will enter a swap under which A pays to B sums based on floating rates and receives from B sums based on fixed rates. The sums are set so as to share the benefit of A's better credit rating in the fixed rate market and each party effectively ends up with the kind of finance it wants at a lower cost than would otherwise have been obtainable. Swaps are used in both the interest and currency markets, often with a bank or financial dealer as intermediary, and they often perform a hedging function for companies. The volume of swaps has increased considerably over recent years and they represent a major activity in the financial markets.

2. Under existing law it is doubtful whether many swap payments are deductible for tax purposes at all. However, Inland Revenue practice, now formalised in this extra statutory concession, has been to accept that they are deductible as annual payments in computing the payer's tax liability but to require tax to be deducted before they are paid to the counter party unless one of the parties is a recognised bank for the purposes of paying interest without deduction of tax. This practice is now being extended to those swaps where one or other party is a swap trader and is approved under financial services regulations by the Bank of England or The Securities Association. Under the legislation proposed in the consultative document swap payments by all parties would be payable without deduction of tax subject to certain safeguards to protect the Exchequer.

3. An extra-statutory tax concession is a relaxation which gives the taxpayer a reduction in tax liability to which he is not entitled under the strict letter of the law. Most concessions are made to deal with what are, on the whole, minor or transitory anomalies under the legislation and to meet cases of hardship at the margins of the code where a statutory remedy would be difficult to devise or would run to a length out of proportion to the intrinsic importance of the matter.

4. Inland Revenue Extra-Statutory Concessions are of general application, but in a particular case there may be special circumstances which must be taken into account in considering the application of the concession. A concession will not be given in any case where an attempt is made to use it for tax avoidance.

5. Inland Revenue concessions are published in the booklet IR 1 which is available free from tax offices. The concession published today will be included in the next edition of the booklet (unless there is legislation before this is published).

SECRET

INLAND REVENUE

Press Release

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

[3x] 14 March 1989

INCOME TAX RATES AND ALLOWANCES FOR 1989-90: PAY AS YOU EARN

The Chancellor proposes in his Budget

- to increase the main income tax allowances and the basic rate limit by about 6.8 per cent in line with the statutory indexation requirement;
- to extend to those aged 75 and over the higher level of age allowance currently given to those aged 80 and over;
- to reduce the rate at which the age allowance is withdrawn when a taxpayer's income exceeds the income limit;
- to make no change in the basic and higher rates of income tax.

This Press Release gives details of the changes and explains how these and other proposals will be implemented through PAYE.

/DETAILS OF CHANGES

SECRET

DETAILS OF CHANGES

1. Income tax allowances

	1988-89	Proposed for 1989-90 £	PAYE Code Normally ends in letter £	Increase in Code (x 10 = Increase in Allowances)
(i) Basic allowances				
Single allowance or wife's earned income allowance	2,605	2,785	L	18
Married allowance or single allowance plus additional personal allowance (APA) (a)	4,095 (or 2,605 + 1,490)	4,375 (or 2,785 + 1,590)	H	28
Widow's bereavement allowance	1,490	1,590	-	-
(ii) Age allowances				
Full single age allowance (age 65-74)	3,180	3,400	P	22
Full single age allowance (age 75-79) (b)	3,180	3,540	(c)	36
Full single age allowance (age 80 and over)	3,310	3,540	T	23
Full married age allowance (age 65-74)	5,035	5,385	V	35
Full married age allowance (age 75-79) (b)	5,035	5,565	(c)	53
Full married age allowance (age 80 and over)	5,205	5,565	T	36
Age allowance income limit	10,600	11,400	-	-

(a) The APA is an allowance for a single person who has responsibility for a child. The single allowance and the APA together are equivalent to the married allowance.

(b) See paragraph 2 for further information about the age allowance for those aged 75 and over.

(c) See paragraph 6(c) for an explanation of how the increase in allowances for these taxpayers will be implemented under PAYE.

/Age allowance

2. Age allowance for those aged 75 and over

It is proposed to extend to those aged 75 and over the higher level of age allowance currently given to those aged 80 and over . For single people aged 75 to 79 the age allowance will rise from £3,180 in 1988-89 to £3,540 in 1989-90; for a married couple where at least one partner is aged 75 to 79 and the other is not aged over 79 the age allowance will rise from £5,035 in 1988-89 to £5,565 in 1989-90. The allowance will be subject to the same income limit as the existing age allowances. Taxpayers will qualify for the new allowance for 1989-90 if they are already aged between 75-79 or if they will reach the age of 75 between 6 April 1989 and 5 April 1990.

3. Reduction in rate of age allowance withdrawal

Where a taxpayer or his wife is over 65 but their total income is above a certain limit, the age allowance is progressively withdrawn until it is reduced to the level of the basic single or married allowance. It is proposed to reduce this rate of withdrawal from £2 of allowances for every additional £3 of income above the limit to £1 of allowances for every additional £2 of income. This means that the effective rate of tax on income in the withdrawal band will fall from 41.67 per cent for 1988-89 to 37.5 per cent for 1989-90.

4. Rates and bands

	Taxable Income Bands	
	1988-89	Proposed for 1989-90
	£	£
Basic rate at 25 per cent	1 - 19,300	1 - 20,700
Higher rate at 40 per cent	Over 19,300	Over 20,700

IMPLEMENTING THE CHANGES THROUGH PAYE

5. Increase in basic rate limit

New tax tables reflecting the change in the basic rate limit described at paragraph 4 will be used by employers on the first pay day after [17 May].

/6. Changes in income tax allowances

6. <u>Changes in income tax allowances and car scale benefits</u>

a. Tax offices will be sending employers instructions to increase codes ending in L, H, P or V by the appropriate amounts shown in paragraph 1. The new increased codes will take effect on the first pay day after [17 May]. Revised coding notices are not sent to employees when codes are increased automatically in this way.

b. The codes of the taxpayers listed below will be reviewed individually by the tax office who will notify both the employee and the employer of the revised code where a change is due. The revised codes will take effect on the first pay day after [17 May].

i. employees whose codes begin with D or F or end in T;

ii. employees whose codes include adjustments for car benefits (see separate Press Release "Income Tax: Company Cars" for details of proposed changes to the car benefit scale charges for 1989-90).

c. Tax offices will be reviewing their records to identify, so far as possible from the information already available, those taxpayers aged 75-79 who qualify for the new level of age allowance in 1989-90. Where they can identify such cases and a change in allowance is due, the tax office will notify both the taxpayer and the employer (or the person paying the taxpayer's occupational pension). The revised codes will generally take effect on the first pay day after [17 May]. Any taxpayer who:

i. expects to qualify for the higher age allowance for those aged 75-79 in 1989-90 and

ii. has not been notified individually by the end of May of a changed PAYE code to take account of the new allowance levels

should write to their tax office giving their date of birth. A married man should give his wife's date of birth if he qualifies for the allowance on the basis of her age (see paragraph 2. above).

7. <u>Employers</u>

Tax offices will

- issue to employers codes which have been changed as a result of the reviews under paragraph 6(b) and 6(c): these revised codes will either begin with D or F or end in T.

- instruct them to increase, by the appropriate amount, all remaining codes ending in L, H, P or V.

/New codes

New codes and tax tables will generally be issued by [ ] to be used on the first pay day after [17 May]. Some of the new codes issued by the tax office will be lower than those already in operation. Tax offices will therefore advise employers that it is important to use the new codes and the new tax tables for the first time on the same pay day.

8. Increase in income limit and reduction in withdrawal rate for age allowance

It is proposed to raise the age allowance income limit - below which age allowance is due in full - from £10,600 to £11,400. This means that, in the tax year starting 6 April 1989, after taking account of the reduction in the rate of withdrawal of age allowance described in paragraph 3, the benefit of the married age allowance for those aged 65-74 will not run out until the taxpayer has income of £13,420; for a single person the corresponding figure of income is £12,630. For taxpayers qualifying for the higher level of age allowance for those aged 75 and over, the benefit of the allowance will not run out until the taxpayer has income of £13,780 (married) or £12,910 (single).

Tax offices will amend codes which at present include a reduced amount of age allowance, to take account of the increase in the income limit and reduction in withdrawal rate. Where the size of a taxpayer's income means that no allowance was given for 1988-89 but age allowance is now due, the tax office will revise the code where necessary in the course of examining 1989-90 tax returns from April onwards.

Any taxpayer who is not getting age allowance at present but

a. expects to be entitled to age allowance following the proposed increase in the income limit and reduction in withdrawal rate, and

b. has not been asked by the middle of April to complete a 1989-90 tax return,

should write to their tax office giving details of income and date of birth.

9. Maintenance payments

The limit on maintenance payments qualifying for tax relief under the new rules introduced by the Finance Act 1988 is linked to the difference between the married and single person's allowances (£1,490 for 1988-89). The limit for 1989-90 will therefore be £1,590. [Details of the rules are in leaflet IR77, which is available from local tax offices and Tax Enquiry Centres.]

10. Wife's earnings election

In certain circumstances a married couple may find it to their advantage to elect for the wife's earnings to be taxed separately. For 1989-90 an election will normally be worthwhile only if the couple's combined income before deduction of allowances and reliefs is at least £30,511 including wife's earned income of at least £7,025. (The corresponding figures for 1988-89 are £28,484 and £6,579.) Inland Revenue leaflet IR13 gives further details of the election.

CONFIDENTIAL

INLAND REVENUE

Press Release

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

[3X] 14 March 1989

SIMPLER SYSTEM OF ASSESSMENT FOR EARNINGS

The Chancellor proposes in his Budget changing the basis on which the earnings of employees and directors are assessed. From 6 April 1989 income tax will no longer be assessed on the amount earned for the tax year but on the amount received in the tax year.

The change will not affect the great majority of employees who are already taxed on earnings received in the tax year. But for the half million or so directors and others who regularly receive pay some time after the year for which it was earned it will

- bring the system of collection (PAYE) and assessment into line
- greatly simplify their tax affairs.

DETAILS

1. Most employees do not get an income tax assessment. The tax deducted under PAYE is near enough the correct amount payable for the year to warrant no further action. And most employees who do get an assessment are assessed on what they receive in the year because it is virtually the same as the amount earned for the year. So the vast majority of employees will not be affected by this proposal.

2. But it will simplify the tax position of directors, or employees receiving bonuses or commission, who often receive pay some time after the year for which it was earned. In these cases it will no longer be necessary to apportion the income of an accounting period to the appropriate tax year. Instead earnings will be assessed for the year in which they are received.

/3. This proposal will

3. This proposal will result in an important simplification of the tax system. From 1989-90,

- earnings from which tax should be deducted under PAYE during the tax year will be assessable for the same year;
- what is currently in practice the position for the majority of employees will now apply to all employees and directors;
- earnings of an employee for a companys' accounting period which does not coincide with the income tax year will no longer need to be apportioned;
- the non-statutory "accounts basis" of assessment (see below) will no longer be needed after 1988-89.

4. The new system will eliminate major disadvantages in the present system, which is characterised by:-

Delay in settling tax bills: The need to apportion the earnings of two company accounting periods to arrive at the income earned for a tax year means that at present the amount to be assessed for any tax year cannot be determined until long after the end of it.

Complexity: To reduce this delay, some cases are, by agreement with the tax office, assessed on a non-statutory "accounts basis" under which the earnings of an accounting period ending in a tax year are taken as the earnings for that year. But the accounts basis necessitates special rules at commencement and cessation which introduce many of the complexities of the Schedule D "preceding year" rules which apply to the self-employed.

Incomprehensibility: Taxpayers find assessments under the present system are difficult to understand because there is no link between the amount of income assessed (the earnings for the tax year) and the tax paid (the tax deducted under PAYE from earnings received in the tax year). A taxpayer whose affairs are right up to date may nevertheless receive an assessment showing a large underpayment of tax, simply because income has been earned for the year which was not paid during the year - and consequently the corresponding tax had not yet been deducted under PAYE.

5. The compliance savings from the simpler system for taxpayers and their advisers will also be reflected in staff savings in the Inland Revenue. During the transitional period when the old system is being phased out and the new one introduced - when work under both systems will be necessary - there will be some extra staff costs. But when the new system has settled down - from 1992/93 onwards - there will be savings of about 175 staff.

/6. Over the transitional

6. Over the transitional period there is also an Exchequer cost (£60 million in 1989/90, £80 million in 1990/91) relating mainly to switching existing cases now on the "accounts basis" to the new receipts basis. In the longer term, however, there will be a yield of about £50 million. This is because at present the accounts basis does not always tax the full earnings over the life of the source of the income (ie. a particular employment or directorship). This will no longer happen with the receipts basis.

7. Legislation in the Finance Bill will define when earnings are received. Because the basis of assessment and the basis of collection under PAYE are being brought into line, the legislation will also clarify when payment, for PAYE purposes, occurs. The new definition will apply from 6 April 1989.

8. The legislation will also include transitional provisions to prevent income earned before the change being taxed twice (once when earned before 6 April 1989, and again when received after 5 April 1989), as well as necessary anti-avoidance measures.

Notes for Editors

1. At present earnings are assessed for income tax on the amount due for the year irrespective of when the earnings are received. For most employees paying tax under PAYE on their earnings received weekly or monthly there is little difference between what is earned and what is received in the year. But for some, such as directors who may receive remuneration when it is voted some time after the year for which it was earned, or for people receiving significant commission or bonuses relating to work done in previous years, it is necessary to sort out what income relates to which year. As the information is often not available until long after the tax year has ended, assessments are often substantially in arrear.

2. To reduce this delay many directors have opted to be assessed on the long-standing non-statutory "accounts basis" of assessment. Under this arrangement the remuneration for the company's accounting period ending in the tax year is normally taken to be the earnings for that year.

3. But whichever of these bases is used, the assessment is often complicated and difficult for the taxpayer to understand. It may include earnings which were not paid in that tax year and in respect of which no PAYE tax has yet been paid. The assessment then shows tax underpaid, some or all of which will be collected automatically under PAYE as soon as the unpaid remuneration is paid. But, with variations, the whole process is repeated from one year to another making it difficult to establish at any point whether there is a "real" underpayment which needs to be collected separately or simply a "notional" underpayment which will automatically be collected as soon as unpaid remuneration is paid.

/4. The proposal will

4. The proposal will mean that earnings will only be included in assessments when paid. This will be simpler for taxpayers and their advisers, will cut out some difficult but not very productive work in tax offices, and enable tax liability to be settled more promptly.

Definition of "payment" for PAYE

5. The Keith Committee, recognising that there were particular problems applying PAYE to directors' remuneration, recommended that certain defined circumstances should be "treated as payment for the purposes of Schedule E and PAYE". Section 92 of the Finance (No 2) Act 1987 provided that this could be done in regulations. But it is important that the definitions of payment for PAYE purposes and receipt for assessment purposes under the Chancellor's proposals for the receipts basis should match. Both definitions will therefore be in the Finance Bill and will be effective from 6 April 1989. They will be on the lines suggested by the Keith Committee.

6. Payment (and therefore receipt) will be treated as occurring on the first of the following events:

a) When actual payment is made of, or on account of, emoluments;

b) when a person becomes entitled to payment of, or on account of, emoluments.

And, in the case of directors:

c) when sums on account of emoluments are credited in the company's accounts or records;

d) at the latest, when the amount of the emoluments for a period of account are determined or voted.

In considering whether c) or d) apply, any fetter on the director's right to draw the emoluments is to be disregarded.

7. As the Keith Committee envisaged, these definitions should ease the task of employers by clarifying when PAYE has to be applied in cases where it may at present be unclear.

DRAFT PRESS RELEASE

PAYROLL GIVING SCHEME FOR CHARITIES
TAX RELIEF LIMIT TO BE DOUBLED

The Chancellor proposes in his Budget to double the limit on charitable donations qualifying for tax relief under the payroll giving scheme. The limit will be increased from £240 a year (£20 a month) to £480 a year (£40 a month).

The increase is designed to:

- encourage new people to join in payroll giving schemes; and
- enable those employees already giving the maximum amount of £240 a year to give more if they wish.

The new limit of £480 a year will apply from 6 April 1989, the start of the 1989-90 income tax year.

Growth of payroll giving

Interest in the payroll giving scheme has been growing steadily since it started two years ago. Over [3400] schemes have been set up by employers, enabling their employees to make tax free gifts to charity direct from their pay; and more than [100,000] employees have joined in.

Joining the scheme

An employee who wishes to join the scheme can ask his employer for a charity choice form on which he can ask for donations to be deducted from his pay and say which charity or charities he wants them to go to.

Alternatively the agency may, if it wishes, allow employee to join the scheme by making a simple telephone call to the agency. The agency then follows this up with the employer and does all the necessary paperwork.

Choice of charity

Employees participating in the scheme can give to any charity or charities they wish.

Some individual charities appeal for funds under the scheme using their own name on "coupons". Employees can also use the "coupons" to show how much they want to give to the particular charity, and the details are transferred onto approved charity choice forms by the agency charities.

Donations under the scheme can also be made to consortia, or groups of charities, usually with a common interest, to be shared out among the charities in proportions which they have agreed in advance. This enables charities to share the cost of this part of their fund-raising.

It is also open to the agency to arrange for people who want to support a particular charitable cause, rather than an individual charity, to do so. The donor can simply specify the cause, leaving it to the agency charities to distribute the money to individual charities in the chosen field.

Converting old schemes into new ones

There were payroll deduction schemes for giving to charity before the 1986 Budget, but employees did not get tax relief for their donations. These old-style schemes can be converted into new-style schemes, giving employees tax relief for their charitable gifts, if the

employer signs a contract with an agency charity which has been approved by the Inland Revenue. This means that charities can receive increases equivalent to the tax previously paid on the donations, at no extra cost to the employee.

Agency charges

Agency charges can be met out of the donations made by employees. But employers who pay the reasonable administration costs of agencies running schemes for their employees, thus enabling the full amount of the donations to go to charity, can, by concession, claim those costs as a deduction from their profits for tax purposes.

NOTES FOR EDITORS

1. The payroll giving scheme was introduced in the 1986 Budget and started on 6 April 1987. It is voluntary for employers and for employees.

2. Briefly the scheme operates as follows -

   - The Inland Revenue approves agencies to run the scheme.

   - Employers who wish to set up a scheme for their employees enter into a contract with an approved agency.

   - Employees who wish to participate in the scheme authorise their employer to deduct the gifts from their pay and nominate the charities which they wish to receive their gifts.

- The employer gives his employees tax relief under a "net pay" arrangement, as happens for superannuation contributions - ie the gifts are deducted from pay before calculating the PAYE tax due.

- The employer pays the gifts over to the agency.

- The agency acts as a clearing house, distributing the gifts to the individual charities which have been nominated by the employees.

3. Charities wishing to be approved as agencies must satisfy the Inland Revenue that they can meet all the requirements laid down in regulations.

Charities which have been approved as agencies are -

Barnardo's
BEN - Motor and Allied Trades Benevolent Fund
Birmingham Council for Voluntary Service
Bristar Foundation
Charities Aid Foundation (Give As You Earn)
Charities Trust
Chest Heart and Stroke Association (Scottish Branch)
Lankro Employee Charity Fund
Lloyd's Charities Trust
Minet Employees' Charitable Trust
Northern Ireland Council for Voluntary Action
"S" Group Charitable Trust
Scottish Council for Voluntary Organisations
South West Charitable Giving
United Way Payroll Giving Service
Wales Council for Voluntary Action

BUDGET CONFIDENTIAL

DRAFT PRESS RELEASE

HERITAGE AND CONSERVATION CHARITIES: MEMBERSHIP SUBSCRIPTIONS PAID BY DEED OF COVENANT TO QUALIFY FOR TAX RELIEF IN CERTAIN CIRCUMSTANCES

The Chancellor proposes in his Budget that, for certain types of charity, the benefit of free or cheap entry for members to view the charity's property should be ignored in deciding whether the charity can claim a tax refund on membership subscriptions paid by deed of covenant.

Details

At present, covenanted membership subscriptions to charities do not qualify for relief if there is a significant benefit to the donor in being a member. The proposal is that for certain charities the benefit of free entry to view the charity's property may be disregarded so that it does not disqualify the covenant payments from relief.

The charities concerned are those where membership is open to the general public and whose sole or main purpose is the preservation of property or conservation of wildlife for the public benefit. This includes heritage and conservation bodies, as well as museums and supporters' organisations (such as "Friends" of museums).

The benefit to be ignored is the entry to view the property or collection by the member, or by those of his family covered by family membership arrangements. The benefit must not be capable of being sold or passed on by the member to someone else.

Other benefits provided by charities for their members will continue to be treated in accordance with existing law.

The proposal applies to covenanted membership payments due on or after today, 14 March 1989.

NOTES FOR EDITORS

1. Where a deed of covenant is used to make donations to charity, the donor deducts basic rate tax from each payment and the charity can usually claim this tax back from the Inland Revenue.

2. But is is not quite so straightforward if the donor gets benefits (goods, services or other facilities) from the charity in return for his payments. When this happens, the question is whether they are so substantial that the charity loses its claim to a refund of the tax deducted.

3. The High Court decided in the case of Taw and Torridge Festival Society (38 TC603) that benefits worth practically 25 per cent of a membership subscription cannot be ignored as insubstantial. Based on this, it has been Inland Revenue practice in general for ordinary small subscription to ignore benefits if they are worth less than 25 per cent; but to refuse tax repayments to charities where the benefits provided for members were worth 25 per cent or more of the ordinary annual subscription. It is the availability of benefits which counts for this purpose, not the actual use made of them by members.

4. An important benefit provided by membership charities for their members is the right to free or cheap entry to view property, museum collections or wildlife. It is this benefit which will no longer be taken into account in deciding whether qualifying charities can claim tax relief on covenanted membership subscriptions. The existing law will continue to apply to other benefits.

BUDGET CONFIDENTIAL: DRAFT BUDGET DAY PRESS RELEASE

INLAND REVENUE

Press Release

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PHONE: 01-438 6692 OR 6706

[3x]

14 March 1989

INCOME TAX: GIFTS BETWEEN HUSBAND AND WIFE AND OTHER SETTLEMENTS

The Chancellor proposes in his Budget some changes in the income tax rules for gifts between husband and wife and other settlements. These follow the personal tax reforms in last year's Budget.

The changes will ensure that when Independent Taxation begins in April 1990:

- simple outright gifts of assets between husband and wife will be recognised for income tax purposes. Income from such gifts will be taxed as the income of the person who receives the gift.

- certain allocations of pension between husband and wife will be taxed as the income of the person to whom the pension is allocated.

There will also be a change in the income tax treatment of some trusts where the person who made the trust, or the husband or wife of that person, is able to benefit from the trust income or capital. Beneficiaries of the trusts affected will no longer be able to claim repayment of the basic rate tax suffered by the trustees. This completes last year's reform of non-charitable covenants. It stops trusts being used to obtain the tax advantages which are no longer available through covenants. The change will take effect immediately for trusts made on or after today. Some existing trusts will be affected when Independent Taxation begins.

DETAIL

1. Under Independent Taxation a gift of an asset between husband and wife will only be recognised for income tax purposes if it is an unconditional gift of both the asset and the income arising from it. The income arising after the transfer will then be treated as the recipient's for tax purposes. The income will generally be treated as the donor's for tax purposes if, for example:-

- the donor has the right to get the asset back in the future, or to decide what the recipient should do with it; or

- the donor uses a trust to give the income to his or her partner while retaining control over the capital, or passing the capital to a third party.

2. Some statutory pension schemes allow a pensioner to give up part of his or her pension so that a pension can be paid to the pensioner's husband or wife before the death of the pensioner. The proposal ensures that the allocated pension will be treated as the partner's income under Independent Taxation.

3. The proposals on trusts will alter the effect of Section 683 Income and Corporation Taxes Act 1988. Trust income to which that section applies will be treated as the settlor's for all tax purposes. (At present the income is treated as the settlor's for higher rate purposes only).

4. For trusts made on or after today the changes will take effect immediately. Existing trusts will only be affected by the proposals if trust income goes to the husband or wife of the settlor. In those cases the new rules will apply to that income when Independent Taxation is introduced in 1990-91.

NOTES FOR EDITORS

1. During the debates on last year's Finance Bill, the Financial Secretary promised to look at the provisions relating to settlements in the light of the planned introduction of Independent Taxation and the ending of tax relief on most non-charitable covenants. These proposals fulfil that commitment.

2. Section 683 is part of a series of provisions (Sections 660 to 685) which apply to trusts, covenants, gifts and other settlements. In most cases where the person making the settlement (the settlor), or the husband or wife of that person, is able to benefit from the income or capital of the settlement the income from the settlement is already treated as the settlor's for all tax purposes. However, if Section 683 applies the income is at present only treated as the settlor's for higher rate. For basic rate the income continues to be treated as belonging to the beneficiary to whom it is paid. If that beneficiary has unused personal allowances to set against that income, he or she can reclaim basic rate tax suffered by the trustees.

3. Under Independent Taxation a wife's investment income will no longer be treated as her husband's for tax purposes. These proposals ensure that the rules for settlements will operate in a way which is consistent with the Government's objectives for Independent Taxation.

DRAFT BUDGET DAY PRESS RELEASE

[3x] 14 March 1989

IMPROVEMENTS TO THE RELIEF FOR PROFIT-RELATED PAY (PRP)

The Chancellor proposes in his Budget a range of improvements to the tax relief for PRP. These will

- increase the upper limit on PRP which can qualify for tax relief from £3,000 to £4,000;
- enable employers to set up schemes for central (eg headquarters) units with PRP based on the profits of the whole undertaking;
- abolish the requirement for PRP to equal at least 5% of employees' pay if profits remain the same;
- allow certain alterations to be made to registered PRP schemes without loss of tax relief;
- improve the operation and administration of tax relief for PRP.

These changes will have statutory effect from Royal Assent to the Finance Bill, but the increased limit will apply to all PRP payments made in respect of profit periods beginning on or after 1 April 1989.

/DETAILS OF THE PROPOSALS

DETAILS OF THE PROPOSALS

Increase in Tax Relief

1. Since half of PRP payable for any profit period under a registered scheme can be free from income tax, the current limit on the tax relief of the lower of 20% of pay or £3,000 enables PRP up to 10% of pay or £1,500 to be paid tax-free. For any payments made in respect of a full year profit period beginning on or after 1 April the increased cash limit of £4,000 will have the effect that 10% of pay or £2,000 if less can be free of tax. For a basic rate taxpayer this will be worth up to £[ ]; to a higher rate taxpayer it will be up to £[ ].

Headquarters units

2. An employer may choose the employment unit to which a PRP scheme relates. It may be either the whole or part of a business but the unit must be identified, it must be carried on with a view to profit and it has to be able to establish that profit in the form of a profit and loss account.

3. Where an employment unit covers the operation of only a part of a business, and that part is a general or central function, like a Head Office or Research and Development Division, the employer is likely to have to produce special figures for its profit and loss account. These figures may be both difficult and costly to produce and, given the nature of the activities, they may provide little more than a notional measure of profit.

4. The Chancellor now proposes that an employer who registers one or more conventional PRP schemes will be able also to register a separate scheme or schemes for general or central units with PRP based on the profits of the whole undertaking, not the profits of that particular unit. Such schemes will have to satisfy all the usual requirements, but in addition their registration will depend on

/the number of employees

the number of employees covered not exceeding 33% of the number of employees covered by the conventional schemes. These provisions will come into effect on Royal Assent to the Finance Bill.

The 5% test

5. The requirement that a PRP scheme must contain rules ensuring that PRP is at least 5% of employees' pay in the first profit period (if profits remain the same) will be abolished. This was announced on 3 February 1989, and by concession any schemes registered after that date have been able to disregard that requirement.

Alterations to registered schemes

6. The Finance Bill will also contain legislation to allow certain changes to be made in the rules of schemes already registered without jeopardising their registration. This facility has, with Ministerial approval, been operating extra-statutorily since it was announced on 10 October 1988.

Other changes

Death of sole proprietor

7. If the sole proprietor of a business which has a registered PRP scheme dies registration of the scheme has to be cancelled because the present legislation makes no provision for a substitute employer to take his place. The legal personal representatives of the deceased will now be given the option of continuing to run the scheme, to have it cancelled from the date of death, or, as previously, to have it cancelled from the start of the profit period during which death occurred. In the latter case any tax relief already given for that profit period will be clawed back.

/Excluded employees' remuneration

Excluded employees' remuneration

8. Any employee who has a material interest in a company (that is, he owns it or owns a large part of it), is excluded from receiving PRP under a registered scheme, and the remuneration of such an employee may not be deducted in arriving at the profit of the business for PRP purposes. The effect is to place this type of employee in the same position as a sole trader who cannot receive PRP and whose earnings are not deducted from profits before PRP for employees is calculated. The Finance Bill will make it clear that remuneration in this instance includes fees, percentages, any expense allowance which is charged to income tax, pension contributions and the ~~estimated~~ value of any non-cash benefits received.

Employer's National Insurance Contributions

9. To solve the problem of mutual deductibility of employers' National Insurance Contributions - ie the amount of PRP must be known before NIC can be calculated but NIC must also be known to enable PRP to be worked out - employers will be permitted, if they wish, to provide in their schemes for the exclusion of their own NIC liability on PRP payments from the calculation of profits on which PRP is based. This does not affect in any way the present NIC liability arising from payments of PRP.

Tax recovery powers

10. Present legislation places the responsibility for the operation of PRP relief on the scheme employer. If a scheme is cancelled action to claw back any tax relief wrongly given is against the scheme employer, even if that employer is a parent company of a group and it is actually the subsidiaries who are operating the schemes. Where that group scheme employer is or becomes non-resident in the United Kingdom, recovery of any tax relief overpaid may not be possible. In these circumstances there will be a secondary right of recovery against the employer who operates the Pay As You Earn scheme.

Cost

11. The overall cost of the changes affecting PRP is expected to be £10 million in 1989/90 and £15 million in 1990/91.

Guidance

12. Advice on any aspect of PRP can be obtained from:

Profit-Related Pay Office
Inland Revenue
St Mungo's Road
Cumbernauld
GLASGOW
G67 1YZ

Telephone: 0236 736121

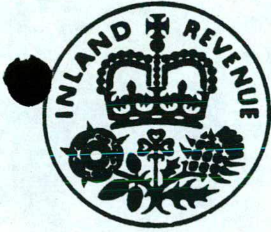
NOTES FOR EDITORS

1. Profit-Related Pay is the element in employees' pay which varies in relation to the movement in the profits of the business in which they work. Subject to certain limits, half of an employee's PRP can be exempt from income tax, provided it is paid under a scheme which has been registered by the Inland Revenue.

2. To qualify for tax relief PRP must be paid under a scheme registered by the Inland Revenue before the date on which the scheme is due to start. Application for registration must be made on a prescribed form and accompanied by a report from an independent accountant that the scheme complies with the legislation.

3. Legislation governing the provision of tax relief for PRP is contained in Sections 169 to 184 and Schedule 8 of the Income and Corporation Taxes Act 1988.

4. Announcements concerning alterations to scheme rules and the 5% test were published in Inland Revenue Press Releases dated 10 October 1988 and 3 February 1989 respectively.



INLAND REVENUE

Press Release

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

[3x] 14 March 1989

STAMP DUTY ON SHARES TO BE ABOLISHED

The Chancellor proposes in his Budget to abolish all stamp duties on transactions in shares, together with stamp duty reserve tax, from 1 April 1990.

Abolition of these taxes will give a boost to wider share ownership, enhance London's competitiveness for dealings in United Kingdom securities, and continue the process of simplifying the tax system.

This is the sixth major tax to be abolished since 1983. It fulfils the process of progressive reductions in stamp duty on shares from 2 per cent in 1984 to 0.5 per cent today.

DETAILS

Stamp duties on shares

1. The main duties to be abolished are:

- stamp duty on individual share transfers, which is levied United Kingdom securities at a rate since 1986 of, broadly, 0.5 per cent of the price paid;
- stamp duty of 1.5 per cent, which is payable where United Kingdom shares are converted into depositary receipts or transferred into clearance services;
- stamp duty reserve tax (SDRT), which applies, at the same rates as stamp duty, to some share transactions which are outside the stamp duty net.

2. Transfers of shares on or after 1 April 1990 will be free of duty. Until then, duty continues to apply at existing rates.

Associated charges

3. Also to be abolished are

/- the stamp duty

- the stamp duty charges on bearer shares;
- the fixed duty on share transfers other than sales;
- stamp duty on all transfers of units under a unit trust scheme.

Effects of abolition

4. The Government believes abolition of these taxes will -

a. encourage investment in United Kingdom equities and so foster wider share ownership, by reducing dealing costs;

b. increase the efficiency and liquidity of the London market and reduce the incentive for offshore trading;

c. further simplify the tax system and ease the compliance burden on individual shareholders, the Stock Exchange and company registrars;

d. facilitate the forthcoming introduction of paperless share transactions.

Cost

5. The cost of these proposals is estimated to be about £850 million in 1990/91, the first year of abolition.

Legislation

6. The appropriate legislation will be contained in the 1989 Finance Bill.

Interim measures

7. It is unlikely that the stock market generally will have moved to paperless share transfers (the so-called "dematerialisation") before the duty on shares goes on 1 April 1990. Nonetheless there could be a limited number of such electronic transactions, eg pilot schemes for the Stock Exchange's new transfer system, before then. The forthcoming Finance Bill will therefore include provisions to ensure any early paperless transfers are charged to duty on a par with ordinary transfers made by document.

Life assurance policy duty

8. The Chancellor also proposes in his Budget to abolish life assurance policy duty - another kind of stamp duty - from 1 January 1990. Details of this measure are given in the Inland Revenue press release [ ].

/Stamp duty

Stamp duty on property

9. The Chancellor is not proposing to make any changes to the stamp duty on the transfer of property (including houses).

NOTES FOR EDITORS

Abolition of duties

1. Abolition of stamp duty on shares represents a further significant simplification of the tax system. Within the stamp duty field it follows the removal of stamp duty on gifts in 1985, and the abolition of capital duty and unit trust instrument duty in 1988.

Stamp duty on shares

2. The ad valorem stamp duty on individual transfers of United Kingdom companies' shares is currently charged at the rate of 50p per £100 or part thereof, ie broadly at 0.5 per cent. There are exemptions for purchases by market-makers and charities. Shares in foreign registered companies, and also Government stock and most commercial loan capital, are outside the scope of the charge.

3. A separate head of charge applies to bearer instruments. Broadly speaking bearer instruments are charged at 1.5 per cent on a once and for all basis, either on issue (for instruments issued in the United Kingdom) or on their first transfer in Great Britain.

4. Certain transfers of shares otherwise than on sale can give rise to a fixed 50p charge - for example transfers where there is no change of beneficial ownership.

Stamp duty reserve tax

5. This tax was introduced in 1986 in order to broaden the base of stamp duty on shares, by charging a wider range of transactions. Unlike stamp duty, which is a tax on documents, stamp duty reserve tax applies to agreements - viz most agreements to sell United Kingdom securities. It therefore brings within the scope of the charge:

the purchase and resale of a security within the same Stock Exchange account;

the purchase of renounceable letters of allotment or acceptance;

the purchase of shares registered in the name of a nominee acting for seller and purchaser;

the purchase of shares which are resold before they are taken into the purchaser's name.

6. SDRT is charged at the same rate, 0.5 per cent, as stamp duty on shares.

/Depositary receipts

Depositary receipts and clearance services - the higher rate charges

7. Where shares are transferred into depositary receipt form or into a clearance service, the higher rate of 1.5 per cent stamp duty or stamp duty reserve tax applies on the initial transfer. This charge is in the nature of a "season ticket" - subsequent transfers of depositary receipts, or of shares within a clearance service, then take place free of stamp duty or stamp duty reserve tax.

Unit trusts

8. Stamp duty arises on the purchase of units by one unit holder from another, and in the more common situation of a surrender for cash of units to the managers. The rates are broadly the same as the ad valorem charge on shares, but special reliefs apply.

DRAFT

[3x]

14 March 1989

APPROVED ALL-EMPLOYEE SHARE SCHEMES : LIMITS TO GO UP

In his Budget the Chancellor proposes to increase limits for tax relief for employees in approved all-employee share schemes.

Approved profit-sharing schemes

Under an all-employee profit-sharing scheme approved by the Inland Revenue shares may be given to employees up to an annual limit of £1,250 or 10% of salary, subject to a £5,000 ceiling.

This limit is to be raised to £2,000 or 10% of salary, subject to a £6,000 ceiling, from 6 April 1989.

Approved SAYE-related share option schemes

Two improvements are proposed to the approved all-employee savings-related share option scheme legislation:

i. Share options may be granted to employees involving monthly SAYE savings of up to £150 (compared with the present limit of £100). This increase will take effect from an early date to be fixed by Treasury Order after Royal Assent.

ii. The price at which options may be offered to employees must, at present, be not less than 90% of the market value of the shares at the time the options are granted. The

/maximum permissible

maximum permissible discount is to be increased from 10% to 20% enabling options to be offered at not less than 80% of market value. This increase will take effect from Royal Assent.

Legislation relating to these changes will be included in the Finance Bill.

Approved employee share schemes : Publicity

Inland Revenue leaflets and booklets on approved employee share schemes are being revised and updated. The new versions will be available later this year.

NOTES FOR EDITORS

1. All-employee share schemes are approved by the Inland Revenue under legislation in the Income and Corporation Taxes Act 1988 which was formerly contained in the Finance Acts of 1978 and 1980. They must be open to any employee who has been employed full-time by the company concerned for at least 5 years. Other employees may be included in the scheme if the company wishes, but all employees who take part must do so on similar terms. Under these schemes an employee is exempt from income tax on the value of the shares he receives, or on option gains, if certain conditions are met.

2. The number of all-employee schemes approved by the Inland Revenue up to the end of February 1989 was [ ] (compared with less than 30 in 1979).

3. It is estimated that by the end of the year to March 1988 about 1.75 million employees had benefited under these schemes, and that they had received shares or interests in shares with an initial market value of over £4 billion.

DRAFT BUDGET DAY PRESS RELEASE

[3x] 14 March 1989

IMPROVED TAX RELIEFS FOR EMPLOYEE PARTICIPATION

A major theme of the Chancellor's Budget Statement was the further encouragement of participation by employees in the ownership and prosperity of the businesses in which they work.

Tax reliefs have already played an important role. More than 1.75 million employees have benefited from approved all-employee share schemes, receiving in all shares or options over shares with an initial value of £4 billion. Last year alone, more than £1 billion of shares were allocated under these schemes. The tax relief for profit-related pay, which was introduced only in 1987, already covers more than 120,000 employees.

The proposals the Chancellor announced fall into 4 main groups, each described in detail in separate Press Releases:

- approved all-employee share schemes: increased benefits available

- employee benefit trusts: corporation tax relief for company contributions to a new form of employee benefit trust which distributes shares to employees

/profit-related pay:

- profit-related pay: a wide range of improvements including an increase in the maximum amount of tax relief, and new arrangements, making it easier for headquarters units, research and development divisions etc to participate

- 'material interest' tests: the rules which exclude employees with a significant interest in the employing company from participating in any of these schemes are being substantially relaxed where the interest derives from an employee benefit trust.

NOTES FOR EDITORS

The separate Press Releases issued today, which detail the changes referred to, are:

"Approved All-Employee Share Schemes : Limits to Go Up"

"Tax Relief for Employee Share Ownership Plans"

"Improvements in Profit-Related Pay"

"Relaxation of Employees' Material Interest Tests".

DRAFT BUDGET DAY PRESS RELEASE

RELAXATION OF EMPLOYEES' MATERIAL INTEREST TESTS

The Chancellor proposes in his Budget to relax the material interest tests on an employee's eligibility to participate in a registered Profit-Related Pay scheme or an approved Employee Share Scheme, and thus to benefit from the tax reliefs associated with those schemes.

The relaxation will allow the shareholding of any trust in which an employee has an interest to be disregarded when determining whether he or she has a material interest, provided the trust meets certain conditions. The same changes will be made to the material interest test on individuals eligibility for close company interest relief, and may have the effect (of) denying that relief in particular cases.

The changes will be effective from Royal Assent to the 1989 Finance Bill for Profit-Related Pay and Employee Share Schemes, but the benefit of the changes may be affected by any distribution of shares or other benefits by the trust on or after today. In the case of interest relief the changes will apply to loans made after Royal Assent, and the distribution by the trust of shares or other benefits after Royal Assent may affect the operation of the changes.

DETAILS

Background

1. Employees who have a material interest in a company may not participate in that company's registered Profit-Related Pay scheme or approved Employee Share Scheme. Individuals with a material interest in a close company may have interest relief on loans to purchase shares in that company.

2. A person has a material interest if he or she together with his or her associates owns, or is able to control, more than a specified percentage of the company's ordinary share capital. Associates include the trustees of a trust in which the employee has an interest. So, if shares in the company are held by a trust set up for the benefit of employees, each employee is at present regarded as being interested in all the shares in the trust because of his or her association with the trustees. The effect can be to give an employee a material interest in the company, although in practice he or she neither owns nor controls any shares of the company.

Proposed changes

3. The trustees of a trust set up for the benefit of employees will be excluded from the definition of associate provided certain conditions are met. This change will enable some companies who have been unable to introduce Profit-Related Pay or Employee Share Schemes because of employee benefit trusts to do so in the future.

4. In order for the trustees to be excluded from the definition of associate

- the trust must be one under which all or most employees are eligible to benefit

- the trust may also benefit former employees, the relatives and dependents of employees or former employees and charitable organisations

- the trust will be acceptable for this purpose if it is capable of benefiting non-individuals, provided no benefits are actually distributed to non-individuals other than charitable organisations and approved profit sharing scheme trusts. If a distribution is made to an unacceptable non-individual the trustees will become associates from then on of all the employees with an interest in the trust.

5. These trustees will be excluded from the definition of associate; but once an employee together with his or her associates other than the trustees

- owns or is able to control more than the specified percentage of the company's ordinary share capital

- or enjoys benefits (eg dividends, bonuses) from more than the specified percentage of the company's ordinary share capital

the trustees will become associates of that employee from then on. They will not, however, thereby become the associates of other employees with an interest in the trust.

6. If the trust holds other investments as well as ordinary shares in the company, a distribution made by the trustees in the form of dividends, bonuses etc will be deemed to have come first from the dividends declared on the shares in the company in the current financial year, then, if necessary, from such dividends in the previous financial year, and then, finally, from dividends declared in the financial year before the previous financial year.

7. The changes will be included in the Finance Bill and take effect from Royal Assent. For the purposes of registered Profit-Related Pay schemes and approved Employee Share Schemes, however, in deciding whether an employee has a material interest under the revised tests account will be taken of

- the shareholding on 14 March 1989 of that employee and his or her associates (other than the trustees of an acceptable trust)

- any distributions made by the trustees on or after 14 March 1989.

8. The same changes will be made to the material interest test on an individual's eligibility for interest relief on a loan to purchase shares in a close company. The changes will have effect in the case of loans made after Royal Assent. For this purpose, however, in deciding whether an individual has an interest under the revised test account will be taken of

- the shareholding at the time of Royal Assent of that individual and his or her associates (other than the trustees of an acceptable trust)

- any distributions made by the trustees after Royal Assent.

Cost of the proposed changes

9. The revenue cost of the proposed changes is estimated as negligible in 1989/90 and up to £m5 in each of 1990/91 and 1991/92.

NOTES FOR EDITORS

1. Legislation governing the provision of tax relief for Profit-Related Pay is contained in Sections 169 to 184 and Schedule 8 of the Income and Corporation Taxes Act 1988. The Employee Share Scheme legislation is contained in Sections 185 to 187 and Schedules 8 and 9 of the Act. The close company interest relief legislation is in Section 360 of the Act.

2. The material interest test for eligibility to participate in Profit-Related Pay applies to employees of all companies and unincorporated associations; any with an interest in excess of 25 per cent may not participate. For approved Employee Share Schemes it applies to employees and directors of close companies only. The specified limit is 25 per cent for profit sharing ~~schemes~~ and savings-related share option schemes, and 10 per cent for discretionary share option schemes; and employees may not participate in an approved scheme while they have a material interest or within 12 months of having had such an interest. The material interest test for interest relief applies to close companies only and the specified limit is 5 per cent.

3. <u>Compliance cost assessments</u>

Assessments of the compliance costs of proposals affecting businesses are available. A copy of the Compliance Cost Assessment can be obtained from:

Inland Revenue
Deregulation Unit
Room 77
New Wing
Somerset House
London WC2R 1LB

BUDGET CONFIDENTIAL

DRAFT PRESS RELEASE

DEEP DISCOUNTED SECURITIES : NEW TAX RULES

The Chancellor proposes in his Budget to introduce new rules for the tax treatment of investors in securities issued at a deep discount. These will provide a certain and consistent basis of taxation of such securities and will cover the wider range of institutions which will be able to issue such securities following the abolition of the queue by a general consent under the Control of Borrowing Order 1958.

The Budget proposals cover three types of securities:-

I. NON-VARIABLE DEEP DISCOUNTED SECURITIES

1. Where securities are issued by companies with a discount of more than ½ point a year, or more than 15 points overall, the discount accruing during the period of ownership by an investor is taxed under existing law as income in the year of disposal or redemption. Any difference between the acquisition cost and disposal or redemption proceeds which is greater or less than the accrued income is normally taxed as a capital gain or loss (except in circumstances where the security is exempt from capital gains tax).

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

II. VARIABLE DEEP DISCOUNTED SECURITIES

3. Where securities are issued with variable features (for example where the date of redemption can vary or the return is index-linked) it is not possible to calculate in advance the precise amount of accruing discount. For such securities, issued by either corporate or non-corporate borrowers, where it is possible for the accrued discount to exceed ½ point per year or 15 points overall, the whole of the difference between acquisition cost and disposal or redemption proceeds will be taxed as income (subject to III. below). Liability to capital gains tax will not arise.

4. <u>Gilts</u> These proposals will not apply to existing issues of gilts which will continue to be taxed in accordance with existing rules. Gilts issued at a deep discount on or after Budget Day (except for further tranches of existing issues) will be taxed in accordance with the new rules.

BUDGET CONFIDENTIAL

III. INDEX LINKED BONDS

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

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

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

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

d. The securities are issued for a period of more than 3 years and are not capable of redemption at any earlier date.

6. The new rules will apply to all disposals on or after Budget Day.

[3x]

14 March 1989

CORPORATION TAX RATES

The Chancellor proposes in his Budget to set in advance the rates of Corporation Tax for the Financial Year 1989. The main rate of Corporation Tax and the rate of Corporation Tax for small companies will remain unchanged at 35 per cent and 25 per cent respectively.

There will be an increase in the profits limits for the rate of small companies and the associated marginal relief. For the Financial Year 1989, the limit for the rate for small companies will be increased from £100,000 to £150,000. The limit for the marginal relief from the main rate of Corporation Tax will increase from £500,000 to £750,000. The marginal relief fraction will remain unchanged at 1/40th.

NOTES FOR EDITORS

1. If a company has "associated companies" its profits limits for the rate for small companies, and for the marginal relief, are reduced proportionately. So if it has three associated companies each limit is reduced to a quarter of the full amount. Two companies are "associated" if one controls the other or both are under the control of the same person or persons.

2. The effect of the marginal relief will be as follows. A company with profits of £150,000 will pay tax of £37,500 (an average tax rate of 25 per cent - the small companies rate). One with profits of £750,000 will pay £262,500 (an average tax rate of 35 per cent - the main rate). A company with profits between these amounts pays at the main rate of Corporation Tax less the marginal relief on the difference between its profits and £500,000. So if its profits are £450,000 the tax liability will be £157,500 (35 per cent of £450,000) less £7,500 (1/40th of (£750,000 - £450,000)), which is £150,000. This represents an average tax rate of 33.3 per cent.

[3x] 14 March 1989

ABOLITION OF CLOSE COMPANY APPORTIONMENT

The Chancellor proposes in his Budget to abolish close company apportionment. (This involves taxing individuals on the undistributed income of close companies in which they have an interest.) Instead there will be a 40 per cent Corporation Tax charge on close investment companies which retain a substantial part of their profits.

The change will simplify the way in which undistributed profits are taxed while still ensuring that non-trading companies are not used by higher rate taxpayers to avoid tax. It will apply for accounting periods starting after 31 March 1989.

DETAILS

Close investment companies (CICs)

1. A close company is one under the control of, usually, five or fewer people.

2. The proposal will apply to "close investment companies" (CICs). These will be all close companies other than those:

- whose business consists mainly (over 50 per cent) of trading and whose investment income does not exceed its other income; or

- which exists mainly to co-ordinate the administration of trading subsidiaries or for the purpose of trades carried on by fellow subsidiaries.

Dealing in land, shares or securities will not be treated as a trade. To protect a trading company which pays out its income as directors' remuneration, any remuneration paid to employees will be added to the company's "other income".

/Distribution test

Distribution test

3. A CIC will be liable to Corporation Tax at 40 per cent unless it distributes a certain proportion of its profits (the "distribution test"). CICs whose income comes mainly from property or trading must distribute 70 per cent of their profits; others must distribute 85 per cent. The test will apply separately to each accounting period.

4. Only dividends paid on ordinary share capital will count as distributions. Dividends paid in the six months following an accounting period may be treated as paid during the period.

5. The distribution test will not be satisfied if the dividends paid do not reflect the underlying ownership of the company (eg, if someone waives a dividend). And the recipients of the dividends will not be entitled to a tax credit. This will discourage anyone from using a CIC which they control to divert income to others (eg children) who have unused tax allowances.

6. For the distribution test "profits" of the CIC will include

- net income and capital gains; and
- dividends etc received from other UK resident companies (there are not normally chargeable to Corporation Tax).

Special rate of Corporation Tax

7. If a CIC fails the distribution test for an accounting period it will be liable to Corporation Tax at a rate of 40 per cent on all its profits as defined for the "distribution test".

8. Any dividends paid by the CIC which count as distributions for the purposes of the distribution test will be deductible from the dividends etc received by the CIC (but not from its normal taxable profits). The excess, if any, of the distributions received over the deductible dividends is called the "relevant investment income" ("RII"). This will be treated as carrying a tax credit at the basic rate of income tax which will be set against the Corporation Tax liability (so the effect will be the same as where an individual liable at the higher rate of income tax receives a dividend carrying a tax credit). It will not be possible to set any reliefs (eg losses) against RII (except where this is already allowed under Sections 242 or 243, ICTA 1988) nor will it be possible to set Advance Corporation Tax against Corporation Tax on RII.

9. Under existing law, a member of a group of companies can surrender trading losses and certain other reliefs to another member of the group, so as to reduce its taxable profits. This will be modified so that a company which is not a CIC will not be able to make a surrender to a CIC. Similarly, Section 273, ICTA 1970 (which prevents a capital gain or loss arising on a transfer of an asset between members of a group of companies) will not

/apply to any transfer

apply to any transfer between a CIC and a company which is not a CIC. The purpose of these rules is to prevent the special tax rate of 40 per cent being avoided when a CIC forms part of a trading group (although, as paragraph 2 explains, a company will not be a CIC if it exists mainly for the purpose of the trades being carried on elsewhere in the group).

Deductions for interest etc

10. Under existing law, companies can get tax deductions for interest and other payments in circumstances where an individual could not. At present, the apportionment provisions can counteract this advantage. The apportionment provisions will be abolished but will be replaced by some restrictions on the tax deductions available to a CIC. These restrictions will apply whether or not the CIC passes the distribution test.

11. A CIC will not get a deduction for any interest payments or annual payments which would not be deductible if made by an individual. This restriction on the deductibility of annual payments, other than interest, will also apply to a close company which is not a CIC (as does the present apportionment provision concerning annual payments). This will not prevent a company getting tax relief for a covenant to charity in circumstances where an individual would get tax relief.

12. At present, an investment company can get tax relief for its management expenses and it can also get capital allowances on its plant and machinery. An individual investor cannot get tax relief for similar expenditure. There will be a provision to prevent a CIC getting tax relief for such expenditure.

Definition of close company

13. The present definition of 'close company' depends partly on the existence of apportionment (Section 414(2) and (3), ICTA 1988). With the abolition of apportionment, these provisions need to be replaced. The replacement will operate by reference to direct or indirect rights to the assets of the company if it were wound up. This definition applies from 1 April 1989.

Cost

14. The abolition and replacement of close company apportionment is not expected to make a significant change to total tax receipts.

Compliance cost assessments

15. Assessments of the compliance costs of proposals affecting businesses are available. A copy of the Compliance Cost Assessment for this proposal can be obtained from:

Inland Revenue
Deregulation Unit
Room 77
New Wing
Somerset House
London, WC2R 1LB

NOTES FOR EDITORS

1. The forerunner of the present close company apportionment legislation was introduced to prevent avoidance of the historically high rates of tax on income which applied during the 1920s (which could exceed 50 per cent for people with large incomes). Various changes were made over the years but as top tax rates continued to rise the apportionment legislation remained essential to prevent tax avoidance.

2. In 1979 the top rate of tax on earned income was reduced to 60 per cent. The Government decided that apportionment of the trading income of trading companies was no longer necessary and so in 1980 this was abolished. The current apportionment provisions occupy 19 pages of legislation but the main features are as follows.

Apportionment of undistributed income

3. Apportionment is a process by which the undistributed income of a close company can be attributed to the participators, who are then charged to income tax if they are liable at the higher rate (but only at the excess of the higher rate over the basic rate). This usually produces a similar result to what would have happened if the company had instead paid out the amount apportioned as a dividend. The rules for determining the amount to be apportioned are complicated but in principle half of the company's trading income or income from property and the whole of its other income can be apportioned. But any amount which the company requires for the purpose of its trade (if any) or to repair or improve any investment properties which it owns is excluded.

4. This apportionment applies only to the extent that the company does not distribute (for example, through a dividend) the amount which is apportionable.

Apportionment of distributed income

5. The income of a non-trading company can be apportioned even where it has been distributed. This power, which is seldom used in practice, prevents tax avoidance by the distributions being made disproportionately to people not liable at the higher rate of income tax. For example, a higher rate taxpayer who controlled a company might waive a dividend so that only his or her children (who were not higher rate taxpayers) received any dividends.

Apportionment of interest paid by a close company

6. The amount of any interest paid by a close company can be apportioned to its shareholders and taxed as their income (but only at the excess of the higher rate of income tax over the basic rate). The purpose of this is to reduce the tax advantage someone gets by borrowing through a company (which normally gets tax relief on the interest) instead of doing so directly (when tax relief is usually not available). The effect is, normally,

to apportion to the participator the amount of the company's income which was sheltered from corporation tax by the payment of interest.

7. This apportionment does not apply to trading companies and certain other companies which are largely concerned with trading activities or property investment.

Apportionment of annual payments

8. If a close company makes an annual payment which would not have been deductible if made by an individual (for example, a covenanted payment to a non-charity) the amount of this can be apportioned to the participators. This apportionment has the same purpose, and works in the same way, as the apportionment of interest.

[3X] 14 March 1989

TRADING LOSSES AND CAPITAL GAINS - NEW RELIEF

The Chancellor proposes in his Budget to allow proprietors of unincorporated businesses to set trading losses against capital gains. The new relief is to apply to trading losses and capital gains in years of assessment from 1989/90 onwards.

The purpose of this new relief is to bring unincorporated traders broadly into line with companies, which can already set trading losses against both income and capital gains. It will also help unincorporated businesses going through temporary difficulties. The proprietors of such businesses may have to sell capital assets - either business assets or personal investments - to tide them over. The relief will enable people in this position to reduce their capital gains to the extent that there are trading losses in the same or the previous year.

DETAILS

1. Under the proposed new relief, someone engaged in a trade, profession or vocation who makes a loss and does not have enough income in the year to offset that loss in full will be able to elect to set the unused loss against capital gains of the same year. In addition, if unused trading losses of a year are carried forward to the following year and there is insufficient income in that year to offset the loss, the trader may elect for the excess of loss to be set against capital gains of that following year. Any trading loss which is not set against income or gains of the same or the following year will, as now, be available against future trading profits.

2. Where an election is made in relation to gains of a year, unused trading losses will be set against gains of the year concerned up to a maximum of the gains on disposals in the year less any losses on disposals in the year. The new relief will be given in priority to relief for capital losses carried forward from previous years.

/3. The relief will not apply

3. The relief will not apply to traders whose losses do not qualify for sideways relief against other income, because they are not in business on a commercial basis, for example, "hobby farmers".

NOTES FOR EDITORS

1. The general rule in the UK tax system is that losses can only be relieved against income from the same source as gave rise to the loss.

2. But - as an exception to this rule - traders and professional people who incur losses can, under Section 380 of the Income and Corporation Taxes Act 1988, set those losses against other income (but not capital gains) for the year in which they make the loss or against other income of the following year. (Any excess losses can then be carried forward and set against future profits from the same trade.)

3. This exception recognises that traders may have to fund their losses out of income from other sources. It is equally true that they may have to fund losses out of capital gains, and the Chancellor's proposal recognises this.

[3X] 14 March 1989

EXTENDED RELIEF FOR PRE-TRADING EXPENDITURE

The Chancellor proposes in his Budget to extend the period for which businesses can claim relief for certain pre-trading expenditure from 3 to 5 years.

The proposal recognises that the existing 3 year period may not be long enough to cater for the long lead times needed for some businesses.

The new five year period will apply to individuals, partnerships or companies who start to trade on or after 1 April 1989.

DETAILS

1. At present, a business can claim tax relief for revenue expenditure incurred in the three years before the start of a trade, profession or vocation, provided the expenditure would be allowable as a business expense if the trade had actually started. The relief is given when trading begins, and is available for example, for the cost of taking on employees, or rent or rates.

2. A time limit on the expenditure qualifying for relief is necessary to make sure that relief is restricted to expenditure directly related to the setting up of a trade.

/ NOTES FOR EDITORS

NOTES FOR EDITORS

1. Expenditure incurred before the start of a trade does not satisfy the normal business expenses rules. However, Section 401 of the Income and Corporation Taxes Act 1988 allows businesses to claim relief for pre-trading revenue expenditure. When this relief was first introduced in 1980, it was restricted to expenditure incurred by traders in the year before trading started. In 1982 this was extended to 3 years because the one year limit was thought to be insufficient to cater for some pre-trading research, especially in high technology areas.

2. The proposal only applies to revenue expenditure. Pre-trading capital expenditure has to be dealt with under the capital allowances code, which provides that capital expenditure incurred by a person about to carry on a trade is to be treated as incurred on the first day of trading.