PO-CH/NL/0752 PART A

2/2

FROM: A C S ALLAN
DATE: 22 February 1989

CHIEF SECRETARY
FINANCIAL SECRETARY
PAYMASTER GENERAL
ECONOMIC SECRETARY
SIR P MIDDLETON
SIR T BURNS
MR ANSON
DAME A MUELLER
MR WICKS
MR HARDCASTLE
MR BYATT
MR SCHOLAR
MR CULPIN
MR SEDGWICK
MR RILEY
MR MACPHERSON
MISS J SIMPSON
MRS CHAPLIN
MR TYRIE
MR CALL
SIR A BATTISHILL IR
MR BEIGHTON IR
MR ISAAC IR
MR PAINTER IR
MR UNWIN C&E
MR JEFFERSON SMITH C&E

cc Mr Gilhooly
Mr Matthews
Mr G Bush - IR
PS/IR
Mr P R H Allen - C&E

Mr McGivern - IR (item ii)
Mr Elliott - IR (item ii)
Mr Wilmott - C&E (item iii)
Mr Corlett - IR (item (iv))
Miss M Hill - IR (item (iv))
Mr Monck (items (iv) & (v))
Mr Neilson (item iv)
Mr McIntyre (item (v))
Mr Mace - IR (item (v))
Mr Gieve (items (vi) & (vii))
Mr Pickford (item (vi) & (vii))

BUDGET OVERVIEW MEETING: AGENDA FOR SIXTH OVERVIEW MEETING ON MONDAY 27 FEBRUARY

... I attach the agenda for the sixth overview meeting, on Monday 27 February at 3.00pm.

A C S ALLAN

AGENDA FOR SIXTH OVERVIEW MEETING: MONDAY, 27 FEBRUARY 1989

Main items

(i) Budget Scorecard:

Mr Culpin's note of 23 February;
Mr Culpin's note of 24 February on "Revised Budget Package".

(ii) CGT set-off against trading losses (Starter 216):

PS/Chancellor's note of 23 February to PS/Financial Secretary; Financial Secretary's note of 22 February; Mr Elliott's (IR) note of 20 February to Financial Secretary

(iii) Unleaded Petrol:

Mr Wilmott's (C&E) note of 23 February

(iv) Stamp Duty:

Ms Hill's (IR) note of 22 February to Financial Secretary ("Stamp Duty: Paperless Transactions");
Mr Monck's note of 24 February (to be circulated)

(v) NICs:

Further discussion

(vi) Presentation:

Mr Culpin's minute of 16 February
Mr Culpin's note of 24 February on "Revised Budget Package".

(vii) Press Notices:

Mr Flanagan's note of 23 February; Mr Denton's (IR) note of 23 February and enclosures; Mr P R H Allen's (C&E) note of 23 February and enclosures.

Other items

(viii) Tax relief for abandonment and nuclear provisions

Mr Scholar's note of 23 February.

Ch

PEM would like a word in margins of overview about Juliet Wheldon. AG is now offering six month hand-over with new (DTI) chap (ie Wh is post). Pete is inclined to think we'll have to go along with this.

AA

Ch.

NB

a) Robert Culpin's "revised budget package" note of 24/2, which appears under Item 1., is highly relevant also to Item 6 on presentation.

b) Pgs. for Item 7 on separate folder.

Sent to No 11

24/2

SCORECARD/cov.minute

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COPY NO 1 OF 45 COPIES

FROM: ROBERT CULPIN
DATE: 23 February 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Dame Anne Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Riley
Mr Sedgwick
Mr A C S Allan
Mr Macpherson
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call

Sir Anthony Battishill)
Mr Beighton)
Mr Isaac)IR
Mr Painter)

Mr Unwin)
Mr Jefferson Smith)C&E

BUDGET SCORECARD

I attach the Scorecard for the Overview on 27 February. I also attach two supplements (this week only).

2. Annex A is a timetable of implementation dates. I think Ministers have agreed them all individually. This simply gives you the opportunity to see the picture in the round, and to make sure you are content.

3. Annex B lists points which still need to be decided, on FP's reckoning. I cannot guarantee that it is complete, but it has been seen by the Revenue Departments.

CULPIN TO C&E 23 FEB

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4. At the time of going to press, Parliamentary Counsel is waiting for instructions on:-

ESOPs	up to 5 pages
life assurance	5 pages
CGT set-off of trading losses	about 1¼ pages
income tax allowances	2/3 page

All of these are promised this week.

5. In addition, I understand that Counsel is waiting for loose ends to be tidied up on close company legislation, the ECJ judgement, and the right to repayment of VAT and excise duties. There may also be work to apply stamp duty to pilot paperless transactions.

6. Counsel is waiting for instructions for Committee Stage on:-

trusts	4-5 pages
CGT avoidance	6-12 pages
electricity privatisation	2-3 pages
Netherlands/Antilles	up to ½ page
Seizure of drug proceeds	½ page.

ROBERT CULPIN

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Additional copies for Scorecard work:

Mr Gilhooly	)	
Mr Flanagan	)	FP
Mr O'Donnell	)	
Mr Matthews	)	ETS
Mr Pickford	)	EB
Mr Gieve	)	IDT
Mr Davies	)	
Dr Courtney	)	MP
Mr Mowl	)	PSF
Mr Bush	)	
Mr Calder	)	
Mr McManus	)	IR
Mr McNicol	)	
Mr Ko	)	
Mr P R H Allen	)	
Ms French	)	C&E

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SCORECARD OF 23 FEBRUARY 1989

TABLE 1: DIRECT EFFECTS OF BUDGET MEASURES

		£ million yield (+)/cost (-)		
		1989-90		1990-91
		Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
		-950	-950	-2740
1.	Reform employee NICs	- 860	- 860	-2440
2.	Freeze excise duties	nil	-1225	-1320
3.	Reduce duty on unleaded petrol; increase on 2 star	- 30	- 30	- 75
4.	VED: coaches and lorries	+ 40	+ 40	+ 40
5.	VAT: non-domestic construction etc	+ 315	+ 315	+ 540
6.	Index IT thresholds	-1465	nil	nil
7.	Increase car scales by 20 per cent	+ 90	+ 90	+ 110
8.	CT: raise small companies thresholds	- neg	- neg	- 35
	Savings			
9.	Abolish stamp duty on shares from 1/4/90	+ 10	+ 10	- 900
10.	Life assurance	- 20	- 20	+ 45
11.	Pensions, PEPs, Share Schemes, Unit Trusts	- 5	- 5	- 10
	Other			
12.	Schedule E: receipts basis	- 60	- 60	- 80
13.	VAT: bad debts, registration, etc	- 105	- 105	- 270
14.	Miscellaneous starters	- 70	- 35	+ 25
15.	TOTAL	-2160	-1885	-4370
			-1975	-4670

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SCORECARD OF 23 FEBRUARY 1989

NOTES TO TABLE 1

Estimated cost (-) or yield (+) in £ million from indexed base unless otherwise indicated. Indexation 6.8 per cent.

1. Reform employee NICs

Below £75 a week, NICs unchanged. Above £75, 5 per cent on £0-75 and 9 per cent on £75 to UEL. UEL increased from £325 to £358.

If UEL not increased, line 1 becomes -930, -2660.

Alternatives in place of line 1:

£1 +9 per cent on £44-358	- 830	-2440
2 per cent of £43 +9 per cent on £44-358	- 880	-2520
just not increased	-950	-2740

2. Excise duties

	1989-90	1990-91
Petrol, derv etc	- 545	- 580
VED	- 190	- 210
Tobacco	- 235	- 250
Alcohol	- 255	- 280
Total	**-1225**	**-1320**

Freeze reduces RPI by 0.48 percentage points compared with base forecast.

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3. Unleaded petrol

	1989-90	1990-91
Reduce tax by 0.7p a litre to make unleaded 2p a litre cheaper than 4 star, if reduction passed on to consumers	- 30	- 60
Increase duty on 2 star (and 3 star) by 1.1p a litre to make it as expensive as 4 star	-neg*	- 15

*cost of extra unleaded take-up balanced by extra yield from 2-star.

See Wilmott of 23 February.

Cost depends on take-up. No significant RPI effect.

4. VED: coaches and lorries

+20 for buses and coaches, +20 for rigid heavy goods vehicles. Over 70 VED rates abolished. No direct RPI effect.

5. VAT: non-domestic construction etc

		1989-90			1990-91		
		Private sector	Public sector	Total	Private sector	Public sector	Total
Construction							
- new	(1)	15	250	265	20	325	345
- option to tax	(2)	20	10	30	40	35	75
Fuel and power	(3)	nil	nil	nil	15	80	95
Sewerage/water	(3)	nil	nil	nil	neg	neg	neg
News services	(1)	5	neg	5	5	neg	5
Protective boots and helmets	(1)	neg	neg	neg	neg	neg	neg
Minor property changes	(1)	15	neg	15	20	neg	20
TOTAL		**55**	**260**	**315**	**100**	**440**	**540**

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SCORECARD OF 23 FEBRUARY 1989

Assuming implementation dates of (1) 1 April 1989
(2) 1 August 1989
(3) 1 July 1990

No impact effect on RPI, because no direct effect on prices to final consumers.

6. Index income tax thresholds

Cost of illustrative alternatives, in place of line 6:

	1989-90		1990-91
	non-indexed base	indexed base	indexed base
Increase thresholds by 10 per cent	-2,130	- 665	- 925
Reduce basic rate by 1p (with indexation)	-2,865	-1,400	-1,725

7. Increase car scales by 20 per cent

No change in structure of car scales. No allowance for behavioural effects (likely to be small).

8. Corporation tax: raise small companies thresholds

50 per cent increase in profits limits for small companies' CT rate of 25 per cent.

- Rate available on profits up to £150,000 (instead of £100,000).
- Benefit not fully withdrawn until profits £750,000 (instead of £500,000).

Reduces CT for about 23,000 companies.

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9. Abolish stamp duty on shares from 1/4/90

Cost revised in light of new forecast and new assumptions about Stock Exchange turn-over and share prices. Net of extra (+100 in 1990-91) yield from CGT, CT, VAT and Income Tax, as a result of increase, in transactions and equity prices. Figures under scrutiny and subject to revision.

If abolition from 1/1/90, cost in place of line 9: -150, -900.

10. Life assurance

Individual figs?

From 1/1/90:

- Life Assurance Policy Duty abolished
- rate on policy holders' income and gains cut to 25 per cent
- expenses from pensions business only deductible from pensions profit
- relief for acquisition expenses spread over 7 years, but change phased in 4 steps.

Yield in 1990-91 (unchanged from last week) is more recent estimate than Deacon of [16] February.

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SCORECARD OF 23 FEBRUARY 1989

11. Pensions, PEPs, Share Schemes, Unit Trusts

	1989-90 non-indexed base	1989-90 indexed base	1990-91 indexed base
Pensions	neg	neg	neg
PEPs	- 5	- 5	- 10
Employee Share Schemes	- neg	- neg	- neg
ESOPs	- neg	- neg	- neg
Unit Trusts	nil	nil	- neg
Total	**- 5**	**- 5**	**- 10**

Pensions

- cash limit of £60,000 on earnings on which tax-privileged pensions can be paid: so maximum privileged pension of £40,000, maximum tax free lump sum of £90,000; any excess taxed;
- limits apply only to new pension scheme members; indexed to prices;
- increase in percentage of earnings payable to personal pensions attracting tax relief, subject to cash limit.

PEPs

- increase in limit on total annual investment from £3,000 to £4,800, and on investment in unit and investment trusts from £750 to £2,400. Full year cost in long term of -30.

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Employee share schemes

- increase FA 1978 all-employee share scheme limit from £1,250 or 10 per cent of salary to £2,000 or 10 per cent

- increase FA 1980 all-employee SAYE share scheme limit from £100 to £150 per month

- increase statutory limit on share price discount for FA 1980 schemes.

- annual cost expected to build up to between 5 and 10.

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ESOPS

- corporation tax relief on company contributions to employee benefit trusts. Could build up to -20.

Unit Trusts

- reduce CT rate on unfranked income from 35 to 25 per cent from January 1990.

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12. Schedule E: receipts basis

Cost is transitional. Yields +10 in 1991-92 and +50 in 1992-93.

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SCORECARD OF 23 FEBRUARY 1989

13. VAT bad debts, registration etc

	1989-90	1990-91
Bad debt relief	- 50	-150
Simplification of registration rules	- 35	-100
Revision of default surcharge	- 20	- 20

14. Miscellaneous Starters

See Table 2.

15. Total direct effects

Not same as effects on PSDR.

MP estimate total call of Budget measures on fiscal adjustment -1720, -3630.

Table does not include pensioners' earnings rule.

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SCORECARD OF 23 FEBRUARY 1989

TABLE 2: MISCELLANEOUS STARTERS (I.E. LINE 14 OF TABLE 1)

Table contains only those starters which cost or yield £5 million a year or more

FB Starter Proposal number		£ million yield (+)/cost (-) 1989-90 Changes from a non-indexed base	1989-90 Changes from an indexed base	1990-91 Changes from an indexed base
32	VAT: charities	- 5	- 5	- 5
40	VAT: r + d cars	- 5	- 5	- 5
43	Motability: car tax relief	- 5	- 5	- 10
107	Relocation costs	+ 5	+ 5	+ 30
Part of 100	Age allowances:			
	- over 75s	- 10	- 10	- 15
	- reduce marginal withdrawal rate	- 5	- 5	- 5
115	Employees' material interest	- neg	- neg	- 5
116	PRP	- 10	- 10	- 15
151	Covenanted membership subscriptions	- 5	- 5	- 10
154	Over 60s private medical insurance	nil	nil	- 40
204	BES: withdraw relief on loans to buy shares	+ neg	+ neg	+ 5
206	Close company legislation	- neg	- neg	- neg
216	CGT: unincorporated businesses trading losses	nil	nil	- 25
251	CGT: freeze exemption limit	nil	nil	+ 10
252	CGT: abolish tax deferral on gifts	+ neg	+ neg	+ 25
259	IHT: index threshold	- 35	nil	nil
261	IHT: instruments of variation	+ 5	+ 5	+ 15
453	Deep discounted bonds (COBO)	nil	nil	+ 15
633	Sale of numberplates	+ neg	+ neg	+ 10
650	ITV levy	nil	nil	+ 50
TOTAL		- 70	- 35	+ 25

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NOTES TO TABLE 2

1. All items in Table 2 now decided.

2. Details in starter reference sheets, under Finance Bill Starter number in first column.

3. Table omits following starters which protect existing revenue:

119 **Mixed residence and non-resident trusts**

254 **CGT: non-resident companies trading in the UK**

264 **CGT: avoidance on sale of subsidiaries**

400 **Tax deductible from tax credit payments to US companies**

These have a cost if not implemented.

4. Starter 100, **age allowances:** Scorecard shows cost of indexing over 80s' allowance and extending it to all over 75. Alternatives:

- increase allowance for over 80s by 10 per cent: cost becomes -10, -10
- double index allowance for over 80s: cost becomes -15, -20.

5. Starter 116, **PRP:** includes effects of changes announced 3 February.

6. Starter 154, **private medical insurance:** announced 31 January.

7. Starter 216, **CGT: unincorporated businesses' trading losses:** applies to gains realised from 6 April 1989 and losses from accounting years beginning with 1989-90. Full year effect -50.

8. Starter 453, **COBO:** includes index linked bonds with life of no more than 3 or 5 years.

9. The following starters still in play are expected to have nil or negligible cost or yield in 1989-90 and 1990-91:

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2	Excise: power to estimate revenue duties payable
3	Excise: restriction of duty-paid blending of made-wine
4	Excise: measurement and declaration of original gravity of beer
5	Excise: misdescription of substances as beer
6	Excise: oil duties relief
34	Raise VAT threshold from £22,100 to £23,600
36	Right to repayment of VAT/excise duties and consequential changes
39	Duty and tax relief for diplomats and visiting forces
60	Prosecution time limits
61	Seizure at export of probable cash proceeds of drug trafficking
62	London Port banking: amendment to CEMA Section 17
63	Unauthorised disclosure of confidential information (C & E)
103	Secure accommodation
114	Taxation of employee priority in company flotations
118	Trusts
158	Charities: payroll giving limit
205	ACT: change in ownership
207	Capital allowances at sports grounds
209	Capital allowances: pre-consolidation amendments
212	Reopening of claims etc
213	Extension of pre-trading expenditure relief
218	Lloyd's stock lending
255	CGT: technical changes associated with rebasing
256	CGT: chattels exemption
262	CGT: sterling non-qualifying corporate bonds
263	Gifts to housing associations
404	Tax charge on switching investments in offshore funds (Umbrella funds)
405	Payments to fund Netherlands Antilles euro-bond interest
450	Keith committee: administrative improvements
451	Sub-contractor tax scheme
452	Unauthorised disclosure of confidential information (IR)
455	Electricity privatisation: miscellaneous taxation provisions
601	VED: trade licensing
602	VED: special types
605	VED: recovery vehicles
606	VED: dishonoured cheques

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SCORECARD OF 23 FEBRUARY 1989

631 VED: update reference to "registration book"

632 VED: grass cutting vehicles

651 Government stock: small estates

652 Gilts redemption monies: new procedures

654 Redemption 3% 1986-1996: wind-up of Annuities Account and Sinking Fund

655 Power to use NLF money to purchase and cancel gilt edged securities ahead of redemption

656 National Savings: abolition of minimum interest rate provision

657 National Savings: restriction of investment and ordinary accounts to personal holders

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SCORECARD OF 23 FEBRUARY 1989

TABLE 3: STAFFING EFFECTS

		Effect in man-year terms in 1989-90	1990-91
1.	Reform employee NICs	not known	not known
2.	Freeze excise duties	nil	nil
3.	Reduce duty on unleaded petrol	nil	nil
4.	VED: coaches and lorries	nil	nil
5.	VAT: non-domestic construction etc	+ 45	+ 130
6.	Index IT thresholds	- neg	+ 40
7.	Increase car scales by 20 per cent	nil	+ 10
8.	CT: raise small companies thresholds	nil	nil
	Savings		
9.	Abolish stamp duty on shares from 1/4/90	- nil	- 30
10.	Life assurance	+ neg	+ neg
11.	Pensions, PEPs, Share Schemes, Unit trusts	+ neg	+ neg
	Other		
12.	Schedule E: receipts basis	+ 10	+ 40
13.	VAT: bad debts, registration, etc	+ 10	+ 20
14.	Other starters	+ 15	+ 55
15.	**TOTAL**	**+ 80**	**+ 265**

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NOTES TO TABLE 3

Line 1: staffing effect on DSS (if any) not yet known.

On line 5, Customs have provision in the PES baseline for extending VAT to non-domestic construction etc.

Line 12 would save 100 staff in 1991-92 and 175 in 1992-93.

Line 14 breaks down as follows:

	1989-90	1990-91
Over 60s medical insurance (includes setting-up costs in 1989-90)*	+ 10	+ 25
Index IHT threshold	+ 5	+ 10
CGT: freeze exemption limit	nil	+ 10
CGT: set off trading losses**	+ neg	+ 5
No change in threshold for stamp duty on housing***	nil	+ 5
TOTAL	+ 15	+ 55

* +45 in subsequent years.

** up to +10 by 1991-92.

*** +10 in subsequent years.

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ANNEX A

IMPLEMENTATION DATES

Figures in left hand column are starter numbers

	Measure	Reason
Retrospective for all time		
400	Tax deductible from tax credit payments to US companies (does not affect pre 25/10/88 Court decisions)	to restore law to what was originally intended
10 October 1988		
116	PRP: allowing alterations (as ESC until Royal Assent)	take-up and existing schemes' distributions
3 February 1989		
116	PRP: 5 per cent test abolition (as ESC until Royal Assent)	take-up and existing schemes' distributions
Budget Day		
1	Excise duty rates (unleaded and 2 and 3 star)	to minimise forestalling
118	Trusts (applies to settlements made on or after Budget day. Independent taxation related measures have practical effect from 6/4/90)	to minimise forestalling
151	Covenanted membership subscriptions	to give relief as soon as possible
153	Pensions: main changes to ocupational schemes	to prevent forestalling

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204	BES (shares issued on or after Budget day)	to prevent forestalling
205	ACT (events after Budget day)	to minimise forestalling
252	CGT: gifts relief	to prevent forestalling
254	CGT: non-resident companies	to prevent forestalling
259	IHT threshold	to give benefit as soon as possible
262	CGT: sterling non-qualifying corporate bonds	to prevent forestalling
263	CGT/IHT: gifts to housing associations	to give relief as soon as possible
404	Umbrella funds	to prevent forestalling
453	COBO	to prevent forestalling

15 March 1989

34	VAT: revalorisation of threshold	)to give traders maximum
35	VAT: simplification of registration requirements	)benefit from change
601-632	VED	tradition

1 April 1989

30	ECJ: new construction news services protective boots and helmets	earliest reasonable date after ECJ Judgement and Budget day
31	VAT: minor property changes	to coincide with new construction changes

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32	VAT: charities	tradition
38	VAT: default surcharge (applies to all returns due on or after 31 March)	to coincide with end of earliest VAT accounting period after Budget day
113	ESOPs (provisional)	start of CT financial year
200+201	Corporation tax rate and thresholds	start of CT financial year
206	Close company legislation (applies to accounting periods beginning after 31/2/89)	start of CT financial year
213	Pre-trading expenditure relief (for businesses starting to trade on or after 1/4/89)	start of CT financial year

6 April 1989

100	Income tax thresholds etc	start of personal tax year
104	Company car scales	start of personal tax year
107	Relocation costs	avoids lengthy implementation period
108	Schedule E: receipts basis	start of personal tax year
112	Employee share schemes. FA 1978 schemes	start of personal tax year

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152	PEPs	relief moved from calendar year to tax year basis
158	Charities: payroll giving	start of personal tax year
251	CGT: annual exemption	start of personal tax year
256	CGT: chattels exemption	start of personal tax year

1 June 1989

34	VAT: change in deregistration threshold	to allow businesses time to decide whether or not to deregister

Royal Assent

112	Employee share schemes: increase in discount	no need for earlier start
116	PRP: Limit etc (will apply to profit periods after 6/4/89)	no need for earlier introduction
153	Pensions: FSAVCs - new tax charge	new charge not to apply retrospectively
261	IHT: instruments of variation	to give people time to change their wills
452	Unauthorised disclosure of confidential information	not needed until Section 2 OSA repealed

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1 August 1989

30	VAT: ECJ - option to tax rents	to allow full Parliamentary scrutiny and give landlords time to decide whether or not to opt

1 September 1989

112	Employee share schemes: FA1980 schemes	to give time for SAYE prospectus to be changed

1 October 1989

37	VAT: bad debt relief (effective from Royal Assent, but 1 October date for first claims)	relief available on "bad debts" 18 months old, backdated to start of review (1/4/88)

December 1989

633	Sale of registration numbers (pilot)	time needed to appoint agents

1 January 1990

156	Unit Trusts	to align with life assurance
215	Life assurance	to align with most insurance companies' accounting periods and give them time to re-write policies

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650	ITV Levy	start of extended contracts

1 April 1990

301	Stamp duty on shares	TAURUS delays. Avoids cost in 1989-90

6 April 1990

154	Over 60s' private medical insurance	set-up time, personal tax year

1 July 1990

30	ECJ: fuel and power, sewerage and water	to give industries time to adjust accounting systems, identify status of customers etc.

Still to be decided

119	Mixed residence and non resident trusts
264	CGT: avoidance on sales of subsidiaries

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ANNEX B

POINTS STILL TO BE DECIDED

Figures in left hand column are starter numbers

Customs and Excise

1. **Excise Duty rates** By usual Customs conventions, formal decision not to increase rates still to be taken. Minor details on leaded/unleaded being pursued by Economic Secretary.

32. **VAT: Charities** Some minor technical details related to ECJ judgement being pursued by Economic Secretary. Also issues of whether ESC relieving d-i-y Village Hall etc constructions from VAT should be turned into statutory provision in this Finance Bill - submission being considered by Economic Secretary.

35, 37 and 38: **VAT "Deregulation Package"** Formal decision needed on whether all three starters can be afforded.

61. **Seizure at Export of Cash Proceeds of Drug Trafficking**

Home Office has raised late difficulties. Customs consulting Economic Secretary. (May have to be dropped? - cannot now be ready before Committee Stage.)

Motability Decision on 20 February to include. Details being worked up by Customs. (Now seems legislation will be needed. Instructions on way to Counsel.)

Inland Revenue

100. **Income Tax**. Final formal decisions still to be taken, under Inland Revenue's usual conventions.

103. **Benefits in Kind Misc 2** FST held meeting 22 February. Conclusions being reported to Chancellor.

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104. **Benefits in Kind: car and car fuel benefit** Financial Secretary pursuing details. Revenue submission to him under consideration.

113. **ESOPs** Financial Secretary has held meeting on outstanding issues. Conclusions being reported to Chancellor.

153. **Pensions** Need to settle detail of legislation to ensure employers do not get CT deduction for generalised provisions (where no taxable benefit to identified employees): IR advising. Can we allow people to run their own personal pensions?

156. **Unit Trusts** Issue to be decided about interest relief. IR submission under consideration by FST.

215. **Life Assurance** A number of secondary but important issues to be decided. Revenue submission to Financial Secretary, instructions to Counsel both promised by end this week (24 February). ETS looking at behavioural effects in 1989-90.

301. **Stamp duty : rate on shares** Effect of possible pilot exercises on timing. Behavioural effects being pursued by ETS.

453. **Deep discounted bonds** Decision on 3 years or 5 years cut-off (including Lloyd's angles); and on details of rules. Revenue submission with Financial Secretary for consideration.

455. **Electricity privatisation** Still unsettled whether legislation needed in 1989 Finance Bill. Issues concern (i) shares for employees on privatisation; (ii) nuclear decommissioning. PE submitting for overview meeting.

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Joint Revenue/Customs Starter

632 & 452 **Taxpayer confidentiality** Decision needed on whether "purported" information in or out. Submission from IR to Financial Secretary this week.

OTHER STARTERS

Employee National Insurance Contributions

Under active consideration.

Sub-contractors scheme

Draft 32 paragraph "consultative document" for issue on Budget Day (plus press notice) just submitted to Financial Secretary. Decisions needed on content, size, timing and handling.

Sterling commercial paper and short-term corporate bonds

Not a tax matter (therefore not a "starter") but a Budget Measure. FIM planning to submit by close Friday 24 February.

ITV levy

Letter awaited from Home Secretary - promised for Friday 24 February.

Sale of registration numbers

SoS for Transport has raised last - minute uncertainties about whether for inclusion this year. FP have submitted to Chancellor.

Committee stage starters

Apart from Electricity Privatisation and seizure of probable proceeds of drug trafficking (see above) list is:

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119: Mixed residence and non-resident trusts

264: Capital gains avoidance on sale of subsidiaries.

Both may need further consideration/decisions.

Also for Committee Stage would be!

Netherlands/Antilles Double Taxation Agreement

Technical "loophole" legislation may be desirable. Submission under consideration by Financial Secretary.

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chex.ps/jmt/5 BUDGET CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 23 February 1989

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Gilhooly
Mrs Chaplin
Mr Tyrie
Mr Jenkins - OPC

Mr McGivern - IR
Mr Elliott - IR
PS/IR

STARTER 216: CGT SET-OFF AGAINST TRADING LOSSES

The Chancellor has seen the Financial Secretary's note of 22 February.

2. He is content with the Financial Secretary's proposals - unless there is something costing less than or equal to £75 million which the unincorporated sector would sooner have (at this stage it would have to be pretty uncomplicated). He would like to discuss this at next week's Overview.

J M G TAYLOR

JMGT TO PS/FST 23 FEB

FINANCIAL SECRETARY TO THE TREASURY

FROM: **FINANCIAL SECRETARY**
DATE: **22 February 1989**

CHANCELLOR

cc Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Gilhooly
Mrs Chaplin
Mr Tyrie
Mr Jenkins - OPC

Mr McGivern)
Ms Elliott) IR
PS/IR

STARTER 216: CGT SET-OFF AGAINST TRADING LOSSES

I have discussed Mr Elliott's note of 20 February with officials.

On the detailed points, I agree with what the Revenue are proposing. The new relief would (broadly) follow the existing ones for relief of income and capital losses. There is a wrinkle in aligning the relief with the introduction of independent taxation. But anticipating it by one year and not allowing set-off between spouses in 1989-90 would I think be justifiable. However, I don't think we should backdate the relief to the start of 1988-89 as Andrew Tyrie originally suggested; that would be unnecessarily generous.

The key question is the cost. I don't think we should restrict the relief to gains on trading assets qualifying for rollover relief. It would be difficult to defend for the reason Judith Chaplin has highlighted; why, if a business is in temporary difficulties, should the businessman get relief if he sells a business asset to get it out of trouble but not any other asset? Moreover, the narrower relief would make the legislation much more complicated.

FST TO CX 22 FEB

However, the wider relief has a full-year cost of £75 million. This does seem quite a lot of money. I assume we are comfortable defending it as a measure to provide a better balance between the incorporated and unincorporated sectors. The way the Revenue have framed it seems sensible.

NORMAN LAMONT

BUDGET CONFIDENTIAL

Inland Revenue

Business Tax Division
Somerset House

FROM: M J G ELLIOTT
DATE: 20 FEBRUARY 1989

FINANCIAL SECRETARY

CAPITAL GAINS TAX: SET OFF AGAINST TRADING LOSSES
STARTER 216

1. You are holding a meeting tomorrow to discuss this starter. This note is intended to serve as background to that meeting, and in particular

(a) to report on the further work we have been doing on the cost, and

(b) to set out the main questions for decision on the way the relief is to work, on which it would be helpful to have your views so that we can press ahead with instructing Counsel.

Cost

2. The main outstanding question, following Mr Taylor's note of 8 February recording the Chancellor's views, is whether the relief should extend to allow set off of trading losses against all the trader's capital gains or, as Lord Young proposed, only against gains on trading assets qualifying for rollover relief. The Chancellor has said that the relief should run against all gains subject to the final figures for cost, which, as you will see, is our recommendation.

---

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Gilhooly
Mrs Chaplin
Mr ~~Tyrie~~ Tyrie
Mr Jenkins
(Parliamentary Counsel)
Mr Isaac
Mr McGivern
Mr Pitts
Mr Elliott
Mr Cayley
Mr Gonzalez
Mr Hamilton
Mr Campbell
Miss Brand
PS/IR

ELLIOTT TO FST 20 FEB

3. On the basis of what we now propose on the shape and scope of this relief, we have refined the cost figures which we suggested earlier. Briefly, what our proposals would mean for the cost of the relief is

- the cost profile becomes

1989/90	1990/91	Full Year
Nil	£25m	£75m

- the full year difference between allowing the relief against all gains and only against trading gains is £30m.

4. On this basis we would very strongly recommend Ministers to allow relief to run against all gains. To restrict it to trading gains would be very difficult to justify in principle, for the reasons we discussed at your last meeting and which Mrs Chaplin underlined in her note to the Chancellor of 1st February. If a business is going through a bad patch, it hardly makes sense to allow relief only if the businessman sells off an asset of that business, and not any other asset.

5. Including all gains would also considerably simplify the legislation.

Outline of proposed scheme of relief

(i) What losses are to be available for set off

6. The basic proposition is that if in any year (ie tax year) an unincorporated trader both sustains a trading loss, and realises a capital gain, he should be able to set off the one against the other.

7. The present rule is that a trading loss for a particular year may be set off against any other income the trader has

either in that same year, or in the following year. Trading losses not set off in that way may be carried forward indefinitely, but only against income from the same trade.

8. We propose that we should build the new relief on to the existing relief for losses against other income, ie the new relief should be available only for losses incurred in the year the gain was realised, or the preceding year, and should not be available for losses carried forward for more than one year within the same trade. (I will call these "brought forward losses" in what follows). That approach would broadly ensure parity of treatment for an unincorporated businessman's losses as between income and capital gains: and we think it would be generally seen as logical and reasonable.

9. It will not however be without its critics. Suppose for example that a sole trader's business runs into difficulties and he makes a sizeable loss in a particular year, (year 1). He has a small amount of other income, but that is covered by personal allowances. In year 2 he again makes a loss. In year 3, he just manages to break even. In year 4, faced with the prospect of another smallish loss, but confident that things are going to get better, he sells (an) asset(s) and realises a capital gain. Under our proposed scheme, he will be able to set against the capital gain the losses of year 4, but not the brought forward losses of years 1 and 2. The critics will argue that he realised the gain to fund all his losses and that it is unreasonably restrictive to allow him to set off against those losses only the smallish loss in year 4.

10. The answer to that sort of criticism should we suggest be on the lines that -

- in circumstances like this, the earlier trading loss will still be available to set against future trading profits; the relief, as you have already

decided, is not to be presented as aimed at prolonging the death throes of failing businesses, but at helping businesses to survive (reasonably) short term difficulties.

- the second objective of the relief is to achieve parity so far as possible with the position for companies - and companies do not have total flexibility of this kind in relation to setting income losses off against gains.

- to allow carried forward losses against gains without time limit would look very odd if losses could not also be set off against other income without time limit. But that would be to open Pandora's box (at potentially very considerable cost) by creating a range of new opportunities for tax shelters, and the Government are not prepared to contemplate it.

(ii) How is the set-off to work?

11. There are some basic questions which need to be settled at this stage. First, in a year when an unincorporated trader, with trading losses, has both other income and capital gains, how is the loss to be set off as between the income and the gains?

Order of set-off

12. The options here as we see them are -

(a) allow the taxpayer to choose how the loss is to be divided up as between income and gains

(b) impose an order of set off, eg that losses have to go against income first with only the balance available to go against gains

(c) say that in any year the taxpayer must choose to set the whole of his loss against either income or gains.

13. Option (c), it seems to us, would be absurdly restrictive and does not merit detailed consideration.

14. Option (a) is clearly the most generous. But we do not favour it. The existing income tax rule - (which we want to supplement, not replace, by the new relief) is an all or nothing rule - you cannot choose to set against your other income just so much of your loss as will leave a balance to be covered by personal allowances. To allow a taxpayer a free choice in the context of this relief would undermine that rule. (It would also cause both legislative and operational complexity.)

15. We therefore favour option (b) - ie stipulating in the legislation that the order of set off is to be (i) against other income (ii) against capital gains. This is logical; these are, after all, income losses. It also preserves the existing all or nothing principle in relation to income losses. And, so far as we can see, it makes for greater legislative and operational simplicity.

Extent of set-off against gains

16. We propose that the amount of losses available for set-off against gains should not exceed the chargeable gains, net of allowable losses but before deducting the annual exemption, for the relevant year. This would broadly equate the treatment of trading losses transmuted into capital losses under the new relief with the existing treatment of "genuine" capital losses, which have to be set off against gains arising in the same year before the annual exemption is given (ie just as for income tax losses and personal allowances, you cannot choose to set against your gains for any year just so much of your capital losses as will leave a balance to be covered by the annual exemption).

17. This will mean that any balance of trading losses left after set off against (i) other income and (ii) gains will be available for carry forward against the following year's income and gains.

18. There is a difficulty however which may arise if a gain for a particular year, against which losses have been set, is subsequently the subject of a claim for rollover relief (or indeed any hold over relief, eg gifts relief). This could happen anything up to 10 years after the event. If it does, the gain against which the losses have been set will have ceased to exist at that time, in whole or in part; and the taxpayer will have lost some relief. The problem is how we are to give it back to him.

19. The logical solution - given the scheme of relief we are proposing - would be to treat the wasted loss as if it was now retrospectively available against other income, and reopen the relevant years. But given the possible timescale that would be an operational nightmare.

20. We therefore propose that the "wasted loss" should be left as a capital loss, and could therefore run forward indefinitely against gains. In other words in these circumstances trading losses would be allowed against gains of a different year - possibly several years. That is not conceptually very satisfactory, and might open up avoidance possibilities, but we can see no realistic alternative. But we could prevent the most blatant avoidance by providing that these losses could be carried forward only as long as the trade continued and we recommend that we should import that restriction (but at the cost of some complexity).

Husband and Wife

21. For 1990/91, and subsequent years, there should be no question of trading losses incurred by one spouse being available for set off against capital gains realised by the

other spouse, just as it will not be possible for trading losses of one spouse to be set off against the other spouse's income. That will follow automatically from the introduction of independent taxation.

22. The question then is what we do for 1989/90, before independent taxation. Legislatively the simpler course would be to anticipate 1990/91, and not to allow set off of trading losses and capital gains between spouses. Since we are only talking about one year, we for our part doubt whether the extra legislation needed to provide for inter-spouse set off would be justified, and, if Ministers were content to anticipate independent taxation, that is what we would recommend.

Commencement

23. We think it would be operationally and presentationally preferable to run the new relief, in relation to both losses and gains, from 6 April 1989. That would mean, on the gains side, that the relief would be available against gains made in 1989/90 but not in 1988/89. On the loss side, the position is a little less clear cut because of the way losses are measured. If a trader makes his accounts up on a fiscal year basis, ie to 5 April every year, there is no problem; his losses for the year 1989/90 will obviously be those shown in the accounts to 5 April 1990, and we propose that the new relief should apply to those losses but not to any balance of losses which he has carried forward from 1988/89 to set against other income in 1989/90.

24. If a trader makes up his accounts to some date other than 5 April (say to 31 December) we ought strictly to apportion the loss as shown in the accounts between years of assessment; and we will always do that if the taxpayer wants. But normally, with his agreement and to save trouble all round, we take the loss shown in the accounts for the accounting period ending in the year of assessment as the

loss for that year. So, if a trader made up his accounts to 30 June every year, we would accept that a loss shown in the accounts to 30 June 1989 was a loss for 1989/90; and under our proposal that loss would be available for set off against gains of 1989/90. It seems to us that that small degree of retrospection would be unexceptionable.

25. Mr Tyrie asked us earlier to consider running the relief as a whole from 1988/89, which would mesh it in with last year's Budget alignment of capital gains and income tax rates. We see his point, of course. But new tax reliefs are not normally introduced retrospectively in that way; the point I have made in paragraph 23 would mean that some losses actually sustained in 1987/88 would come into relief, and that seems very over-generous. So, while as I have said we take Mr Tyrie's point, we would strongly favour a 1989/90 start.

MJG.

M J G ELLIOTT

BUDGET SECRET

Overview

H.M. CUSTOMS AND EXCISE
NEW KING'S BEAM HOUSE, 22 UPPER GROUND
LONDON SE1 9PJ
01-620 1313

Copy No 1 of 34

FROM: P G Wilmott
DATE: 23 February 1989

CHANCELLOR

UNLEADED PETROL

Parliamentary Counsel is busy drafting the clause to give effect to the decision taken at the Overview meeting on 6 February (that we should increase the duty and tax differential for unleaded petrol to 2 pence a litre and introduce a higher rate on two and three star fuel of 1.1 pence a litre).

Circulation:

Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Culpin
Mr P N Sedgwick
Mr Riley
Mr Macpherson
Miss J Simpson
Mrs Chaplin
Mr Tyrie
Mr Call
Mr Gilhooly
Mr Matthews
Sir A Bittishill IR
Mr Beighton IR
Mr Issaac IR
Mr Painter IR
CPS
Mr Jefferson Smith
Mr Allen
Mr Vernon
Mr Gaw
Mr Spackman

When do LT vote? 3rd?

WILMOTT TO CX 23 FEB

Our 'green' petrol package has two components: a reduction in the duty on unleaded fuel and an increase in that on two and three star. The first question is, then, **"are the numbers right?"**. The widening of the gap between unleaded petrol and four-star fuel by around 0.7 pence (duty plus VAT) should take the pump price differential to about 2 pence a litre (9 pence a gallon) and increase the uptake of unleaded to a projected 15 per cent of the market by the end of 1989-90 and 20 by 1990-91. There is nothing in the latest market information, or public campaigns for action, to suggest that any more is needed. The higher rate on two and three star is more difficult. What matters is the differential on the forecourt; average price differences (less than 1 pence per gallon nationwide) are misleading, since it is the perceived price advantage of two and three star at his usual pump that is most likely to encourage the motorist to buy it. To ensure that two and three star are at least as expensive as four-star the latest industry figures suggest that the higher rate could be shaded down to 0.9 pence a litre.

A further question is **"do we still need the two and three star higher rate?"**. The market is declining fast. Although we think there is little risk that it may collapse before the Budget itself, it could be only a matter of months before the lower grades become virtually unavailable. This exposes the Budget measure to the criticism that it is unnecessary and (perhaps) gimmicky. Against this, public opinion is widely conditioned to expect a widening of the unleaded differential. The figure in the package could be lower than many hope to see; the addition of an unexpected component could help prevent the measures turning out to be something of a damp squib. Our advice, on balance, is to keep the package as it is.

A subsidiary point, finally, is publicity. As the paper explains, DoE now see little need for a further campaign centred on the Budget (although CLEAR and the RAC are pushing for one). They argue that recent events have done more than enough to raise the profile of the unleaded initiative - and it is true that the use and availability of the fuel are growing at an accelerating rate. We shall approach the DoE again to convey Ministers' concern about the need for further publicity following on from the Budget.

for P G WILMOTT

CHOSEN OPTION

1. The Overview Meeting of 6 February adopted Option A (increase the present tax differential by 0.7p/litre and the rate of duty for two star leaded petrol by 1.1p/litre).

2. In setting out the Options, no account was taken of the availability of three star, which has an octane rating between two and four star. If only the rate of duty for two star were increased it is probable that the trade would find it attractive to market three star. We have therefore interpreted the decision to require an increase on all petrol other than four star and have instructed Parliamentary Counsel accordingly.

does all that market share?

PUMP PRICES

3. Detailed information about differentials in pump prices between four star, two star and unleaded on individual forecourts is not available. The picture is further complicated by product promotions at week-ends, "cheap days", and so on. However, oil companies' prices to motor spirit retailers show price differentials between two and four star ranging from 0.26 pence per litre (Texaco) and 0.35 pence per litre (Amoco, BP, Total) to 0.87 pence per litre (Elf, Esso, Mobil, Shell). On this evidence a higher rate of at least 0.9 pence per litre would be needed to ensure that the price of two and three star is at or above that of four star sold on the same forecourt. Unleaded will be cheaper than four star on the same forecourt by around 2 pence a litre on average, but we cannot exclude the possibility of heavily discounted four star sometimes being cheaper than unleaded in the same area.

4. On this latest information, the proposed two and three star higher rate could be reduced to 0.9 pence a litre. Since two and three star are likely to get dearer rather than cheaper, relative to four star, as their market share drops over the coming months, a slightly lower increase of this order should achieve the desired objective. This

should have no appreciable effect on our estimates of the magnitude of the switch to unleaded.

UNLEADED - THE MARKET PICTURE

5. There has been a recent dramatic upsurge in availability. At the end of January 4,300 sites stocked unleaded, some with more than one pump. The rate of conversion has more than quadrupled to 250 a week. About 22 per cent of filling stations were therefore selling unleaded at the end of January and because they tend to represent the higher throughput outlets 40-45 per cent of fills were obtained at sites where there is a choice of unleaded. The trade are building a market base in the expectation of a further pricing incentive in the Budget.

6. Unleaded market share based on tanker deliveries to filling stations was 1.1 per cent for the whole of 1988, 3.14 per cent for December and 4.1 per cent for January 1989. These trade figures correspond closely with Customs figures for clearances from bonded warehouse which showed just over 4 per cent for the month ended 14 January. Figures for the month ended 14 February, available on 28 February, are expected to show a figure in excess of 4.5 per cent.

7. We would expect Option A (even with a reduced higher rate for two and three star) to increase the unleaded market share to around 15 per cent by 31 March 1990 and to some 20 per cent by 31 March 1991. The effects of a similarly large differential in Germany is discussed in paragraph 13. We see no strong evidence in favour of a larger diferential for unleaded than is envisaged by Option A.

PUBLICITY

8. The position on publicity has changed since the beginning of the month with a surge of activity boosted by the Queen's attendance at the Motability "I Love Lead-Free" launch on 13 February. CLEAR are running their final "Lead Free Petrol Weeks" in Hampshire on 17-24 February and

in Tyne and Wear on 10-17 March. Much publicity effort is being organised in anticipation of the Budget and although the RAC and CLEAR are pressing for a Government-led campaign to co-incide with the Budget, Department of the Environment officials are reluctant to sanction large expenditure. We believe that Budget action will crown existing publicity plans but we will approach the Department of Environment to convey Ministers wishes in this matter.

9. Two pieces of negative publicity have emerged - both spurious. The Daily Mail published a report purporting to come from the Warren Springs laboratory showing an increase in lead in the air. The 1988 figures were fabricated. In the second incident the Chief Fire Officer for Wiltshire apparently alleged that unleaded petrol fires were more difficult to extinguish than leaded petrol fires. This is untrue but received wide credence. A Home Office working party is considering a rebuttal.

TWO AND THREE STAR

10. The market share of two and three star continues to fall sharply and is conservatively estimated to have declined in January to 6.3 per cent. Virtually all cars using two and three star can use unleaded but there are a number of vehicle types (but not many vehicles) which must use leaded: a list is annexed (Annex A). Most petrol-engined equipment other than cars, including motor cycles, lawnmowers and all two stroke engines can use unleaded. All engines using two and three star can run without adjustment on four star leaded.

11. Ministers may wish to confirm where the balance of advantage now lies in squeezing out remaining two and three star. The imposition of the higher rate can be expected to accelerate the already steep decline and has the attraction of being a novel and innovative measure. On the other hand opinion in the industry is that the decline in two and three star will continue in any case and CLEAR appear to have dropped their demand for a ban of two star.

NETHERLANDS AND GERMANY

12. Historically in the Netherlands there was a 20 per cent market share for two star leaded petrol because of engine design. The introduction of a duty differential between two star leaded and unleaded resulted in a switch to 26 per cent unleaded market share. In December 1988 the unleaded share was still 26 per cent but only 4 per cent was two star and 22 per cent four star unleaded. The unlooked-for and marked shift from two star (Regular) to four star (Premium) is not yet fully understood.

13. In Germany too a substantial proportion of the car fleet, some 40 per cent, has long been designed to run on two star. When two star leaded was banned most users switched to unleaded two star and they account for most of the current unleaded market share of around 50 per cent. The duty differential between leaded and unleaded four star was set at the equivalent of 10p a gallon and since 1 January 1989 has been increased to 13p a gallon. The market share increase of unleaded since September 1988 has been only some 4 per cent. Part of the resistance to unleaded is because it is only 95 octane - many German motorists demand 98 octane. A major oil company is countering by marketing a Super Premium unleaded. Further information on pump prices is given at Annex B. There are no known plans to market two star or super premium unleaded in the UK because the demand is relatively insignificant.

EFFICIENCY DIFFERENTIAL

14. We have no statistics, but for most cars there is no difference in efficiency between leaded, two, three, or four star, and unleaded petrol which could be detected by the normal motorist (as opposed to controlled scientific testing). The occasional exceptional vehicle which may exhibit inferior efficiency or performance will depend very much on the type and model of car and the way in which it has been serviced and driven.

ANNEX A

VEHICLE TYPES RECOMMENDED TWO STAR WHICH CANNOT USE UNLEADED

MODEL	TYPE	YEAR	ENGINE CODE
AUSTIN ROVER			
Mini	850	1977-84	85H
Mini	1000	1976-78	99H
Mini Van	850	1976-81	85H
Mini Van	1000	1976-83	99H
Metro	1,3LC	1980-86	12H
Metro Van	1,0	1980-84	99H
Metro Van	1,0	1985-89	99H
Metro Van	1,3	1986-89	12H
Maestro Van	1,6LC	1984-89	16HS
Marina	1700LC	1978-80	17V
Marina Van/Pick-up	1,1	1976-78	10V
Marina Van/Pick-up	1,3	1976-78	12V
Ital Van Pick-up	1,1	1980-85	10V
Ital Van Pick-up	1,3	1980-85	12V
Sherpa	1600	1974-78	16V
Sherpa	1800LC	1974-78	18V
Sherpa	V8	1985-89	-

MODEL	TYPE	YEAR	ENGINE CODE
BEDFORD			
HA/Chevanne	HA	1978-88	92170
HA/Chevanne	HA	1978-88	92370
CF	1,8	1975-82	18
	1,8	1983-84	18
	2,3	1975-82	23
	2,3	1983-84	23
CITROEN			
2CV6	602	1978-84	A06/635
Dyane 6	602	1978-83	AM2
Visa	652	1979-82	VO6/630
DAIHATSU			
Fourtrack	F20/F25	1978-83	12R/J
FIAT			
126	652	1977-87	126A/1,000
MITSUBISHI			
Colt (RWD)	1,4 Turbo	1982-83	4G12T
Mirage (RWD)	1,4 Turbo	1983-84	4G12T
Celeste	1600 GSR	1976-81	4G32GS
Sigma	2000 GLX	1977-81	4G52
New Sigma	1600	1983-84	4G32GS

MODEL	TYPE	YEAR	ENGINE CODE
NISSAN			
Pick-up	1,6	1979-80	J16
Urvan	2,0	1980-82	H20
Cabstar	2,0	1978-82	H20
OPEL			
Ascona-B	1,3	1975-81	13
Ascona-B	1,6	1976-81	16
Ascona-B	1,9N	1975-81	19N
Ascona-B	2,0N	1975-81	20N
Manta-B	1,6	1979-82	16
Manta-B	1,9	1979-82	19N
Manta-B	2,0	1979-82	20N
Rekord-E	2,0N	1978-81	20N
Kadett-D	1,0	1979-84	10
Kadett-D	1,0S	1979-84	10S
Kadett-D	1,2	1979-84	12N
PORSCHE			
924	924S	1985	M44/07/08
SUBARU			
GTi		1984-86	EA82(m)
GTi		1987-89	EA82(m)
Turbo		1985-86	EA82(T)
'L' Series Coupe	Turbo	1986	EA82(T)
'XT' Hardtop	Turbo	1985-86	EA82(T)

MODEL	TYPE	YEAR	ENGINE CODE
TALBOT			
Dodge 1100	1100	1979-84	350
Express	1,8	1986-89	169B
TOYOTA			
Celicia/Supra	2,0ST	1978-82	18R
Celicia/Supra	2,OXT	1978-82	18R
Cressida	1,8	1977-81	18R
Hi-Lux	1,6	1979-84	12R
Hi-Lux	1,8 4x4	1979-84	18R
Hi-Ace Van	1,6	1977-86	12R
Hi-Ace Van	2,0	1977-83	18R
Hi-Ace Pick-up	1,6	1977-86	12R
HI-Ace Pick-up	2,0	1977-83	18R
Landcruiser	4,2	1981-84	2F
VAUXHALL			
Cavalier	1900	1975-81	19N

ANNEX B

GERMAN PUMP PRICES: INCLUDING DUTY AND VAT

ANNEX B

	END OCT 88		END JAN 89	
	DM/litre	£/Gallon	DM/litre	£/Gallon
LEADED				
Premium (4 Star)				
Major brand,full service	1.049	1.514	1.229	1.703
Major brand,self service	1.009	1.456	1.189	1.650
Supermarkets/white pumps	0.979	1.413	1.129	1.565
UNLEADED				
Premium 98 RON (5 Star)				
Major brand,self service	N/A	-	1.169	1.620
Euro Grade 95 RON (4 Star)				
Major brand,self service	0.959	1.384	1.009	1.523
REGULAR UNLEADED				
Major brand,self service	0.909	1.1312	1.049	1.454

The only direct comparison between leaded and unleaded pump prices that can be made is for four star self service. The differential was 7.3 pence per gallon in October and 12.7 pence per gallon in January 1989.

Rates of exchange October 3.15DM= £ January 3.28DM= £

BUDGET CONFIDENTIAL

FROM: N MONCK

DATE: 24 February 1989

FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gilhooly
Mr S Matthews
Mr Macpherson
Mr Neilson
Mr J C Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill, IR
PS/IR
Mr Beighton, IR
Mr Isaac, IR
Mr Painter, IR
Mr Corlett, IR
Mr G Bush, IR
Miss M Hill, IR
Mr Unwin, C&E
Mr Jefferson Smith
Mr P R H Allen, C&E

STAMP DUTY AND PAPERLESS TRANSACTIONS

I have some comments on Miss Hill's submission of 23 February which I did not see in draft.

2. It is useful to distinguish between problems raised by water and the potential problems raised by possible pilot studies for TAURUS. We are now fairly clear on the likely arrangements for water, as a result of a major piece of work set up in my joint group and carried out by the receiving banks, the Stock Exchange and DOE's advisers. These arrangements involve trading Renounceable Letters of Allotment through Talisman. The Revenue had not until now expressed serious concern about this. They expected, as reported in my minute of 9 February that an ESC would suffice. It is not clear why a change of three months in the

MONCK TO FST 24 FEB

assumed date for abolishing stamp duty should invalidate this view, particularly since RLAs are only likely to be traded through Talisman for 6-8 weeks.

3. The difficulty of dealing with trades in water shares between overseas brokers - the so-called "black hole" - had not been raised with us before. But we have now discussed it with the Revenue. The water proposals for (temporary) paperless trading do create a new problem by making it harder to collect SDRT from offshore brokers. It is not clear how the Revenue's proposal for preventing overseas brokers from trading in water shares would be built into the structure of the water sale. But we have agreed with the Revenue that we should discuss this with the DOE and the Stock Exchange to find a solution without requiring primary legislation. We can set this up at the meeting of the joint group next Wednesday.

4. The position on potential pilot studies is much less clear. We don't of course know whether there will in fact be pilots before April 1990 or, if there are, how large they will be. The main concerns are that pilot transactions might be taxed more than once. The problem originally foreseen for water was of this sort and was thought to be soluble by an ESC. It is not clear why arrangements embodied in an ESC or in regulations made under an enabling power should be unduly contentious, if they are designed to avoid double taxation, unintended by Ministers, as opposed to new arrangements designed to prevent tax evasion or to impose a new tax, especially as they would not last long.

5. I am not qualified to judge whether new enabling powers both for stamp duty and for SDRT are needed, given the availability of ESCs and of new regulations made under the existing power for SDRT (see Miss Hill's paragraph 26). But the Revenue paper gives the impression that problems with water and the potential problems with pilots in the months before April 1990 should be surmountable either through ESCs and existing powers or through new enabling powers.

N MONCK

BUDGET CONFIDENTIAL

Inland Revenue

Savings and
Investment Division
Somerset House

This is the outcome of careful consideration here, following the Overview discussion. 16/2 22/2

FROM: M A HILL
DATE: 22 FEBRUARY 1989

1. MR CORLETT
2. FINANCIAL SECRETARY

STAMP DUTY: PAPERLESS TRANSACTIONS

1. This note follows on from the discussion at the 13 February Overview meeting of the date from which stamp duty on shares should be abolished. It examines the possibilities for applying SDRT to the limited forms of dematerialised share transfers which could well take place in the period November 1989 to April 1990.

2. The first part of the note outlines the various situations during this 5 month period when the present stamp duty/SDRT rules are likely to be found wanting. Second we analyse briefly the sort of tax problems to which those situations give rise. The final part of the note focuses on the options - ad hoc measures; primary legislation; or Regulations - for adapting the present stamp duty/SDRT law as is necessary. We conclude by recommending Regulations as the only real option for making the fairly major changes required

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Chancellor of the Exchequor
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Dame A Mueller
Mr Hardcastle
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gilhooly
Mr McPherson
Mr Neilson
Miss J C Simpson
Mrs Chaplin
Mr Tyrie
Mr Call
Mr Bowman (OPC)
97.TXT

Sir A Battishill
Mr Isaac
Mr Corlett
Mr Bush
Mr Cleave
Mr Johnston
Mr Pipe
Mr Adderley
PS/IR
Miss Hill

HILL TO FST 22 FEB

to the stamp duty and SDRT code, recognising that even then there may be instances where ad hoc arrangements are needed as well.

LIKELY DEVELOPMENTS

3. The Stock Exchange have made clear that, with a project the nature of TAURUS, they would wish to run pilot schemes before introducing the new system generally. A certain amount of systems testing could be done using dummy stock. But it seems inevitable that some pilots will involve actual trading in actual securities. The plans the Stock Exchange have outlined to us are for several institutions trading in one alpha stock in dematerialised form.

4. The timetable for the pilot schemes depends on the timetable for TAURUS generally, which in turn hinges on the crucial decisions to be taken next month. But in a paper they produced for the last meeting of Mr Monck's joint group on privatisation (on the prospects for the electricity sale), the Stock Exchange suggested the pilot schemes for TAURUS could begin as early as November 1989.

5. The water sale, currently planned for November 1989, is almost certain to take place in the crucial 5 month period. The details of the sale have not yet been decided, though the possibility of it being a totally dematerialised issue has not yet been ruled out. In any event the water sale is likely to incorporate features which, even if the issue itself is not a paperless one, represent moves in the direction of a TAURUS - type system. For example, it is probable that all the initial trading (whether through renounceable letters of allotment or otherwise) can be settled through TALISMAN, the Stock Exchange market settlement system. Also possible is that the water sale will involve an agency broker offering cheap dealing services (eg Barclayshare, Sharelink etc) being given full access to the central Stock Exchange nominee, SEPON. Neither of these features is catered for by present tax rules.

6. Our own links with potential TAURUS users suggests there is also a possibility of agency brokers undertaking some limited form of dematerialised trading outside the context of the water sale. There are a number of organisations with the basic technology to enable them to handle paperless trades. Particularly if the TAURUS 3 option is chosen, and especially if any or all of those organisations are given a special role in the water sale, we would expect them to be clamouring to extend their dematerialised trading functions to other shares. Even before the TAURUS system was ready to go live generally, it could probably accommodate such isolated pockets of paperless trading.

TAX PROBLEMS

7. As Mr Isaac outlined at the 13 February Overview meeting, trying to cope with these sorts of development under existing SD/SDRT rules would throw up a number of very difficult tax problems. These stem from the fact that SDRT - the tax which would of necessity apply where there were no documents to stamp - was not designed for a paperless world, and is ill-adapted to the sort of situations which would arise there.

No charge at all

8. At the one extreme there would be no tax charge at all (the "black hole"). In general terms the SDRT charge is very broadly drawn: it applies to all agreements to transfer UK securities for money or money's worth. But, in contrast to stamp duty, it does not cover the circumstances where the deal was done through a system in the UK, but the two parties to that deal were themselves non-resident.

9. There are likely to be many deals between non-residents when TAURUS is in operation generally. The risks of there being a significant number in the context of TAURUS pilots is perhaps slight. The water sale may however be a different matter. Insofar as deals in water shares are handled by non-resident brokers, eg in the Channel Islands or Isle of Man, there could be cases where the present SDRT charge fails to bite. This in turn would generate a much bigger collection problem. Because the Stock Exchange has no way of distinguishing these non-liable deals, it does not apply its normal tax collection machinery to deals done by its member firms based in the Channel Islands or Isle of Man. A significant loss of tax, particularly if deals were then deliberately channelled through offshore brokers for tax reasons, could result. There would also be unfairness as between different Stock Exchange member firms: those who happened to have offshore arms would be put at a distinct advantage by having an effective stamp duty exemption.

10. Tackling this problem by amending the scope of the SDRT charge to non-residents - which would inevitably mean primary legislation - would be to take a very large sledgehammer to crack a very small nut. Therefore we suggest the Government should, if they are worried about tax leakage here, ensure that the water sale was not handled by offshore brokers. If Ministers agree, for the purposes of deciding what sort of legislative or Regulatory cover is needed for tax for the period before abolition, the "no charge" problem can safely be ignored.

Double or multiple charges

11. Second there could under present law be double - or even multiple - charges to stamp duty and SDRT. We do not know at present in precisely what form this problem will arise, and cannot know until the Stock Exchange makes up its mind about which version of TAURUS to go for. In the best of all

possible worlds there would be no problem at all (because, for example, all TAURUS pilots are delayed until after April 1990). But we see potential for multiple charge problems in several areas.

12. An important example is wherever renounceable letters of allotment are traded through TALISMAN - as might be the case with the water sale. In these circumstances on a single transaction there would at least one charge to SDRT and one to stamp duty. (This tax situation arises from the complex scheme the Stock Exchange have devised (their "Project 76"). Crucial to its operation is a "release authority form". This is a letter of direction which would attract a stamp duty charge, but not one that would frank the SDRT charge on the basic agreement to transfer.)

13. Much the same problem would arise under a TAURUS pilot scheme as all the variants of TAURUS enable individual transfer agreements to be amended or aborted. In this case there would be more than one charge to SDRT itself.

14. There would be a similar sort of result if pilot schemes, the water sale etc took such a form that particular stamp duty or SDRT reliefs were denied. For example, if an agency broker were to given full access to the market, because he would not be trading as a principal he would not get the SDRT exemption for those of his purchases he on-sells within 7 days. Similarly in the context of the water sale there could well be circumstances where he cannot qualify for the abatement of the ADR charge normally available where ordinary stamp duty has already been paid.

Duty due but impossible to collect

15. Finally with both TAURUS pilots and the water sale, we could find ourselves facing a situation where a SDRT charge was legally due, but it was impossible to collect.

16. This is because the Regulations specifying who is accountable for the tax due simply do not cater for a dematerialised world and it would be very difficult to make them do so. For example if TAURUS 3 (the nominee option) were chosen, any pilot is likely to involve lots of transfers within the nominee itself. Under the existing Regulations, it is the individual transferee who would in each case be accountable for the SDRT due. But, even if we knew about these transactions, it is simply not feasible to pursue the hundreds of thousands of individual tax liabilities that would be involved. And if the water sale were to follow this route, these collection problems would be multiplied by at least a factor of 10.

17. For all practical purposes the tax at stake here would be uncollectible. Typically it would arise in penny packets, particularly with the water sale. Even if the manpower resources could be found, pursuing these hundreds of thousands of small tax liabilities would be a very expensive operation. It would thus involve a cost wholly out of proportion to the extra tax that would be collected.

OPTIONS

18. There are broadly three options for dealing with the various tax problems which would arise from the sort of paperless transfers likely in the November 1989 to April 1990 period:-

- ad hoc arrangements
- primary legislation
- Regulations.

Ad hoc action

19. This option would involve taking no legislative action at all, but dealing with problems by muddling through as best we can within the existing legislative and Regulatory framework.

20. The sort of thing this would imply is issuing extra-statutory concessions to relieve the multiple charges if dealings in renounceable letters of allotment are settled through TALISMAN. We might also seek, where possible, to come to some arrangement, with any cheap dealing service handling the water sale, about collection of the SDRT due on deals within that service. In cases where such arrangements were not possible, there would of course be no choice but to accept the tax charge would remain uncollectible.

21. There is room for judgement whether this approach would have been acceptable effectively for a few weeks in December, shortened by the Christmas break, with a 1 January abolition. Even then, it implies there would be some instances where the tax legally due would remain uncollectible. But for this very short period, such a result might have been acceptable on de minimis grounds. On the other hand relying wholly on ad hocery would hardly be feasible or defensible for a 5 month period which is likely to see both a wide range of TAURUS pilots and substantial dealings in water shares.

Primary legislation

22. As discussed in paragraphs 9 and 10 above, it seems it will not be necessary actually to impose a charge (unless one is needed to cater for dealings in water shares being handled by Channel Island or Isle of Man brokers). There is thus no pressing reason to go for detailed primary legislation - which in this case would of course mean substantive provisions in the 1989 Finance Bill - rather than one of the other options.

23. In many respects there would seem some quite strong arguments against relying on primary legislation. It would mean extensive amendments to existing SDRT, and to a lesser extent stamp duty, provisions: we can see no way of short-circuiting this. As we all know from past experience, such amendments would be technically very complex. As such they would necessarily take up a fair amount of Finance Bill space.

24. In any event, the timing would be a decisive objection. For the reasons explained earlier, neither we - nor the DTI who likewise have to legislate - are able even to get to the legislative start line. But until we know what form both the TAURUS pilots and the water sale will take, it is simply not possible for Parliamentary Counsel to formulate the sort of detailed amendments that would be required. That means that the best that could be hoped for is to have such amendments ready for introduction at Committee or Report stage of the Bill. But even that depends on early decisions, not just on the substance, but about the details of the final TAURUS scheme.

Secondary legislation

25. Against that background, secondary legislation - ie Regulations - is the only reliable way of taking action in the forthcoming Finance Bill to meet the Chancellor's objective of applying SDRT to any TAURUS pilot schemes etc pending the abolition of stamp duty. Such a course would involve introducing fairly broad enabling powers in the Bill, and then waiting until the details of the TAURUS pilots and water sale were clear before drawing up the Regulations themselves. This itself will present us with a major task, requiring co-operation from the Stock Exchange and others affected. Experience of existing Regulations in the SDRT field suggests that, even where the central Stock Exchange is anxious to co-operate, they can find it very difficult to get agreement with all their member firms.

26. There are in fact quite wide Regulation-making powers in the existing SDRT code. In general these are probably sufficient to get the collection arrangements on to a more appropriate footing - we would need to issue fresh Regulations under the existing power. But these powers do not stretch to cancelling double charges or providing reliefs where the statutory conditions are not satisfied.

27. The new SDRT Regulations would need to cover broadly two sorts of situation. The first would be to cancel double or multiple charges to SDRT, such as would arise under any TAURUS scheme which provides for bargains to be aborted or amended. Second they would need to provide reliefs in circumstances where the strict statutory conditions were not satisfied, eg to enable a broker trading as an agent to qualify for the usual exemption for a broker's deals. In addition there may be one or two matters to be picked up on the collection front, such as ensuring the Revenue has power to prescribe appropriate returns.

28. There may be analogous problems with stamp duty. In principle the best way to cope with these would again be by Regulations. So this will mean introducing the appropriate enabling powers for stamp duty as well. But it could be that, in the stamp duty field perhaps even more than for SDRT, there will be instances where solving a particular problem by trying to draft Regulations will prove disproportionately complex. In these circumstances we hope that Ministers would approve appropriate extra statutory concessions instead.

29. There are precedents within the direct tax field for enabling powers to make the sort of Regulations now required for SDRT and stamp duty. Examples are the Inheritance Tax (Double Charges Relief) Regulations 1987 (SI 1987 No. 1130) and the Personal Equity Plan Regulations 1986 (SI 1986 No. 1984). You will recall that, in an exchange with Mr Johns in November 1986, you accepted that such uses of Regulations were quite legitimate.

30. Nonetheless the sort of SD/SDRT Regulations now envisaged are likely to be seen by the outside world as a fairly bold use of regulatory powers. There were a number of complaints that the 1987 IHT Regulations were "unconstitutional". There might also be criticisms from the stock market itself, who could well see these Regulations as "discriminatory" (because they do not apply to physical stock) and as imposing

additional compliance burdens on them. It would be unfortunate if any controversy on these scores were to cloud the reception of the Budget announcement that stamp duty on shares is to disappear altogether from 1 April 1990.

31. As we see it, there would be two main justifications for the use of wide-ranging Regulations in this instance. First only by using the regulatory route is it possible to provide the flexibility to deal with problems which cannot be precisely identified until later in the year. Second these particular Regulations will have a very short shelf life: they will expire before the next Finance Bill.

32. Clearly the new SDRT Regulations would need to be Treasury (ie effectively made by Ministers rather than officials), as opposed to Board of Inland Revenue, Regulations. The latter are usually concerned only with procedural matters. But they could still be subject to the more low-key negative resolution procedure, thus avoiding debate on the Regulations themselves except in the unlikely event of a prayer being moved against them.

33. These new Regulations, like the amended version of our administration Regulations, would need to be in place by, say, August-September 1989. Such a timetable means that the necessary enabling powers would have to be in the forthcoming Finance Bill. We would hope that the appropriate legislation could be got ready for the Finance Bill as published - though this must depend crucially on the other pressures at Parlimentary Counsel.

CONCLUSION

34. Each of the options has its own problems. All would involve considerable bending of the current stamp duty/SDRT rules and require co-operation from the other parties involved - the Stock Exchange, the institutions etc.

35. But clearly some of the options are less bad than others. Do Ministers therefore agree that

i. For the "black hole" (paragraphs 8-10), the right course is to eliminate the tax problem by building the appropriate safeguards into the arrangements for the water sale themselves?

ii. For the remainder

- relying solely on ad hoc measures is out of the question for arrangements which have to run for up to 5 months?

- detailed primary legislation is also a non-starter because of the impossibility of knowing within the Finance Bill timetable just what changes we should be legislating for?

- we should therefore aim to take enabling powers in the forthcoming Finance Bill to make appropriate SDRT and stamp duty Regulations, recognising there might still be instances where these need to be backed-up by ad hoc arrangements?

Margaret Hill

M A HILL

Stamp Duty

6. In discussion, the following points were made:

(i) it was unlikely that the Stock Exchange would be able to get Taurus 3 fully operational before March 1990 at the earliest. But it was possible they might wish to use the system for some pilot stocks before then;

(ii) it was very difficult at this stage to know whether, under the existing legislation, the pilot transactions would attract (a) a double charge to both stamp duty and stamp duty reserve tax; or (b) no charge at all; or (c) a single charge that was legally due but impossible to collect;

(iii) it was most unattractive for there to be a possibility that transactions in some shares, but not others, might be free of stamp duty before stamp duty for all transactions was abolished.

The Chancellor asked the Revenue to provide advice to the Financial Secretary urgently on whether it would be possible to devise a rough and ready scheme which would apply stamp duty reserve tax to any pilot schemes pending the abolition of stamp duty. It might be acceptable in the circumstances for the charge to be imposed by regulations. The details could be discussed with the Stock Exchange immediately after the Budget. Pending further information, the Scorecard should show the date for abolition of stamp duty as being 1 April 1990.

EXTRACT FROM NOTE OF MTG 15 FEB

BUDGET - SECRET

BUDGET CONFIDENTIAL

Overview

MONCK → CH/EX 9/2

FROM: N MONCK

DATE: 9 February 1989

CHANCELLOR OF THE EXCHEQUER

cc Financial Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr Neilson

PS/IR
Mr Isaac
Mr Corlett
Miss M Hill

PRIVATISATION AND THE STOCK EXCHANGE

There is still a good deal of work to be done in my group with the Stock Exchange on possible special arrangements for the Water and Electricity sales. But we are unlikely to learn much more about the prospects for the introduction of paperless trading for the market as a whole until much nearer the Budget and possibly not then. This minute therefore reports our preliminary conclusions on the general system.

2. The Stock Exchange have told us that even if the very ambitious timetable for decisions on the version of TAURUS* to go for holds, the earliest possible completion date for the Stock Exchange end of the system would be March 1990. A more realistic date for the Stock Exchange would be May 1990. But the other participants, notably the registrars who would maintain the "distributed data bases", would not be ready till a good deal later, sometime between the autumn of 1990 and Christmas.

3. For TAURUS 3 (the nominee approach) the Stock Exchange has not been able to give a realistic date for their own systems development work. But both the Stock Exchange and the participants' end of the system might be ready by June 1990.

---

* Transfer and Automated Registration of Uncertified Stock

4. In practice the decision timetable is already slipping a little and is likely to slip further. The annex gives our latest information about some of the key events.

5. This boils down to saying that there is no possibility that any version of TAURUS will be generally accessible until after the 1990 Budget, though it may well be running before the 1990 Finance Bill completes its passage.

6. The joint group has been told that, as the Financial Times reported on Monday, there is no consensus about the best version of TAURUS to go for. That is the main problem. The registrars and probably major companies are said to prefer TAURUS 2, whereas the institutions and many brokers (especially the smaller ones) prefer TAURUS 3. The "registrars" in this case includes NatWest and Lloyds but not Barclays which is said to prefer TAURUS 3.

7. The Government has undertaken to deal with some potential obstacles to a decision. For example, the DTI has told my group that it would be ready to legislate to preserve shareholder rights and companies' ability to identify their shareholders if the decision were to be in favour of TAURUS 3 (the nominee system). The Revenue has made clear that we would take steps to avoid dematerialised trading from bearing a higher rate of stamp duty. (This may be necessary for Water if early trades are handled on Talisman: the Revenue consider an Extra Statutory Concession would do the trick). The Stock Exchange has not asked for more in this context.

8. Given the lack of consensus on the choice of system, and the fact that the report assessing the "business case" for each option has not yet been produced, I do not think that heavy pressure for an early decision exerted by the Bank or the Government is likely to be helpful at this stage. But this might change by the second half of March or April.

Stamp Duty

9. The fact that TAURUS lies ahead, whether it starts during 1989-90 or later, is an argument for announcing your decision to abolish Stamp Duty in this Budget and for legislating in this

year's Finance Bill. I doubt if announcing a fixed date for abolition will exert any strong pressure on the Stock Exchange to speed up its decisions or increase its ability to arrive at a decision that will stick. But it must help them to have early warning of abolition and to know that they do not have to provide for collecting Stamp Duty in designing the major changes involved in any version of TAURUS. The possibility that TAURUS may be in place before the 1990 Finance Bill becomes law supports legislating this year. (Early legislation may also be helpful if special arrangements, in advance of paperless trading for the market as a whole, are made for the Water sale in November and the Electricity Distribution companies next May.)

10. These arguments do not, however, point to one date rather than another for the effective date of abolition, so long as it is before TAURUS could reasonably be expected to be on stream. Your intention to abolish the duty at the end of 1989 rather than, say the end of the financial year could not be reliably explained by these arguments. The Stock Exchange itself will no doubt welcome abolition whenever it occurs - and the sooner the better - and however it is presented. But even in their Budget representations they did not link abolition to TAURUS. You could no doubt find other arguments related to the cost in 1989-90 and the size of the overall tax reduction you had decided to make.

11. The Revenue are concerned that there might be <u>some</u> paperless share transfer (eg an early pilot scheme) in the first quarter of 1990. Dealing with such dematerialised transfers while the duty on shares remains could in each case require special non-statutory arrangements or possibly even Finance Bill legislation. They therefore recommend sticking with the 1 January 1990 start date. I think this risk is extremely unlikely to materialise. The Stock Exchange have had many opportunities to make something of it but have not done so.

N MONCK

Annex

TAURUS; TIMETABLE FOR DECISIONS AND FOR IMPLEMENTATION

Decisions timetable

23 February:	SISCOT Meeting to consider interim business case report by Touche Rosse.
10 March:	Final business case report by Touche Rosse.
13 March:	Meeting of SISCOT to agree recommended option, on basis of business case report.
20 March:	Stock Exchange Council meeting to consider SISCOT recommendation, and make final decision.

(provisional).

Implementation timetable

TAURUS 2

Earliest date for implementation: August 1990

Realistic date for implementation : December 1990

Stock Exchange system ready by: March 1990

TAURUS 3

Earliest date for implementation: April 1990

Realistic date for implementation: June 1990

Stock Exchange systems ready by: March 1990

Notes

(i) Decision making timetable represents Stock Exchange's current plans, which are very likely to slip.

(ii) Implementation timetable assumes decisions are taken by the end of March 1989.

(iii) SISCOT is the "Securities Industry Steering Committee on TAURUS", which is charged with identifying the best TAURUS option.

Additional copies:

Chief Secretary
Paymaster General
Economic Secretary
Sir T Burns
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Sedgwick
Mr Riley
Mr Macpherson
Miss J Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Beighton, IR
Mr Painter, IR
Mr Unwin,C&E
Mr Jefferson Smith,C&E

chex.ps/jmt2/89

PERSONAL AND
BUDGET CONFIDENTIAL

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

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

Mr Odling-Smee
Mr Gilhooly
Mr Ilett
Mr Michie
Mrs Chaplin

Mr Corlett - IR
PS/IR

PRIME MINISTER

STAMP DUTY

As you know, I intend to announce in the Budget that the ½ per cent duty on share transactions will be abolished from the end of 1989, making it the sixth tax abolished since we came to office.

You asked me whether there is any risk of distorting stock market trading in the period between the Budget and the actual abolition of stamp duty at the end of the year. I have considered this point and have concluded that there is not for the following reasons.

Economic studies suggest that, although the long-term effect of abolition on share dealing will be substantial, the full effect may take time to build up.

When I cut the rate from 1 per cent to ½ per cent in 1986, there was no evidence of any market problems although the gap between the announcement on Budget Day and its implementation on the date of Big Bang was not a great deal shorter than the gap I now have in mind.

Now, as then, the immediate impact is small relative to the price of shares. Even if the full benefit were passed on to buyers, it would be equivalent to only 10 points off the FTSE index at its current level; the market can move a good deal more widely than that in the course of a day's trading. Many factors enter into decisions about whether and when to buy shares, and it seems

CH/EX → PM 6/2

unlikely that the prospect of a change in stamp duty would have a substantial effect on the timing of transactions, even in the few weeks immediately preceding abolition. And to the extent that, in that period, some buyers did decide to hold off until after abolition, the expectation that prices would rise as a result post-abolition would encourage other buyers to enter the market in anticipation of arbitrage gains.

[N.L.]

6 February 1989

fp.ac.gilhooly/178

BUDGET CONFIDENTIAL

FROM: J F GILHOOLY

DATE: 3 February 1989

CHANCELLOR OF THE EXCHEQUER

cc PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Mr Scholar
Mr Culpin
Mr Odling Smee
Mr Ilett
Mr Michie
Mrs Chaplin

Mr Corlett - IR
PS/IR

STAMP DUTY

You asked (Mr Allan's note of 1 February to Mr Culpin) for a note to the Prime Minister on why we do not foresee any market problems from announcing the abolition of stamp duty in the Budget, but not bringing it in until the end of the year.

2. I attach a draft, agreed with FIM and the Revenue. The first three paragraphs of the draft summarise the arguments for abolishing stamp duty and are pretty optional. The question about the effect on markets is covered in paragraphs 4 to 7, which could be made free-standing by replacing 4 with:

> " You asked whether there is any risk of distorting stock market trading in the period between the Budget and the actual abolition of stamp duty at the end of the year. I have considered this point and have concluded that there is not for the following reasons. "

J F GILHOOLY

GILHOOLY → CH/EX 3/2

fp.ac.gilhooly/179

BUDGET CONFIDENTIAL

DRAFT MINUTE **FROM: CHANCELLOR**

TO: PRIME MINISTER

STAMP DUTY

As you know, I intend to announce in the Budget that stamp duty on shares will be abolished from the end of 1989, making it the sixth tax abolished since we came to office.

2. This is a very desirable change. Transaction taxes are bad for markets in principle and stamp duty is becoming increasingly difficult to administer with the computerisation of markets. This step will reduce the cost of dealing in shares in London and make it easier for markets to introduce the modern trading systems which are essential to out wider share ownership policy. It will be very welcome both to investors and to the City. And - although this is not itself a decisive consideration - it will be of some help to us in dealing with the pressures from other EC countries and the Commission on capital taxes in a liberalised capital market. Aspects of our stamp duty has been an irritant to countries such as France; and indeed, if retained, could in time put the City at a slight competitive disadvantage compared with other European centres.

3. That said, there is no need to abolish stamp duty on Budget Day. The considerations set out above are longer term structural ones. We do not need to give the market an immediate boost; on the contrary, it could harm confidence if we gave the impression that we thought the market needed help. I do not, therefore, wish to forgo yield unnecessarily - about £1½m billion from Budget Day to the end of this year. But there would be considerable advantage in letting the Stock Exchange know about the decision before they get much further with planning TAURUS, their new computerised dealing system which is likely to come into operation at the

beginning of 1990. It makes sense to announce the abolition in good time to save a lot of wasted work both by them and by the Revenue (who would otherwise have to prepare complex legislation and a new collection system to cover paperless share transfers).

4. I have considered carefully whether there is any risk of distorting stock market trading in the period between the Budget and the actual abolition of stamp duty, but I have concluded not, for the following reasons.

5. The economic studies which have been done suggest that, although the long-term effect of abolition on share dealing will be substantial, the full effect may take time to build up.

6. When I cut the rate from 1 per cent to ½ per cent in 1986, there was no evidence of any market problems although the gap between the announcement on Budget Day and its implementation on the date of Big Bang was not a great deal shorter than the gap I now have in mind.

7. Now, as then, the immediate impact is small relative to the price of shares. Even if the full benefit were passed on to buyers, it would be equivalent to only 5 points off the FTSE index at its current level; the market can move a good deal more widely than that in the course of a day's trading. Many factors enter into decisions about whether and when to buy shares, and it seem unlikely that the prospect of a change in stamp duty would have a substantial effect on the timing of transactions, even in the few weeks immediately preceding abolition. And to the extent that, in that period, some buyers did decide to hold off until after abolition, the expectation that prices would rise as a result post-abolition would encourage other buyers to enter the market in anticipation of arbitrage gains.

chex.ps/aa/45 **BUDGET CONFIDENTIAL**

FROM: A C S ALLAN
DATE: 1 February 1989

MR CULPIN

cc **PS/Financial Secretary**
PS/Economic Secretary
Sir P Middleton
Mr Scholar
Mr Odling-Smee
Mrs Chaplin

Mr Corlett - IR
PS/IR

STAMP DUTY

The Chancellor would be grateful for a self-contained note explaining why we do not foresee any market problems from announcing the abolition of stamp duty in the Budget, but not bringing it in until the end of the year. This should, among other things, point out that we did a similar thing in the 1986 Budget, when we announced that stamp duty would be reduced by ½ per cent on the date of Big Bang; that did not cause any market problems. The Chancellor would wish to send the note to the Prime Minister.

ACSA

A C S ALLAN

ALLAN → CULPIN 1/2

chex.ps/jmt.63 **CONFIDENTIAL**

FROM: J M G TAYLOR
DATE: 27 January 1989

TAYLOR → MONCK 2741

MR MONCK

cc PS/Financial Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Culpin
Mr D J L Moore
Mr Odling-Smee
Mr Bent
Mr Gieve
Mr Ilett
Mr M L Williams
Mr Neilson

Miss M Hill - IR

PRIVATISATION AND THE STOCK EXCHANGE

The Chancellor was most grateful for your note of 25 January.

J M G TAYLOR

ind.rj Jan CX.24

CONFIDENTIAL

FROM: N MONCK

DATE: 25 January 1989

CHANCELLOR OF THE EXCHEQUER

cc Financial Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Culpin
Mr Moore
Mr Odling-Smee
Mr Bent
Mr Gieve
Mr Ilett
Mr M Williams
Mr Neilson

Miss M Hill, IR

MONCK → CH/EX 25/1

PRIVATISATION AND THE STOCK EXCHANGE

Our second meeting with the Stock Exchange on Monday confirmed that, as Mr Yassukovich put it in his letter of 11 January, "The introduction of a version of TAURUS able to accommodate a large new issue is unlikely before the first quarter of 1990 at the earliest". This means:

(a) other arrangements will be needed for Water in November of this year; and

(b) it remains possible, though not probable from what we have heard so far, that some skeletal version of TAURUS might be ready early enough to be tested and available for Electricity DistCos.

Water

2. For Water, the Stock Exchange seem pretty confident that sales of water shares in the first six to eight weeks could be settled through TALISMAN, if certain conditions were met. This might even be tested by the Abbey sale. But its benefits would be limited to avoiding a capacity problem and lowering the costs of Stock Exchange participants (as opposed to small shareholders) in the first few weeks. There would be no long lasting or perceptible reduction in dealing costs. Department of Environment are considering with their advisers and us whether this is feasible and desirable.

Electricity

3. The Stock Exchange are looking further at the possibility of having some version of TAURUS ready for Electricity DistCos in May 1990. We are taking care to avoid expressing any preference between TAURUS 2 (distributed database) and TAURUS 3 (a nominee system). But in practice it is only TAURUS 3, which the Stock Exchange themselves favour though the clearing banks may not, which could be ready for Electricity. If this proves possible, it would offer a permanent reduction in dealing costs and might bring forward the general availability of paperless trading.

4. There are, however, a number of problems about TAURUS 3 other than the sheer feasibility of this timetable. The reliance on a nominee system means that ways have to be found of preserving shareholders' rights and the company's ability to find out who owns the shares. We have asked the Stock Exchange and DTI for a note on ways of overcoming these difficulties.

5. A further difficulty is that DTI's planned legislation to legitimise paperless trading is based on TAURUS 2. We suggested the DTI should consider what legislation is needed for a TAURUS 3 scheme. DTI are not convinced that <u>any</u> legislation is needed for TAURUS 3. Our view is that we shall certainly need to legislate to preserve shareholders' rights, though we shall be proposing this to DTI bilaterally rather than through the Joint Group. Finally, we have asked them to consider whether the principle in the consultation document that dematerialisation should not be compulsory really requires them to insist that there should be a paper option for a new issue. We argued that the decision whether or not to buy the new share provided a sufficient choice in this case.

Other Points

6. There are a number of potentially awkward points in these talks. We are trying to avoid, at least at this stage, appearing to push the Stock Exchange into one TAURUS option rather than another, though the privatisation timetable may imply some bias towards TAURUS 3 if its problems can be overcome. We also want to avoid becoming identified with any of the different parties represented on SISCOT or the clearers or other participants in the new system. We may have to come off these tightropes at a later stage but we need to stay on them now.

7. The most immediate question is whether the ISE will be able to meet their deadline - early March - for decisions on which option to pursue. If they fail, the chances of having TAURUS in place for Electricity become more remote. The key players here are the clearers. So far the soundings FIM have taken with CLSB suggest that there is a fair chance that they will be ready to make decisions close to the Stock Exchange's timetable. But of course this could easily change. In that case we may need to suggest a higher level approach to the clearers.

8. Both the Stock Exchange and the vendor departments need to talk to people outside our joint group. Although we shall make it clear we would prefer to keep the talks out of the press, there must be a risk that they will be picked up sooner or later. If that happens we can point out that it is natural for the Government, with these very large privatisations coming up, to see if there is scope for improving on the methods which have been used in the past, despite their undoubted success. This will help to refute any suggestion that the feasibilty of sales, as opposed to potential improvements, is at issue.

N MONCK

Susan 06.24.1.89

BUDGET CONFIDENTIAL

P/ECS/5

FROM: MISS S J FEEST
DATE: 24 January 1989

MS M A HILL - IR

pwp

cc Chancellor
Mr Monck
Mr Ilett
Mr Nielson
PS/IR

FEEST → HILL 24/1

STOCK EXCHANGE AND TAURUS

The Financial Secretary was grateful for your minute of 19 January 1989 and has noted the contents.

Susan Feest

SUSAN FEEST

Merrill Lynch Europe Limited
Ropemaker Place
25 Ropemaker Street
London EC2Y 9LY
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Merrill Lynch

From the office of
Stanislas Yassukovich
Chairman

20 January 1989

The Editor
Financial Times
Bracken House
10 Cannon Street
LONDON
EC4P 4OY

MERRILL LYNCH LETTER 20/1

The Lex Column of 18th January and your leader of 19 January make important contributions to a constructive debate on the question of pre-emption rights. However, both have missed an important point regarding the relationship between this question and the issue of wider share ownership. Greater flexibility on pre-emption will not in itself contribute directly to wider share ownership. The point is that such flexibility would be needed to allow for reform in the new issue system which would offer an opportunity to companies to achieve greater balance in share holder registers by directing new issues of equity to individual shareholders. There are currently no techniques for distributing new issues widely amongst more shareholders in the UK but these do exist in the United States and in some European countries, notably France. In 1988 my firm raised nearly $7.8 billion through 92 new issues of equity in the United States and worldwide. Approximately 54% of the shares which we placed were with individual shareholders largly at the specific request of the issuing company.

This percentage even excludes two large funds of over $2.2 billion in total, all of which were placed with individual investors. In a large global equity capital issue for Citicorp (approximately US$1.2 billion) sold both in the United States and internationally, 71% of the US tranche was placed with individuals and 42% of the international tranche was also directed away from institutional shareholders in keeping with the issuer's desire to broaden ownership amongst individuals.

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Merrill Lynch

The critical aspect affecting rights of shareholders is the question of dilution and it is clearly not the case that less rigorous enforcement of rights of pre-emption must necessarily involve dilution of shareholders' interests.

It is important to note, however, that a great many constraints currently exist which frustrate the development of wider share ownership. Notable amongst these are the fiscal bias in favour of collective investment schemes and the absence of large securities distribution networks. The question of pre-emption rights is a relatively minor and indirect aspect of a complex question but nevertheless deserves continuing examination.

S M Yassukovich

TAURUS ETC

BUDGET CONFIDENTIAL

Inland Revenue

Savings and
Investment Division
Somerset House

FROM: M A HILL
DATE: 19 JANUARY 1989

1. MR ~~CORLETT~~ seen in draft

2. FINANCIAL SECRETARY

HILL → FST 19/1

STOCK EXCHANGE AND TAURUS

1. In the light of the discussion this morning of TAURUS and privatisation, you may like to know of a couple of points which emerged from our subsequent working level meeting with the Stock Exchange.

2. The first relates to your concern about the role of tax in the TAURUS exercise, given that Ministers are inclined to abolish the tax on share transfers in the forthcoming Budget. On TAURUS 3 (the nominee option), the Stock Exchange were worried that the sort of system they would like to set up would fall within the stamp duty definition of a "clearance service". In that case transfers of shares to the system would be liable to stamp duty of the higher 1.5% "ADR" rate, rather than the normal 0.5% charge.

3. In present circumstances it would clearly be ridiculous if tax requirements were to determine the shape - or even delay the introduction - of the TAURUS system. We tried to reassure the Stock Exchange that it was no part of Government policy to increase the tax charge through dematerialisation: if that was the result of the particular scheme chosen, tax legislation would be introduced to restore the status quo ante. Mr Monck has said, if necessary, he will repeat this message at his meeting next Monday with Jeffrey Knight and his Stock Exchange colleagues.

---

cc Chancellor of the Exchequer
Mr Monck
Mr Ilett
Mr Neilson
Mr Isaac
Mr Corlett
Miss Hill
Mr Pipe
PS/IR

4. Second it became clear that the Stock Exchange themselves are giving a lot of thought to what could be done for the water sale in advance of a full TAURUS scheme. That suggests we cannot yet rule out the possibility of some limited dematerialised system in advance of TAURUS proper.

5. Such a scenario would be relevant to the issue that was discussed at the end of this morning's meeting - ie the precise date from which stamp duty on shares should be abolished. Insofar as there are any dematerialised share transfers whilst the duty still exists, changes both in primary legislation and Regulations would be required. The present tax rules simply do not work for dematerialised transfers.

6. It may be with a limited scheme a number of corners could be cut. Even so it is difficult to see how in these circumstances we could get away without any 1989 Finance Bill legislation at all. These tax problems would of course be greatly increased if a late date were chosen for stamp duty abolition; but in the event the Stock Exchange managed to get its act together and introduce a full dematerialised scheme before then.

7. I should perhaps make clear that what is said above does not really apply to one of the pre-TAURUS options being discussed this morning. Were renounceable letters of allotment to be traded through TALISMAN, some tax legislation may be required to ensure there is no double charge to stamp duty. But, relative to the changes needed for any dematerialised system, this should be a fairly small and straightforward amendment.

MAH

M A HILL

chex.md/jmt/23 **CONFIDENTIAL**

FROM: J M G TAYLOR
DATE: 16 January 1989

MR MONCK

cc PS/Financial Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Moore
Mr Odling-Smee
Mr Bent
Mr Ilett
Mr M Williams
Mr Neilson

Miss M Hill IR

TAYLOR → MONCK 16/1

PRIVATISATION AND THE STOCK EXCHANGE

The Chancellor was grateful for your note of 12 January. He awaits further information in due course.

J M G TAYLOR

ind.rj Jan CX.12

CONFIDENTIAL

FROM: N MONCK

DATE 12 January 1989

CHANCELLOR OF THE EXCHEQUER

cc Financial Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Moore
Mr Odling-Smee
Mr Bent Mr Ilett
Mr M Williams
Mr Neilson

Miss M Hill, IR

PRIVATISATION AND THE STOCK EXCHANGE

We had the first meeting with the Stock Exchange this morning. Jeffery Knight said the Stock Exchange fully shared the Government's objectives, took a constructive line and was encouragingly well briefed. We agreed on a sequence of future meetings and the Stock Exchange will provide a number of papers as rapidly as possible (see attached extract from letter I have sent today).

2. The Stock Exchange have set up a steering committee on TAURUS. It is due to report at the end of February and the Stock Exchange intends to reach a decision by the middle of March on the choice between two variants of the original TAURUS concept. Both depart from the original notion of a single electronic book entry transfer service at the centre of the system (TAURUS 1):

- under TAURUS 2 there would be a series of book entry transfer services provided by a range of institutions (probably the banks that currently provide custodian and nominee facilities) and the Stock Exchange would provide a network for linking the data bases to each other, and to the registrar. Under this option each shareholder would appear on the list held by the registrar;

- under TAURUS 3 the Stock Exchange would extend their existing book entry nominee system to all shareholders (it is currently restricted mainly to market makers). The registrar's list would be made up of the names of the nominees rather than individual shareholders.

3. The third system is likely to be cheaper and quicker to set up, although there are also some disadvantages. But at this stage we are a long way from fully understanding either the technicalities or the pros and cons.

4. The Stock Exchange are going to give us a written view about timing, assuming that decisions on the system really are taken in early March. This assumption is highly uncertain, not least because it requires an agreed view to be arrived at by the clearers. This may be difficult since there will probably be conflicts within each group as well as between groups to resolve. The paper will give both an earliest and a "central" timing, distinguishing both between TAURUS 2 and TAURUS 3 and between a big new issue and the conversion of an existing share to a paperless basis.

5. We should wait for that paper before putting any reliance whatever on what the Stock Exchange say. But their line today was that particularly if TAURUS 3 were chosen, the Stock Exchange end of the system ought to be ready for use by the end of 1989 and in use in "early 1990". It was not clear whether the registrars or other necessary elements in the system could meet that timetable. New issues should be easier to handle than existing shares. Existing shares would be converted to the new system in stages, probably starting with some big alpha stocks.

6. This timetable is likely to be too late to cope with Water with any reliability, and we shall of course press the Stock Exchange hard on this. But I emphasise that many things could go wrong to prevent the timetable in para 5 from being achieved, and the Stock Exchange may well be much less optimistic when they reply formally to our questions.

NM

N MONCK

P.S. The story we heard this morning tallies pretty well with Mr Yassukovich's letter to you of 11th January which I have just seen

NM

Extract from Mr Monck's letter to Mr Knight of 12th January - Stock Exchange & Privatisation

You kindly agreed to provide papers covering the following ground:

- An explanation of your proposal for TALISMAN to handle new issues.

- Why you think it important that each privatised water/electricity company should have only one receiving bank (as you will recall our current planning assumption is that each receiving bank will hold all the shares, in whatever company, of a particular alphabetical group of investors).

- A description of the two strongest options for TAURUS (ie the network approach and the nominee based approach). You thought you had a ready made note on this.

- An explanation of your concern about how the principles set out in the DTI consultative paper on share dematerialisation may restrict the potential for reducing processing costs on the major privatisations (as I understand it, your concern was that it might be expensive to run a dematerialised system alongside a paper based system, and that this might be required if the "freedom of choice" principle in the consultative document were interpreted too literally).

- Setting out the timetable, including the earliest possible implementation date, and the date by which you would be confident that the scheme will be in place, for both the network option and the nominee based option, distinguishing between potential implementation for new issues, and for existing stock. You also agreed to give an estimate of when your own systems will be ready, and of when you expected registrars to be ready.

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11 JAN 1989
FM2
cc MB Thorpe
CHX
10771/89

Merrill Lynch

From the office of
Stanislas Yassukovich
Chairman

11 January 1989

Rt Hon Nigel Lawson MP
HM Treasury
Parliament Street
London
SW1P 3AG

Dear Chancellor

When we last met, you asked me to keep you informed on the progress of the TAURUS project. I am writing unofficially to draw your attention to some inevitable delay which I think likely in the light of recent developments.

When we last met before Christmas I referred to the fact that The International Stock Exchange no longer enjoys exclusive control of the TAURUS project. In the last months of 1988 a Steering committee was established at the suggestion of The Bank of England to guide the further development of TAURUS. This committee, named SISCOT, is comprised of representatives of a variety of interests affected by the introduction of dematerialisation. Although a potential users consultative committee had been in existence for some time, the clearing banks in particular became concerned some months ago that dematerialisation could significantly impact their business as registrars and custodians. These concerns were communicated to The Bank and in turn The ISE was urged to establish a body representing clearing bank and other interests at a more senior level. Hence the establishment of SISCOT which is chaired by a Member of the Council of The ISE and whose terms of reference are broad but are based on an understanding that ultimate policy determination remains the perogative of the Council of The International Stock Exchange.

As SISCOT's deliberations have taken place at a series of meetings, it has become clear that the clearing banks do not represent a single and uniform interest. This is because their existing involvement in the processing of securities transactions varies from bank to bank. For example, Barclays and National Westminster own major market makers but are less prominent as registrars, whereas Lloyds Bank is a significant registrar and Midland Bank has a large business providing custodial services. It is clear that the original concept of TAURUS owned and operated exclusively by The International Stock Exchange is not likely to be acceptable to the clearing bank and other interests involved in the securities process.

MERRILL LYNCH LETTER 11/1

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Discussions within SISCOT have led to the emergence of three alternative approaches to the project as a whole. TAURUS I, as it is called, represents the original Stock Exchange controlled project, offering a so-called "name on register" centralised service for computerised transfer of securities. This alternative is likely to be ruled out on grounds of cost. TAURUS II and III, now being studied more intensively, represent alternatives based on a decentralized system leaving greater independence for so-called direct account operators and representing a network rather than a single centralised system.

SISCOT has replied to enquiries made by the Department of Trade and Industry designed to ensure that enabling legislation proposed to facilitate dematerialisation takes full account of industry requirements whilst avoiding controversial questions. Two controversial issues likely to pre-occupy Parliament are the degree to which dematerialisation can be subject to mandatory introduction over a period of time and the extent to which dematerialisation might hamper the rapid identification of beneficial interest in companies.

What emerges now, following the submission of representations to the Department of Trade and Industry by SISCOT and after further discussion amongst the widening community of interested parties, is that the introduction of a version of TAURUS able to accommodate a large new issue is unlikely before the first quarter of 1990 at the earliest.

For technical reasons which I would be happy to describe more fully to your officials, TAURUS III represents the most rapid, and probably the most cost effective route to dematerialisation, providing the economic benefit for individual share ownership which must be a prime objective for the project as a whole. Agreement at the clearing bank level would be a major step in accelerating the introduction of TAURUS III or some variant.

There is a meeting to be held shortly between your officials, ISE officials and a number of other interested parties at which a status report will be made and alternative solutions discussed.

You will appreciate that these issues are politically sensitive in City terms. For this reason I am communicating this information as an industry observer of current efforts to develop the TAURUS project rather than in my capacity as a Deputy-Chairman of The ISE.

Please let me know if I can be of further assistance to you or your officials in connection with this important aspect of City infra-structure.

Yours sincerely,

Stock Exchange

chex.rm/aa/86 CONFIDENTIAL

FROM: A C S ALLAN
DATE: 21 December 1988

MRS BROWN

cc PS/Financial Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Culpin
Mr D J L Moore
Mr Odling-Smee
Mr Ilett
Mr M Williams
Mr Bent
Nr Neilson
Mr Call

Mr Corlett - IR
Miss M Hill - IR

THE STOCK EXCHANGE - TAURUS

The Chancellor was grateful for your minute of 20 December. He thought the proposals in your paragraph 10 were clearly sensible.

2. He also thought that the delays to Taurus add to the case for persuading Department of Energy to drop the distribution share system for electricity.

ACSA

A C S ALLAN

ALLAN → BROWN 21/12

pe.sh.docs.mb.19.12.1

CONFIDENTIAL

FROM: MRS M E BROWN

DATE: 20 DECEMBER 1988

1. MR MONCK

2. CHANCELLOR

This is a follow up to Sir Peter Middleton's meeting with Northgate - Spirit earlier this month.

cc: Financial Secretary
Sir P Middleton
Mr Anson
Mr Culpin
Mr Moore
Mr Odling-Smee
Mrs Brown
Mr Ilett
Mr M Williams
Mr Bent
Mr Neilson
Mr Call

Mr Scholar

Mr Corlett - IR
Miss M Hill - IR

Thanks. 2. Propose a para 10 clear first. 3. Adds OBR & drop for clearance for publication Share system for Blackwell on Yasukovich. 4. AA: PSR effect on timing.

THE STOCK EXCHANGE - TAURUS

As you may already know, Sir Peter Middleton has asked Mr Monck to hold talks with the Stock Exchange about progress in implementing the Taurus electronic share dealing system, and about their role in enabling the market to cope with the forthcoming Water and Electricity sales. The purpose of this minute is to spell out the background and the scope of the discussions.

2. The background is that the Stock Exchange have now told us that the Taurus project is badly delayed. They have set up a Committee to review the basic design of the system. The earliest date for implementation has slipped from November 1989 to March 1990, but we view that figure with caution.

? What Yassukovich told you

BROWN → CHI EX 20/12

3. This is extremely irritating, since the Treasury had pushed hard to get the enabling legislation for Taurus into the legislative programme, and we had had no previous inkling from the Stock Exchange of problems.

??

4. It is also worrying for two specific reasons:

i. **Water and Electricity privatisation**

These are planned to be major retail sales. Simultaneous sales, however structured, will put new strains on paper based systems. We need to make sure that the ISE realise their full market implications, and take the action necessary to ensure that the market can cope with them. As you know, the Exchange has complained in the past - albeit in bull markets - that brokers could not handle bearer trading in Renounceable Letters of Allotment on the scale we expected. We also need to find ways of cutting dealing costs for the small investor: these now average about £25 per bargain. There would be a particular problem if Electricity was sold by a Distribution Share and retail investors were given the option of converting into more than one of the underlying shares on advantageous terms.

ii. **Stamp Duty**

Not really affected in 1/1/90

It becomes difficult for you to reach decisions about the future of stamp duty when the date of implementation of TAURUS is so uncertain, and may indeed be after the 1990 budget. But potentially more awkward is that the Inland Revenue need to continue contingency planning for TAURUS should you decide against abolition. As long as there is still a possibility that TAURUS may be implemented before the 1990 Finance Bill it may be necessary to include provisions in the 1989 bill, and these cannot be formulated until it is clear what form TAURUS will take.

! easy if abolition.

5. On the stamp duty side what we now need is to keep close to the Stock Exchange's thinking, on both timing and design of TAURUS. The privatisation problem is more complex. If TAURUS was up and running it would solve most of the capacity problems, by reducing paper flow. It could also, probably, form the basis for cheap dealing arrangements. For the water sale this might allow a

much lower minimum subscription for the "stapled share"*, effectively allowing smaller investors to take a stake in the industry as a whole. If there is an electricity distribution share an electronic share transfer system is pretty well the only feasible way of reducing the cost of exploding the distribution share outside the option period.

6. However, we have to accept that TAURUS will not now be ready for Water, and may well not be ready for Electricity. We shall have to find other ways of dealing with the logistical problems of the sales. Even without TAURUS, the Stock Exchange may be able to make some contribution to this (for example we could resurrect an earlier proposal for dealing in letters of allotment through TALISMAN). At the very least, the proposals being put forward by the Department of Energy (see below) will need the Stock Exchange's active co-operation.

7. We think this alone merits considerable effort on our part to get the Stock Exchange to co-operate. Past experience suggests that Stock Exchange technicians take a very narrow view of these questions. We need to get the message across at high level that the Stock Exchange should get their act together in facilitating privatisations. That is why we cannot leave this to the advisers, whose contacts are, largely, at a technical level.

8. If we are in close touch with the Stock Exchange on this it will allow us to achieve other objectives. First, the Inland Revenue will know what is going on for stamp duty purposes. Second, on wider share ownership grounds we have a close interest in getting the market infrastructure right for the small investor. More efficient settlement systems are critical to this. Getting close to the Stock Exchange on TAURUS will allow us to emphasise the importance of setting up a system that will suit the small investor (the only interest not properly represented on the TAURUS working groups are the small investors). We will be looking to see how any work we do on privatisations can be applied more generally.

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*a package of shares in all the individual water plcs

9. We are also pursuing other ways of achieving cheaper and more efficient share dealings for Water and Electricity. For Water, we think it unlikely that any major improvements in market practice can be made in time, but we hope to encourage applicants to use Barclayshare and other nominee systems. For Electricity, Department of Energy and their advisers have been working up a computerised register, which could be accessed by a selected group of brokers to facilitate early and low cost dealings.

10. It is proposed to set up a group, chaired by Mr Monck, with representatives from PE, FIM, Inland Revenue and the Bank, together with DoE, DEn and DTI. Jeffrey Knight (Chief Executive of the Stock Exchange) will be invited to join the discussions with suitable supporters. The remit will be:

i. to establish clearly where the Stock Exchange are going on Taurus and other projects;

ii. to make sure the Stock Exchange are aware, at a senior level, of the market implications of the two major Water and Electricity sales, so that they can ensure that the market can cope adequately;

iii. to discuss whether there <u>are</u> ways of achieving cheaper and more efficient share dealings in time for either the Water or the Electricity sales simply by making improvements to the Stock Exchange's current arrangements, (eg, using the Talisman settlement system for new issues) or by setting something up ourselves, but with their co-operation;

iv. to make clear the importance that we attach to Taurus being properly focused on the needs of the small investor.

11. We will aim to report on progress in February.

12. This submission has been agreed with FIM.

R. Jackson

pp **MRS M E BROWN**

BUDGET CONFIDENTIAL

Inland Revenue

Personal Tax Division
Somerset House

FROM: P LEWIS
EXT: 6371
DATE: 27 FEBRUARY 1989

CHANCELLOR

CAR SCALES

1. I understand that, following Mr Culpin's note of 23 February, you would like to consider the distributional impact of somewhat larger car scale increases combined with the new NIC package. I am sorry this note was not ready sooner, but it was not possible quickly to analyse these complex packages, or to assess the operational implications of linking income tax increases with NIC reductions occurring part way through the tax year.

Car scale increases with UEL remaining at £325

2. The figures in this note are based on the same assumptions as in Mr Mace's note of 23 February ie a 2% of earnings charge at the LEL (£43 per week in 1989/90) and with 9% of earnings (7% for the contracted out) payable above the LEL up to an unchanged UEL of £325. It is assumed also that the change takes effect from October, so that only half the annual gain is available to set against increased car scales ie about £1.50 a week averaged over

---

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Riley
Mr Gilhooly
Mr Matthews
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Mr Call
Sir Anthony Battishill
Mr Painter
Mr Bush
Mr Lewis
Mr Mace
Mr Massingale
Mr Hodgson
Mr I Stewart
Mr Evershed
PS/IR

the whole year. (This is the basis used in paragraph 4 of Mr Mace's note of 23 February, but not the car benefits annex attached which looked at the position as if the new regime applied for a full year).

3. Eight tables are attached. They are similar to tables D and D2 in my note of 26 January, in providing an analysis of losers both by annual amount of losses and by income range.

4. The options looked at in the tables are increases of 20% up to 50% in 5% steps.

5. The main features of the options are summarised in the following table which, for comparison, also shows how the 20% option stood before the NICs package.

CAR SCALE OPTIONS

Option	No of losers* (thousands)	Average loss in year	Revenue yield+ from car scale increase	
			1989/90 £m	1990/91 £m
20% increase (before NICs package)	370	£49	90	110
20% increase (with NICs package)	60	£25	90	110
25% increase	110	£32	120	140
30% increase	180	£41	140	170
35% increase	270	£47	160	200
40% increase	370	£58	180	220
45% increase	530	£62	200	250
50% increase	590	£79	230	280

* In addition there would be people brought over the £8,500 P11D threshold for the first time, ranging from about 10,000 (20% increase) to 30,000 (50% increase).

+ These figures exclude behavioural changes. If scales rise by 20%,the behavioural response would probably be negligible; but we ought to do further quick work on this if you wish to go significantly higher.

6. In comparing these options with where we stood before the NICs package (Table 1) the main feature (apart from total number of losers and average loss) is that their distribution by income has changed significantly. When you get up to broadly the same number of losers as before, with the 40% option, there are a few more losers below £15,000, substantially fewer losers in the middle income bands (£15,000 to £30,000 - broadly the "middle managers" for whom Lord Young was concerned) and many more over £30,000. As before, at the bottom we have to add in also those brought over the P11D threshold for the first time, perhaps 25,000 in all with a 40% increase. (For them, a car scale increase brings forward the time at which they come into the P11D field.)

Presentation/Operational

7. In looking at the car scales again you will want to keep in mind the presentational aspects of setting off a full year income tax increase against a half-year NIC reduction. The car scale changes would normally be implemented with the Budget recoding, effective from the first pay day after 17 May. At that point car drivers would see their weekly/monthly net pay reduced, to the extent that car scale increases exceeded the benefit of indexation ie by up to about £1.50 a week (on average) if you decided that company car drivers should get no net benefit in 1989/90 from the NIC changes. From October they would gain £3.00 a week in NIC, leaving a net gain of £1.50 each week to set against the previous income tax losses of the same amount.

8. The picture shown by the tables is for 1989/90 taken as a whole, ie the position reached by 5 April after there have been 6 months of net NIC gains to set against the income tax losses of the first half of the tax year. It follows from the pattern of events described in the previous paragraph that purely in cash flow terms during the course of the year there would be more

losers than shown in the tables; and that those who end up losers at 5 April would "lose" more in cash-flow terms during the first half of the year.

9. If you see no particular difficulty with this in-year cash-flow pattern, incorporating any increased car scales in the normal Budget recoding would be much the easiest approach to implementation (for employers as well as the Revenue).

10. Any other approach - which would necessarily involve an additional, later recoding exercise - would certainly be more complicated, and we would need to do a good deal of further work over the next day or two to be certain that it would work and to assess the implications for the workstate and competing priorities. Time is now very short for sorting out any alternative approach.

Car scale increases if UEL increased to £358

11. Even if you were to decide to increase the UEL as part of the NICs package, there would probably still be some scope for further increases in the car scales before you got back to the same number of losers you were contemplating before the NICs package. The reason for this is that the 150,000 basic rate taxpayers below the UEL who were previously losers would still gain from the NICs package, as well as basic rate taxpayers above the UEL who were losers and who fall in the income band £325 to £358.

12. We would, of course, be happy to do further work on these options, or any others you would like to consider.

Other car questions

13. I hope to let you have a note shortly on the other two car points raised at the end of last week (private use of high business mileage drivers and the proportion of cars on the road which are company cars).

Questions for Decision

14. Final decisions on car scales are needed quickly (ie by close on Friday if possible, or next Monday morning at the latest if we are to maintain the 17 May implementation date). Subject to any further work you would like us to do over the next day or two

a. Are you inclined to stick with the 20% increase, taking the benefit of the NICs package in the substantially reduced number of losers, or to go for a higher figure?

b. If the latter, what should it be?

c. If you wish to go for a higher figure, do you agree that Budget implementation should follow its normal course?

P LEWIS

Table 1

20% increase in car scales BEFORE NICs package

Tax and NIC: analysis of losers by annual amount of losses

	Main Scale	"Perk Car"	Over 18,000 business miles	Total
	(number of losers - thousands)			
Annual loss				
over £200	-	1	-	1
£100-£199	19	5	-	24
£50-£99	104	9	25	138
£1-£49	146	26	35	207
Totals	269	41	60	370
Average annual loss	£49	£56	£45	£49

Tax and NIC: analysis of losers by income range

A = Average loss
B = Number of losers (thousands)

Income range 18,000 (total income of tax unit)	Number of losers (thousands)	Average loss
under £15,000	59 } 181 } 299	£27
£15-£20,000	122	£42
£20-£25,000	118	£62
£25-£30,000	39	£50
over £30,000	32	£66
All income ranges	370	£49

Table 2

20% increase in car scales WITH NICs package

Tax and NIC: analysis of losers by annual amount of losses

	Main Scale	"Perk Car"	Over 18,000 business miles	Total
	(number of losers - thousands)			
Annual loss				
over £200	-	-	-	-
£100-£199	-	1	-	1
£50-£99	2	2	-	4
£1-£49	51	5	1	57
Totals	53	8	1	62
Average annual loss	£22	£45	£ 1	£25

Tax and NIC: analysis of losers by income range

Income range (total income of tax unit)	Number of losers (thousands)	Average loss
under £15,000	-	-
£15-£20,000	24	£22
£20-£25,000	26	£20
£25-£30,000	7	£23
over £30,000	5	£65
All income ranges	62	£25

Table 3

25% increase in car scales WITH NICs package

Tax and NIC: analysis of losers by annual amount of losses

	Main Scale	"Perk Car"	Over 18,000 business miles	Total
	(number of losers - thousands)			
Annual loss				
over £200	-	1	-	1
£100-£199	1	2	-	3
£50-£99	15	3	-	18
£1-£49	80	9	3	92
Totals	96	15	3	114
Average annual loss	£27	£65	£ 8	£32

Tax and NIC: analysis of losers by income range

Income range (total income of tax unit)	Number of losers (thousands)	Average loss
under £15,000	1	£10
£15-£20,000	37	£26
£20-£25,000	53	£24
£25-£30,000	10	£33
over £30,000	13	£78
All income ranges	114	£32

Table 4

30% increase in car scales WITH NICs package

Tax and NIC: analysis of losers by annual amount of losses

	Main Scale	"Perk Car"	Over 18,000 business miles	Total
	(number of losers - thousands)			
Annual loss				
over £200	1	2	-	3
£100-£199	2	4	-	6
£50-£99	34	8	-	42
£1-£49	107	18	5	130
Totals	144	32	5	181
Average annual loss	£36	£66	£14	£41

Tax and NIC: analysis of losers by income range

Income range (total income of tax unit)	Number of losers (thousands)	Average loss
under £15,000	38	£ 14
£15-£20,000	42	£ 41
£20-£25,000	65	£ 35
£25-£30,000	14	£ 42
over £30,000	22	£100
All income ranges	181	£ 41

Table 5

35% increase in car scales WITH NICs package

Tax and NIC: analysis of losers by annual amount of losses

	Main Scale	"Perk Car"	Over 18,000 business miles	Total
	(number of losers - thousands)			
Annual loss				
over £200	2	5	-	7
£100-£199	5	9	-	14
£50-£99	63	4	-	67
£1-£49	139	23	23	185
Totals	209	41	23	273
Average annual loss	£42	£95	£11	£47

Tax and NIC: analysis of losers by income range

Income range (total income of tax unit)	Number of losers (thousands)	Average loss
under £15,000	52	£27
£15-£20,000	62	£42
£20-£25,000	86	£42
£25-£30,000	19	£54
over £30,000	54	£80
All income ranges	273	£47

Table 6

40% increase in car scales WITH NICs package

Tax and NIC: analysis of losers by annual amount of losses

	Main Scale	"Perk Car"	Over 18,000 business miles	Total
	(number of losers - thousands)			
Annual loss				
over £200	2	10	-	12
£100-£199	22	7	-	29
£50-£99	93	20	1	114
£1-£49	166	22	24	212
Totals	283	59	25	367
Average annual loss	£52	£102	£19	£58

Tax and NIC: analysis of losers by income range

Income range (total income of tax unit)	Number of losers (thousands)	Average loss
Under £15,000	67	£39
£15-£20,000	86	£47
£20-£25,000	87	£53
£25-£30,000	30	£59
over £30,000	97	£84
All income ranges	367	£58

153 240

Table 7

45% increase in car scales WITH NICs package

Tax and NIC: analysis of losers by annual amount of losses

	Main Scale	"Perk Car"	Over 18,000 business miles	Total
	(number of losers - thousands)			
Annual loss				
over £200	5	13	-	18
£100-£199	63	10	-	73
£50-£99	125	26	2	153
£1-£49	226	13	46	285
Totals	419	62	48	529
Average annual loss	£56	£137	£17	£62

Tax and NIC: analysis of losers by income range

Income range (total income of tax unit)	Number of losers (thousands)	Average loss
Under £15,000	97	35
£15-£20,000	159	45
£20-£25,000	118	51
£25-£30,000	39	68
over £30,000	116	115
All income ranges	529	£62

Table 8

50% increase in car scales WITH NICs package

Tax and NIC: analysis of losers by annual amount of losses

	Main Scale	"Perk Car"	Over 18,000 business miles	Total
	(number of losers - thousands)			
Annual loss				
over £200	12	15	-	27
£100-£199	141	27	-	168
£50-£99	133	12	4	149
£1-£49	187	15	46	248
Totals	473	69	50	592
Average annual loss	£72	£162	£25	£79

Tax and NIC: analysis of losers by income range

Income range (total income of tax unit)	Number of losers (thousands)	Average loss
Under £15,000	106	50
£15-£20,000	172	58
£20-£25,000	120	64
£25-£30,000	52	73
over £30,000	142	136
All income ranges	592	£79

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BUDGET CONFIDENTIAL

FROM: A G TYRIE
DATE: 24 February 1989

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Ms Wallace
Mr Culpin
Mr Macpherson
Mrs Chaplin
Mr Call

THE NICS PACKAGE AND THE SELF-EMPLOYED

(Nick Macpherson very kindly gave me some help, and the numbers, at short notice. They are rough and ready.)

2. The logic for doing something would run something like this: "We are reducing the entry fee to Class 1. Class 2 NICs are linked to Class 1 by a formula. It would be unfair to ask the self-employed to carry on paying £4.25 a week when the Class 1 entry fee has been reduced. Therefore the Class 2 entry fee should be reduced by the same proportion.

3. This would mean reducing Class 2 to just below £3. It would cost around £50 million in 1989-90. Like almost everything else we are doing this year, we have a much larger second year cost, of £140 million.

4. The self-employed complain about Class 4, partly because they don't get any entitlement to unemployment benefit. Nonetheless, the logic points to acting on Class 2: Class 4 doesn't start until the LPL of £5,000 a year, whereas our Class 1 reform is helping people right at the bottom end.

5. The decisions we are taking on this NICs package are adding gradually to its cost and I am suggesting a further addition here. Nonetheless, I think we might spoil the ship for a ha'porth of tar.

6. Apparently each 5% on car scales is worth £20 to £25 million in 1989-90 and £25 to £30 million in a full year. So

an increase to 30% would give us around £50 million to play with. The net (after the car scale rise) cost of nil in year 1 and £100 million in year 2 looks a reasonably inexpensive way to buy off complaints from the self-employed and provide a bit of symmetry with the "even-handed" approach you took in the 1985 reform.

AGT.

A G TYRIE

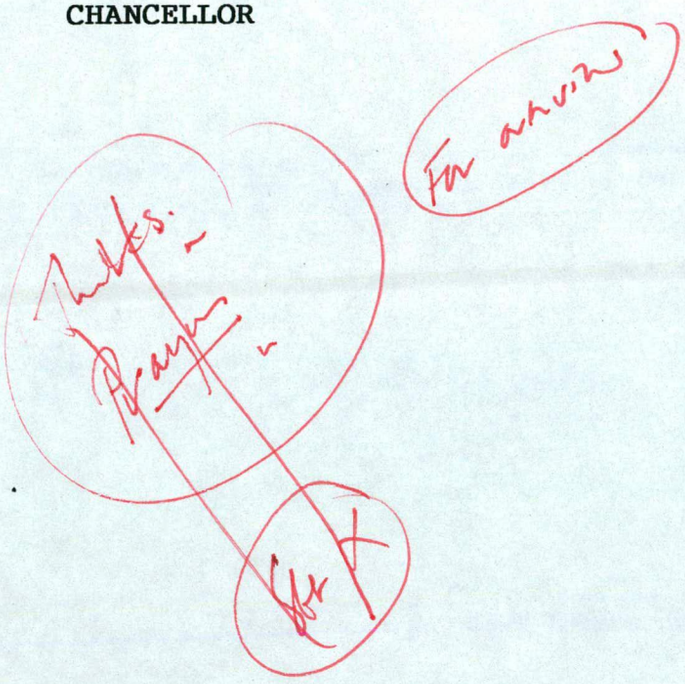
CHANCELLOR OF THE EXCHEQUER

Q

Is there a case for going on to oil now? We've got Revenue people waiting outside?

FROM: J P MCINTYRE
DATE: 23 February 1989

CHANCELLOR



cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Riley
Mr Sedgwick
Mr Culpin
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace IR
PS/IR

MCINTYRE TO C 23 FEB

NICS REFORM

You asked for information on the people affected by the choice between keeping the UEL at £325 and increasing it to £355 or £360.

2. Over 2½ million employees earn more than the current UEL of £325, which is about 1.2 times average earnings.

3. You asked particularly about nurses and teachers. Very few nurses earn above the current UEL, perhaps 5,000 out of ½ million. These are very senior sisters, directors of nursing services, etc. Most sisters will get about £13,000 - £14,000 in 1989-90, well below the current UEL of £16,900.

4. As for teachers, something like 55,000 out of 400,000 earn above the current UEL. These include heads and deputy heads, plus about 35,000 ordinary teachers who get merit increases, responsibility allowances etc.

5. Policemen: Some constables, most sergeants, all inspectors and above (in all over 40,000 out 125,000) earn over the current UEL.

6. So the majority of these three groups, particularly the nurses, would get the NIC reductions whether or not the UEL is increased to £358.

7. More generally, those affected by a rise in the UEL from £325 to £355/£360 would be in a wide range of occupations. They will tend to be in middle-management grades and above. However, some highly paid occupations such as printing and financial services would have relatively junior staff affected as well.

8. One other point worth noting. Contracted-out employees earning above the current UEL would still gain if the UEL were raised to £355/£360. This is because £355/£360 is the break-even point for contracted-in employees ie at that point, their gains from the NIC reductions on income below £325 would be offset by the extra contributions they have to pay on the slice of income between £325 and the new UEL of £355/£360. For contracted out employees, these extra contributions would be less because of the rebate. So they would still gain though by less than the £3 a week gained by employees on earnings below the current UEL. The maximum employee NIC for the contracted out would be 70p less than at present. About two thirds of employees earning over the current UEL are contracted out.

Other Issues

9. When you have decided in principle on which option to go for, there will be a number of secondary issues to be resolved. We (and the nominated DSS officials) are already thinking about these, and we will let you have advice. Some of these issues are

relatively minor. But one you ought to be aware of is the self employed.

10. You could take the line that the package was nothing to do with the self employed (or employers), bearing in mind the relatively generous treatment they already get under the NIC system. And, subject to checking with DSS, there appear to be no links between employee and self employed NICs in the legislation which would require corresponding changes in the self employed regime.

11. However, you might judge it difficult to give away £2 billion or more to employees while doing nothing for the self employed. (You will remember that, in the 1985 reforms, the self employed were given tax-relief on 50 per cent of their Class 4 contributions.) If the UEL were raised for employees and you left the UPL as it is, that might be a sufficient prize for the self employed. Otherwise, whichever option you go for may have a total cost slightly above the GAD costings we gave you yesterday. We are not talking about very large amounts. For example, a reduction in the step at the LEL to 2 per cent (Option 4B) could point to a cut in the Class 2 rate of £1.15 to £3.10, under the formula currently used for determining Class 2. This would cost around £100 million. But similar extra costs might be incurred with the other options, whether or not the NIC payable at the LEL was changed, given the wider political considerations.

12. We do not think the self employed aspects are important enough to influence the basic choice among the various options. But you should know that there may well be self employed implications and that they may add a little to the cost of the package.

JPM

J P MCINTYRE

BUDGET SECRET

Inland Revenue

Personal Tax Division
Somerset House

FROM: B A MACE
DATE: 23 FEBRUARY 1989

CHANCELLOR OF THE EXCHEQUER

MACE TO CX 23 FEB

NICs REFORM

1. We agreed with Mr McIntyre in Treasury ST Division that we would respond to your request for information about the impact of the proposed NICs reform on cash losers from the (already announced) rise in the UEL for 1989-90 and from the proposed increase in car scales.

2. The figures in the attached tables are based on a NICs option with 2 per cent of earnings payable at the LEL (£43 per week in 1989-90) and with 9 per cent of earnings payable above the LEL up to a UEL of either £325 or £358. The results for the other options under consideration would be very similar.

---

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Mr Hardcastle
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call
Mr McIntyre

Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Calder
Mr Lewis
Mr Bush
Mr Mace
Mr Eason
Miss White
Mr Stewart
PS/IR

3. At this stage the figures should be regarded as broad-brush estimates only. They compare post October 1989 tax and NIC liabilities with the corresponding position in 1988-89.

4. If you wished to take advantage of the NIC option to raise car benefit scales further, a very quick look suggests that a 35 per cent increase would leave around 350,000 losers* after taking account of tax and NIC changes between 1988-89 and 1989-90. (This estimate is based on the average gain to employees from the 1 October change to NICs (ie £1.50 per week).)

B A Mace

B A MACE

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*ie broadly as for the previous package.

NIC changes

1989-90 tax and NIC regime	Number of Cash losers 1989-90 compared with 1988-89 (millions)
i. Autumn Statement NIC changes only	$2^{3}/_{4}$
ii. Autumn Statement NIC changes plus indexation of tax thresholds in 1989-90	$1^{1}/_{2}$ - $1^{3}/_{4}$
iii. New NIC option only UEL at £358	$2^{1}/_{4}$
iv. New NIC option only UEL at £325	nil
v. New NIC option UEL at £358 plus indexation of tax thresholds in 1989-90	1/2
vi. New NIC option UEL at £325 plus indexation of tax thresholds in 1989-90	nil

Car benefits

Tax and NIC: analysis of losers

Option	No of losers	Average loss £/year	No losing* over £50/year	No brought over P11D threshold
a. Indexation of Tax Thresholds in 1989-90 Autumn Statement NIC regime 20% on car scales	370,000	49	160,000	10,000
b. As a. plus New NIC option UEL at £358	130,000	50	60,000	10,000
c. As a. plus New NIC option UEL at £325	under 5000	45	neg	10,000

*excluding cases brought above P11D threshold by change in scales.

Analysis based on comparison of post October 1989 income tax and NIC liability on:

a. 1988-89 car scales, income tax rates and allowances and NIC regime.

b. Three options listed.

BUDGET CONFIDENTIAL

FROM: J P MCINTYRE
DATE: 23 February 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Mr Hardcastle
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call
Mr Mace (IR)
PS/IR

MCINTYRE TO C 23 FEB

NICS REFORM

You asked why the ratio of costs between 1989-90 and 1990-91 varies between Option 4 and Option 4B (my minute of yesterday).

2. GAD estimates are:

	£ billion	
	1989-90	1990-91
Option 4 (No change upto £75. Threshold at £75. Marginal rate of 9 per cent on earnings above £75 upto UEL of £355 or £360.)	0.85	2.4
Option 4B (As Option 4, except 5 per cent step at LEL is replaced by £1 stamp, with 9 per cent on earnings above £43 upto UEL of £355 or £360.)	0.8	2.4

3. The reason why the cost of Option 4B increases by more in 1990-91 is that we and GAD assumed that the £1 stamp would be unchanged. If we had revalued it in line with prices to £1.06, this would have brought in an extra £60 million or so of contributions and so reduced the 1991-92 cost of Option 4B to around £2.35 billion. The ratios for Options 4 and 4B would then be very similar.

4. One other point on the figures we gave you yesterday. On Option 4B, I said that the extra cost of fixing the stamp at 2 per cent (86p), so as to avoid losers, would be about £150 million in 1990-91. In fact, 86p would be 2 per cent of earnings at the LEL in 1989-90. With a LEL of £46 in 1990-91, an entry ticket of 2 per cent would rise to 92p. The extra cost in 1990-91 would therefore be, very roughly, £80 million, compared with a fixed £1 stamp.

5. The table below sets out the various costings of Option 4B:

	£ billion	
	1989-90	1990-91
Entry Ticket		
£1 fixed and not revalued	0.8	2.4
£1 in 1989-90, revalued to £1.06 in 1990-91	0.8	2.35
2 per cent of earnings at LEL	0.85	2.5

JPM

J P MCINTYRE

cf Option 4 0·85 2·4

BUDGET CONFIDENTIAL

FROM: J P MCINTYRE
DATE: 22 February 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace IR
PS/IR

MCINTYRE TO CX 22 FEB

Ch

(1) almost certain that Scorecard assumes UEL uprating is baseline. So GAD figures are ones that would appear in Red Book

(2) 89-90/90-91 ratio reflects accruals/receipt differences: accruals show a 1:2 ratio.

NICS REFORM

We now have costings from GAD. They are broadly in line with our own rough estimates. These are as follows (again, employees only):

Option 4: No change up to £75. Threshold at £75. Marginal rate of 9 per cent on earnings above £75 up to UEL of £355 or £360.

£0.85 billion (1989-90)
£2.4 billion (1990-91)

Most of the gains (£2.3 billion in 1991-92) are for employees, but the raising of the UEL would also increase employers' contracted-out rebates (£0.1 billion in 1991-92).

The extra SERPS cost in 5 years time would be about £2 million, rising to £300 million in 30-40 years time (at today's prices). The total SERPS bill then is estimated at £14 billion, so that

Option 4 would result in an increase of just over 2 per cent. As no additional contributions would be payable compared with the present system, this would amount to a "free" increase in SERPS payments for those with earnings above the current UEL.

Option 4A: As Option 4, except UEL is unchanged at £325.

£0.95 billion (1989-90)
£2.65 billion (1991-92)

As Option 4A involves no increase in the UEL, there is no change in the employers' contracted out rebates. So all gains go to employees.

Option 4B: As Option 4, except 5 per cent at LEL is replaced by £1 stamp, with 9 per cent on earnings above £43 upto UEL of £355 or £360.

£0.8 billion (1989-90)
£2.4 billion (1990-91)

If the UEL were to be unchanged at £325, the 1989-90 cost would be £0.9 billion, and the full year cost would be £2.65 billion.

2. I should point out that GAD's full year figures for 1990-91 reflect the usual uprating of the UEL and LEL in April 1990 and (for Options 4 and 4A) an uprating of the £75 threshold to £80. Our own estimates were done on the basis of the 1989-90 earnings limits and the £75 threshold. On the same basis, GAD's figures would be lower eg the full year cost of Option 4A would be roughly the same as ours - £2½ billion.

3. You will note that the extra cost of Option 4A, compared with Option 4, is about £250 million in a full year. This would be the cost of not increasing the UEL to £355/£360.

4. It also looks as though we could reduce NICs for the £43-75 band, on the lines of Option 4B, at a cost of no more than Option 4. Further, we could make the "stamp" in Option 4B 2 per cent

(86p) instead of £1, in order to avoid losers, at an extra cost of around £150 million in 1990-91.

5. Tables showing variants of Option 4B are attached.

JPM

J P MCINTYRE

DISTRIBUTIONAL ANALYSIS

The attached tables and charts show the distributional implications of the options specified by the Chancellor (Mr Allan's minute to Mr Culpin 21 February). An entry fee of 2 per cent of the LEL is shown in table 1 and chart 1, an entry fee of £1 in table 2 and chart 2 and an entry fee of 2.5 per cent in table 3 and chart 3.

2. The three options look very similar. For the vast majority of employees, an entry fee of 2.5 per cent of the LEL simply means that the gain from the reform is 21 pence a week lower than with a 2 per cent entry fee. An entry fee of 2 per cent avoids losers just below £75.

3. All options consisting of an entry fee and a single marginal rate produce a jagged pattern of gains. This is an inevitable consequence of attempting to smooth out the existing steps.

4. The options seek to ensure that people above the new UEL are unaffected by the reform. To achieve this precisely would require a fractional UEL. As a result the three options produce small changes for those above the UEL (ranging from a gain of 4 pence/week to a loss of one penny). By comparison the leading option produces a gain of 3 pence. These are not essential features of the options: altering the UEL by £1 determines whether those above the new UEL are small gainers or small losers.

Mark Lon
13p

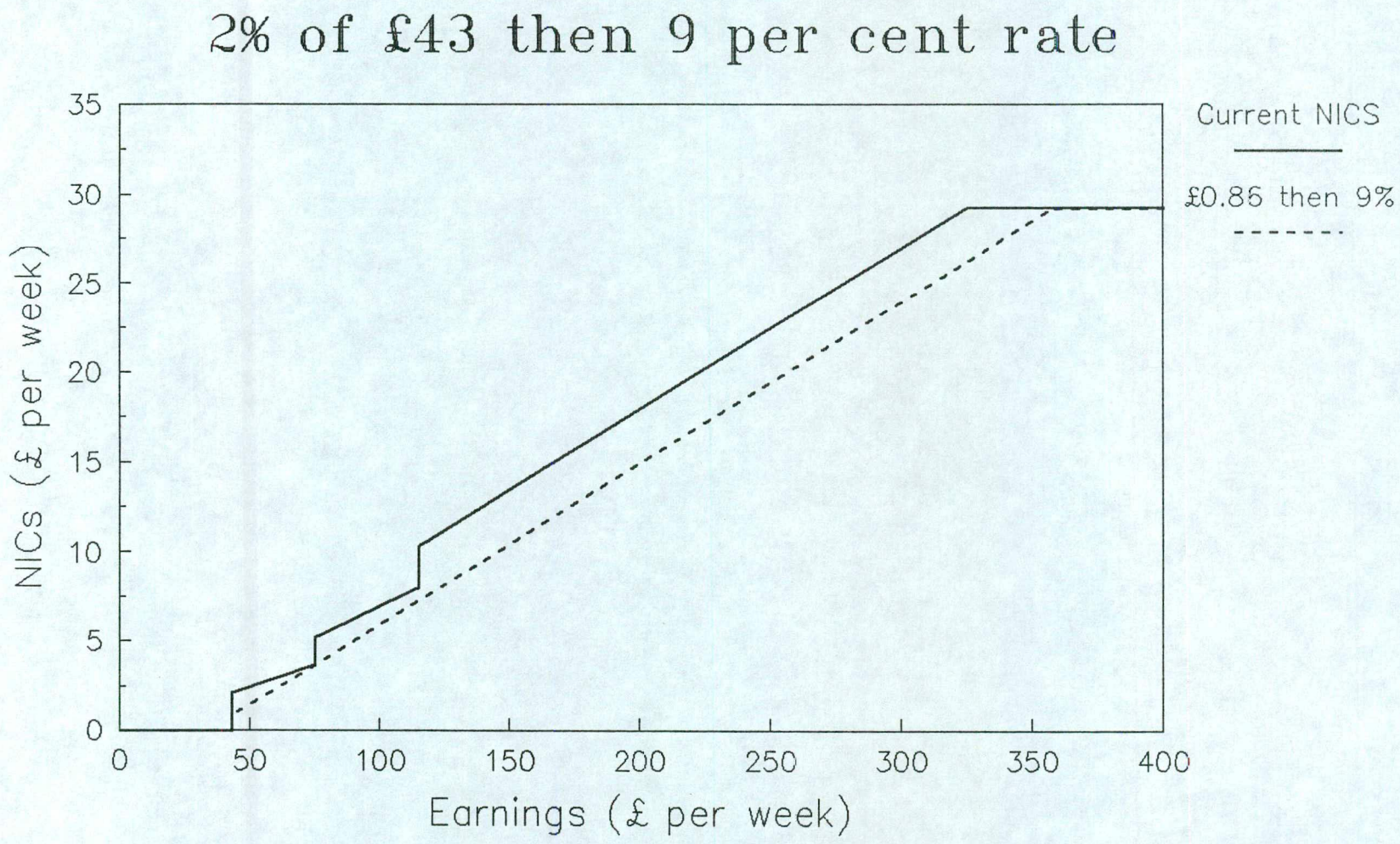
Table 1

2% + 9%

2 per cent of LEL plus 9 per cent of earnings above the LEL

Earnings (per week)	Multiple of average earnings	Current NICs 1989-90	New System	Gain (£ per week)	Gain as % of earnings
43		**2.15**	**0.86**	**1.29**	**3.0**
50		2.50	1.49	1.01	2.0
60		3.00	2.39	0.61	1.0
75		**5.25**	**3.74**	**1.51**	**2.0**
100		7.00	5.99	1.01	1.0
115		**10.35**	**7.34**	**3.01**	**2.6**
125		11.25	8.24	3.01	2.4
137	0.5	12.33	9.32	3.01	2.2
150		13.50	10.49	3.01	2.0
175		15.75	12.74	3.01	1.7
205		18.45	15.44	3.01	1.5
225		20.25	17.24	3.01	1.3
250		22.50	19.49	3.01	1.2
273	1	24.57	21.56	3.01	1.1
300		27.00	23.99	3.01	1.0
325		29.25	26.24	3.01	0.9
350		29.25	28.49	0.76	0.2
375		29.25	29.21	0.04	0.0
410	1.5	29.25	29.21	0.04	0.0

Figure 1



£0.86 "entry fee"
9% on earnings between £43 and £358

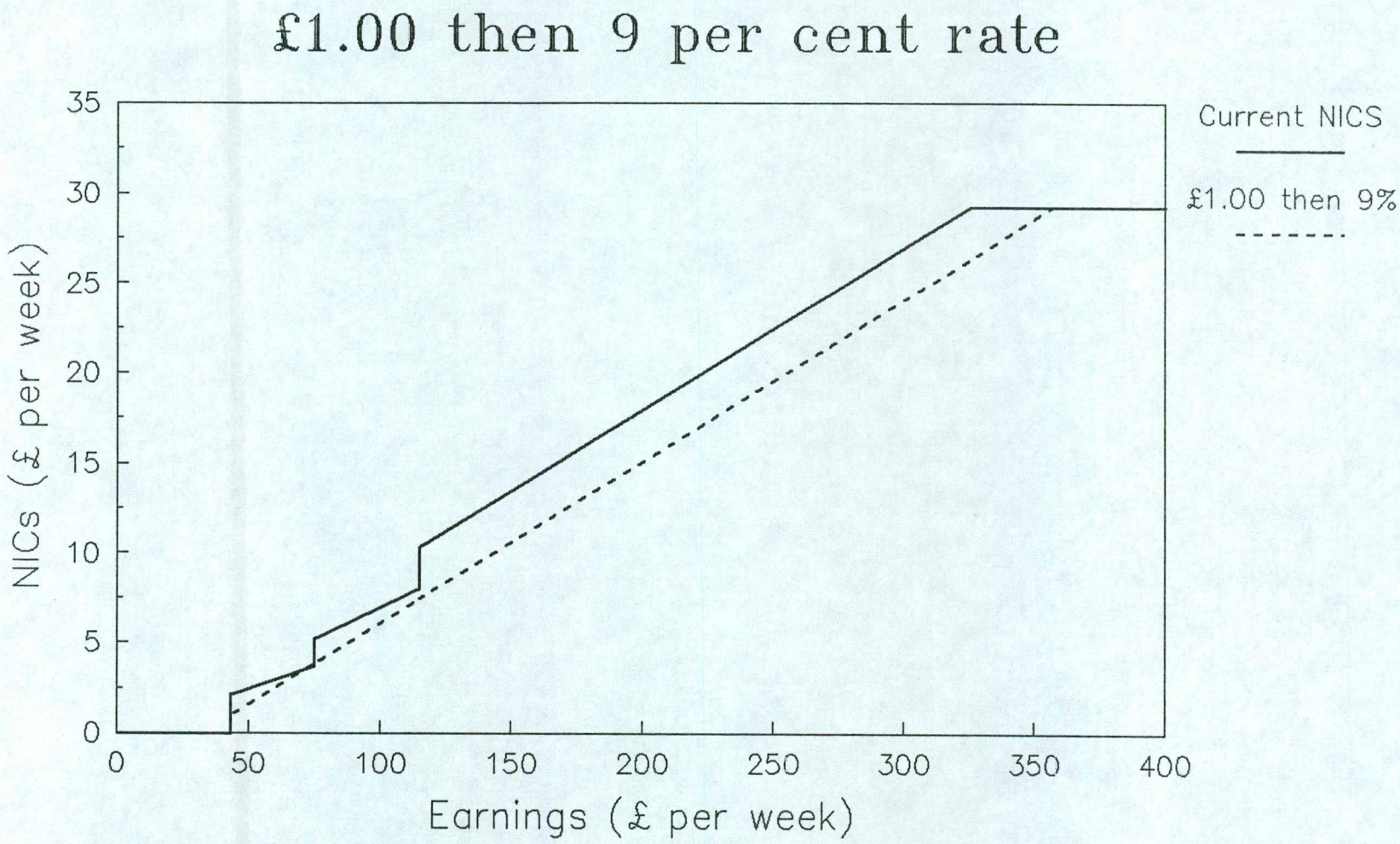
Table 2

£1+9%

£1.00 plus 9 per cent of earnings above the LEL

Earnings per week)	Multiple of average earnings	Current NICs 1989-90	New System	Gain (£ per week)	Gain as % of earnings
43		**2.15**	**1.00**	**1.15**	**2.7**
50		2.50	1.63	0.87	1.7
60		3.00	2.53	0.47	0.8
75		**5.25**	**3.88**	**1.37**	**1.8**
100		7.00	6.13	0.87	0.9
115		**10.35**	**7.48**	**2.87**	**2.5**
125		11.25	8.38	2.87	2.3
137	0.5	12.33	9.46	2.87	2.1
150		13.50	10.63	2.87	1.9
175		15.75	12.88	2.87	1.6
205		18.45	15.58	2.87	1.4
225		20.25	17.38	2.87	1.3
250		22.50	19.63	2.87	1.1
273	1	24.57	21.70	2.87	1.1
300		27.00	24.13	2.87	1.0
325		29.25	26.38	2.87	0.9
350		29.25	28.63	0.62	0.2
375		29.25	29.26	-0.01	-0.0
410	1.5	29.25	29.26	-0.01	-0.0

Figure 2



£1 "entry fee"
9% on earnings between £43 and £357

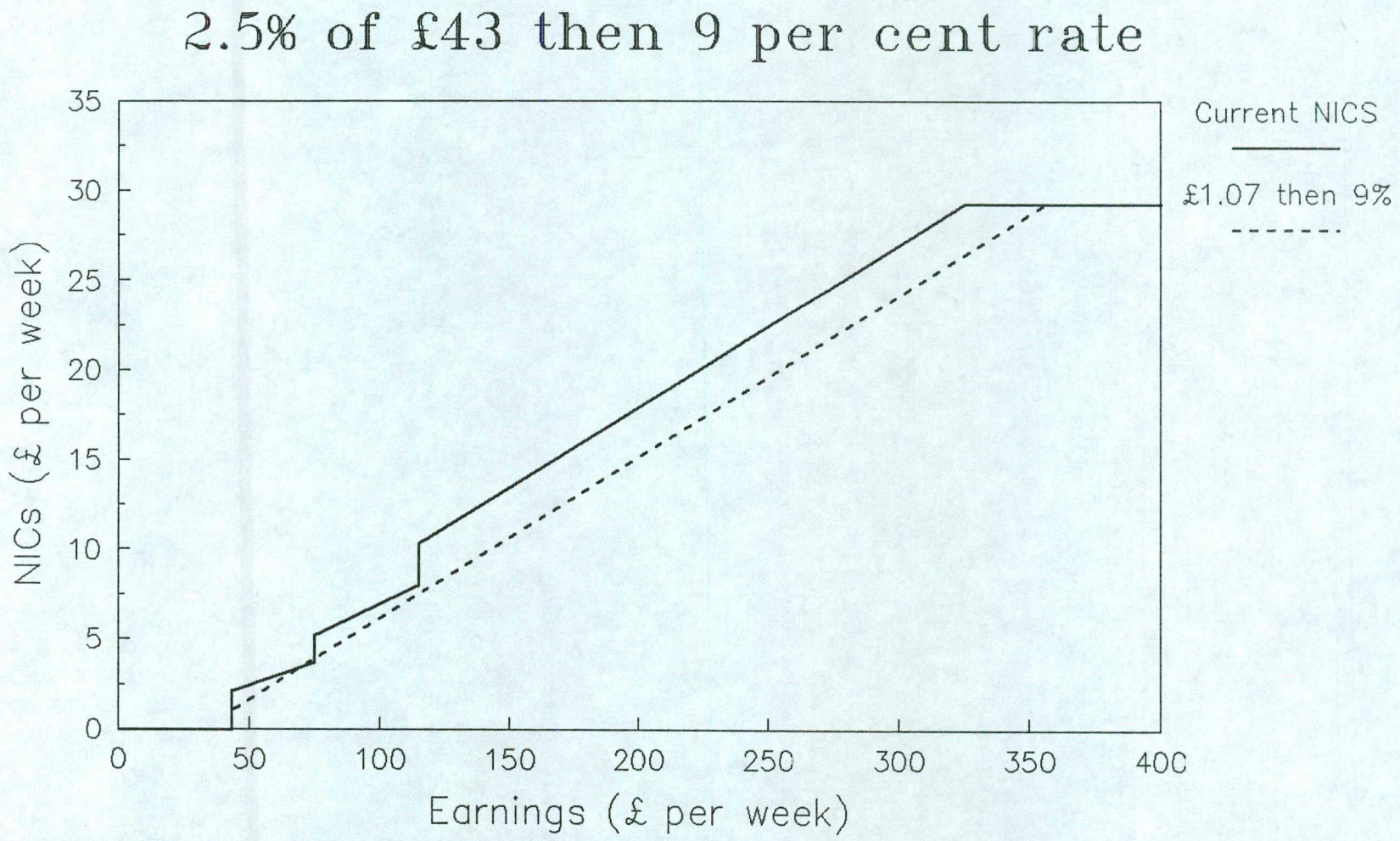
Table 3

2½% + 9%

2.5 per cent of LEL plus 9 per cent of earnings above the LEL

Earnings (per week)	Multiple of average earnings	Current NICs 1989-90	New System	Gain (£ per week)	Gain as % of earnings
43		**2.15**	**1.08**	**1.08**	**2.5**
50		2.50	1.70	0.80	1.6
60		3.00	2.61	0.40	0.7
75		**5.25**	**3.96**	**1.30**	**1.7**
100		7.00	6.21	0.80	0.8
115		**10.35**	**7.56**	**2.80**	**2.4**
125		11.25	8.46	2.80	2.2
137	0.5	12.33	9.54	2.80	2.0
150		13.50	10.71	2.80	1.9
175		15.75	12.96	2.80	1.6
205		18.45	15.66	2.80	1.4
225		20.25	17.46	2.80	1.2
250		22.50	19.71	2.80	1.1
273	1	24.57	21.78	2.80	1.0
300		27.00	24.21	2.80	0.9
325		29.25	26.46	2.80	0.9
350		29.25	28.71	0.55	0.2
375		29.25	29.24	0.01	0.0
410	1.5	29.25	29.24	0.01	0.0

Figure 3



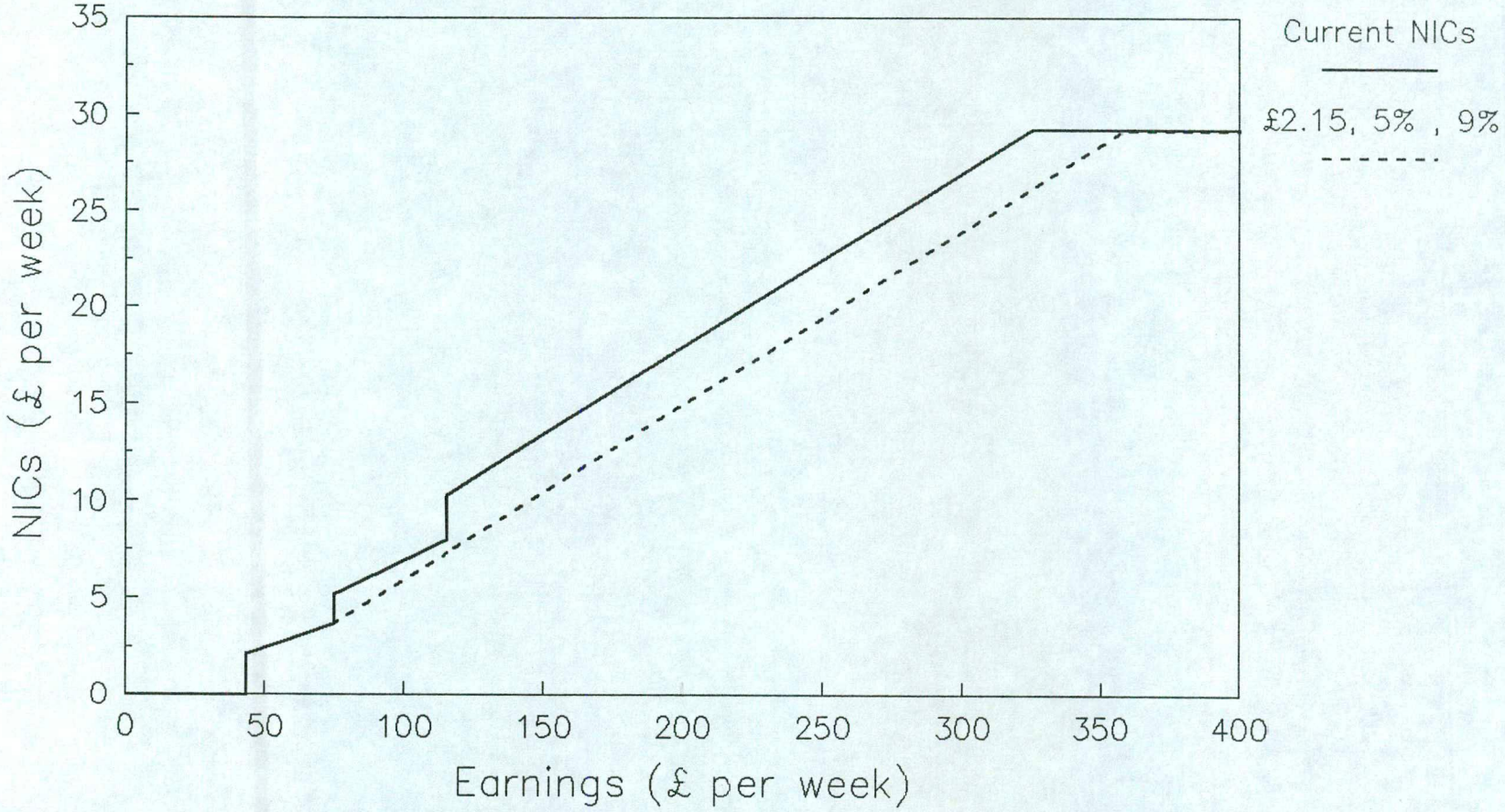
£1.07 "entry fee"
9% on earnings between £43 and £356

McInt[redacted]e option 4

Earnings (£ per week)	Multiple of average earnings	Current NICs 1989-90	New System	Gain (£ per week)	Gain as % of earnings
43		**2.15**	**2.15**	**0.00**	**0.0**
50		2.50	2.50	0.00	0.0
60		3.00	3.00	0.00	0.0
75		**5.25**	**3.75**	**1.50**	**2.0**
100		7.00	6.00	1.00	1.0
115		**10.35**	**7.35**	**3.00**	**2.6**
125		11.25	8.25	3.00	2.4
137	0.5	12.33	9.33	3.00	2.2
150		13.50	10.50	3.00	2.0
175		15.75	12.75	3.00	1.7
205		18.45	15.45	3.00	1.5
225		20.25	17.25	3.00	1.3
250		22.50	19.50	3.00	1.2
273	1	24.57	21.57	3.00	1.1
300		27.00	24.00	3.00	1.0
325		29.25	26.25	3.00	0.9
350		29.25	28.50	0.75	0.2
375		29.25	29.22	0.03	0.0
410	1.5	29.25	29.22	0.03	0.0

Figure 4

£2.15 then 5 per cent then 9 per cent



For those earning under £75 NICs unchanged
No allowance

5% of first £75 of earnings
Marginal rate of 9% between £75 and £358

FROM: J P MCINTYRE
DATE: 20 February 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace IR
PS/IR
PS/C&E

MCINTYRE TO C X 20 FEB

NICS REFORM

Mr Allan's minute of 17 February asked further questions on Option 4. I am again grateful for Mr Speedy's assistance and also to Mr Willis in the Revenue.

Self Employed

2. At present, the Upper Profits Limit (UPL) for the self employed is linked to the Upper Earnings Limit (UEL) for employees. In 1989-90, the UPL will be £16,900 which is 52 times the UEL of £325. But this link is not required by statute. So Option 4's increase in the UEL would not be matched automatically by an increase in the UPL.

3. The possibilities for handling the UPL issue are:

a. **No change in UPL**

4. This would end the link with the UEL, and we would have to find some other basis for fixing the UPL in future. Uprating by prices is one obvious possibility. The existing legislation (Section 20 of Social Security Act 1975) appears to give the Secretary of State discretion on how the annual uprating is done.

5. The main advantage of this approach is that there would be no distributional impact among the self employed, in contrast with the other options below. There would be no losers to give a real edge to self employed complaints. And the breaking of the link with the UEL could answer the question: what's in it for us?

6. The disadvantage is in the inequity between self employed and employees. Why should the amount of profits relevant for Class 4 purposes be any less than for earnings under Class 1? And while it is true that Class 4 does not count towards benefit entitlement, the self employed's combined Class 2 and 4 contributions are already well below (about half) the total they should be paying for their benefits on an actuarial basis.

7. The answer would have to be that it would be unreasonable to increase the NICs payable by the self employed at the same time as cutting employees' NICs by £2 billion.

b. **Increase UPL/cut Class 2**

8. If the UPL were to follow the UEL, it would increase from £16,900 to £18,600. (In practice, we might well want to delay the increase to April 1990 in order to avoid having to apportion profits between the first half of 1989-90 and the second. On this basis, there would be no change in October 1989 and a larger increase, in line with UEL for 1990-91, in April 1990.) An increase to £18,600 would raise the Class 4 yield by around £40 million. Total Class 4 income (including NHS allocation) in 1989-90 is projected at £486 million.

9. Class 2 will be £4.25 a week in 1989-90, raising £469 million. So a compensating cut in Class 2 would reduce it by 35p to £3.90.

10. The gainers would include the 800,000 self employed who pay Class 2 but not Class 4 (because their profits are less than the LPL of £5050 a year). ½ million Class 4 contributors with profits between the LPL and the current UPL would also gain. There would be roughly ½ million losers with profits above the current UPL. The maximum loss would be about £1.45 per week (after tax relief on 50 per cent of the extra contributions and allowing for the 35p cut in Class 2).

11. The case for this option is that it would maintain the UPL/UEL link and help the self employed with profits less than £16,900 (if that were desirable).

12. The case against would be the ½ million losers and the need to justify compensating for a Class 4 increase (carrying no benefit entitlement) with a cut in Class 2 which does carry entitlement.

c. **Increase UPL/cut Class 4 rate**

13. A cut in the Class 4 rate from 6.3 per cent to 5.9 per cent would offset the extra £40 million of revenue from raising the UPL. Annex A shows where the gainers and losers are.

14. The gainers would be those with profits between the LPL and somewhat above the current UPL. The break-even point is where the benefit of the Class 4 cut is offset by the impact of the increase in the UPL - at about £17,750. The Class 2 only group, with profits below the LPL, would not of course gain.

15. The losers would be slightly fewer than the ½ million under (b). The maximum loss would be around 90p a week, after tax relief.

16. The distributional consequences would be less far-reaching than (b), and the UEL/UPL link would be maintained. The self employed might also see more logic in a Class 4 increase (in the UPL) offset by a Class 4 cut (in the rate).

d. **Increase UPL with no compensation**

17. This would produce an adverse reaction from the self employed, which you may want to avoid. About ½ million would lose. The maximum loss would be about £1.80 a week.

18. The case in favour is:

* Without a UPL increase, we would need to defend breaking UPL/UEL link;

* £40 million extra revenue would be a modest contribution towards financing employee NICs changes;

* £40 million should be seen in context of £1 billion "shortfall" in self employed NICs;

* Change (and so impact of losses) would be delayed till April 1990;

* Maximum loss of £1.80 per week in April 1990 would be partly offset if the Schedule D tax allowance were increased at the same time in the normal way.

* No losers among the 80 per cent or so of self employed with profits less than £16,900.

19. If you think (d) is ruled out by the losers and if DSS come up with no additional arguments for retaining the UEL/UPL link, my vote would go for (a) as the option likely to cause least fuss from the self employed.

£75-115 : INCREASE IN MARGINAL RATE

20. There are, very roughly, 1.8 million employees in this group. About 90 per cent are full time; of these, around ½ are under 21. A full breakdown is at Annex B.

21. Those earning a little less than £115 would see a significant overall improvement in their marginal NIC rate because the £115 step would be replaced by threshold. Marginal NIC rates of well over 100 per cent would be replaced by 9 per cent.

£325-£358; INCREASE IN MARGINAL RATE

22. Around 700,000 employees earn between £325 and £358 (the existing UEL and the Option 4 UEL). They would experience an increase in their marginal NIC rate from zero to 9 per cent and in their marginal tax/NIC rate from 25 per cent to 24 per cent. Without Option 4, the total number of employees in the kink would be about 1½ million.

PUBLIC EXPENDITURE SAVINGS

23. We estimate savings in income-related benefits at very roughly £50 million in a full year. However, this figure is well within the margin of error of the estimate of £2¼ billion for the loss of NIC income arising from Option 4.

CONTRIBUTORY PRINCIPLE

24. I suggested in my minute of 16 February that one of the arguments we could use to deal with criticism that Option 4 gave no help to the poorest (those in the £43-75 band) was that the contributory principle required some reasonable minimum subscription. Mr Scholar (16 February) has commented that you would not wish to major on this argument if you were planning soon to turn the LEL into a threshold.

25. In fact, we might try to have our cake and eat it. If we were to go for LEL reform in a future Budget, we could retain a small employee step at the LEL, perhaps 2½ per cent, to ensure what might be regarded as an adequate minimum contribution. If 9 per cent were the chosen marginal NIC rate for employees generally, this would mean a small band between £43 and about £60 in which the current system would apply. At £60 and above, employees would be charged at 9 per cent of earnings above £43. This would be a complication but one well worth considering if it helped to overcome objections to reform from supporters of the contributory principle.

CONCLUSIONS

26. Among outstanding issues on Option 4 are:

i. Do we increase the UEL despite the SERPS consequences? (It may be prudent to defer a firm decision on this until GAD have quantified the cost of Option 4 and the SERPS impact more accurately.)

ii. What are the implications for the self employed?

(see paras 2-19 above).

iii. Will there be a strong employer reaction against it, if we cut employees' NICs and leave employers' NICs unchanged, and how could we respond?

iv. Are the increases in marginal rates for those in the £75-115 and (assuming we raise the UEL) £325-358 bands acceptable?

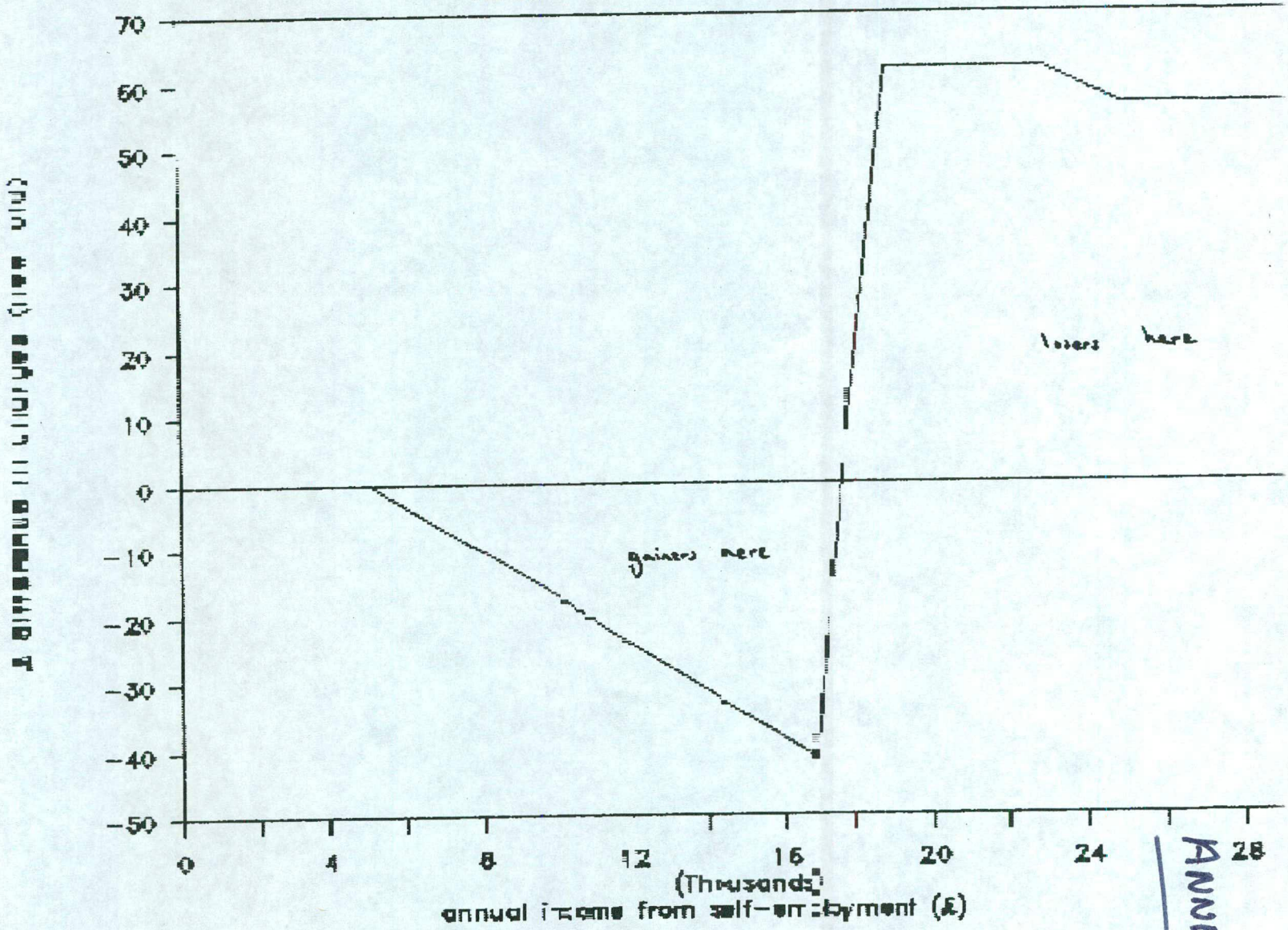
v. Could we satisfactorily defend not helping those in the lowest NIC band, £43-75? Can the contributory principle play a part in this defence?

JPM

J P MCINTYRE

EFFECT OF INCREASING LPL TO £18,900

CLASS 4 RATE CUT TO 5.9 PER CENT



ANNEX A

ANNEX B

EMPLOYEES IN £75-115 BAND

	Thousands
Part-time	
Single man	4
Married man	6
Single Women	31
Married Women	119
Total Part Time	160
Full time	
Men under 21	345
Women under 21	436
Single men over 21	153
Married men over 21	156
Women over 21	551
Total Full Time	**1,640**
Total	**1,880**

chex.ps/aa/45

FROM: A C S ALLAN
DATE: 20 February 1989

CHANCELLOR

NICs PACKAGE

A few thoughts on presentation. It will be important to get that right, against caricature that "realised cutting income tax rates a mistake/sudden conversion to helping poor". The main lines seem to me to be:

(i) did major income tax reforms last year; objective remains to get basic rate down to 20p; but existing rates/structure now on far more satisfactory basis;

(ii) this year right to turn attention to NICs; had made major improvement in 1985 in reducing amounts paid at lower end; but that left problems of steps; couldn't afford to solve that then and other reforms have had to have priority since then; now can complete reform (in spite of what Michael Scholar says, I imagine you will want to say 'done NICs'?)

ACSA TO CX 20 FEB

A C S ALLAN

chex.md/aa/3 BUDGET C [redacted]

FROM: A C S ALLAN
DATE: 17 February 1989

MR MCINTRYRE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Hardcastle
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace IR
PS/IR
PS/C&E

ACSA TO MCINTRYE 17 FEB

NICs REFORM

The Chancellor was most grateful for your minute of 16 February. As you know, we have put this subject on the Overview Agenda for Monday. He would want to concentrate on option 4, and feels that the other options can be forgotten, though it is perhaps just worth considering the variant of option 4 described in your paragraph 13 (not increasing the UEL).

2. On the self-employed, the alternatives are (a) keep the UPL unchanged: does this matter? Or (b) raise the UPL alongside the UEL, with compensating (presumably revenue neutral) cut in class 2 contributions. How large would the cut be? And what are the relative merits of these two options?

3. He had one or two other questions:

(i) How much do we know about the sort of people earning £75-£115 whose marginal rate would increase from 7% to 9%?

(ii) How many people will have their marginal rate increased by 9% (ie those between the old and new UEL)?

(iii) What public expenditure savings are there from option 4? (helping the low paid with NICs will presumably reduce their income support etc entitlement.)

ACSA

A C S ALLAN

BUDGET CONFIDENTIAL

COPY 1 OF 22

FROM: J P MCINTYRE
DATE: 16 FEBRUARY 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Mr Hardcastle
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace (IR)
PS/IR

NICS REFORM

Mr Allan's minute of yesterday asked for further analysis of Options 4 and 5 assuming reform of employees' NICs only, with employers paying the same as now. I am again indebted to Mr Speedy for his help with this. The graph at Annex A compares options 4 and 5 with the current system.

Option 4

2. To recap, employees' marginal NICs would be changed as follows:

Weekly earnings(£)	Present system(%)	Option 4(%)
0-43	0	0
43-75	5	5
75-115	7	9
115-325	9	9
325-358	0	9
358+	0	0

MCINTYRE 16/2

The key change would be the introduction of a threshold at £75 so that those with earnings above this pay only 5 per cent NICs on the first £75 of earnings. The full year cost would be around £2¼ billion. The cost in 1989-90, assuming October introduction, would therefore be roughly £1 billion or a little over.

3. Table 1 attached sets out the distributional effects and Table 2 the impact on the tax/NIC burden. The gains are £3 a week for most of the 15 million employees affected ie in the £115-£325 bracket. This is because each employee in this band of earnings would get a NIC reduction of 4 per cent on his first £75 of earnings.

4. Option 4 raises the following issues:

a. **Does nothing for 1.8 million employees earning £43-£75**

The answer might be that: this group were the main beneficiaries of the 1985 reforms, having their NIC rate cut from 9 per cent to 5 per cent and also of last year's big increase in tax thresholds; introduction of a threshold at £75 would help those near the top of the band in removing the step (though not for employer NICs); and we want to focus help on full time employees. About half those in the £43-£75 band are part-time; the proportion falls to about 10 per cent in the £75-£115 band.

b. **Does not remove the first step at £43**

There were around 700,000 employees within earnings within £3 of the LEL in 1985, most of them bunched below. (See chart at Annex B). The defence against charges of inaction here would be on grounds of cost (a £43 allowance is worth £3.87 a week to employees on the full 9 per cent NIC rate); the aim of focusing help, within available resources, on full-time employees above £75 a week many of whom did not gain from the 1985 reforms; and the contributory principle (the initial NIC payment is a ticket to contributory benefits which should not be bought for virtually nothing). We could also point to elimination of the two other

employee steps, at £75 and £115, where the problem posed by the contributory principle does not arise; together these steps have something like 750,000 employees earning within £3 of them. In this sense we would be broadly halving the steps problem.

c. **Effect on SERPS**

Option 4 would raise the UEL from £325 to £358 and, with the LEL unchanged, would therefore increase the relevant band of earnings for calculating SERPS entitlements. The UEL increase of £33 would widen the SERPS earnings band by 11½ per cent. After 40 years or so, when this would be fully reflected in SERPS entitlements, it would therefore add 11½ per cent to the maximum SERP - for someone whose average lifetime earnings were at or above the UEL. But the increase in SERPS expenditure would be rather less, because the average lifetime earnings of many contracted-in employees would be less than the UEL. A rough estimate of the ultimate extra cost is £300 million a year (1989 prices). After 5 years, the increase in SERPS expenditure might be something like £30 million a year (1989 prices).

d. **Effect on contracted-out rebates**

The widening of the SERPS band would increase contracted-out rebates for those earning above the existing UEL. The maximum rebate (including the temporary 2 per cent incentive) would rise from £22.0 to £24.57 a week, resulting in reduced income to the NIF of perhaps £200 million a year. The higher rebates available to those earning above the current UEL might be expected to balance the inducement of higher SERPS entitlements arising from the raising of the UEL, so that the effect on the choice between SERPS and occupational/personal pensions may be broadly neutral. But this is something on which we should take advice from GAD.

e. **Self employed**

Under the usual rules, the increase in the UEL for employees would be reflected in an increase in the Upper Profits Limit (UPL) for

the self employed's Class 4 contributions. The UPL would rise from £16,900 to £18,600 a year, implying a £1.85 a week increase (after tax relief) for someone on the new UPL or above. This might well be attacked; Class 4 is already unpopular with the self employed because it earns no title to benefits. One option might be to break the link with the UEL and uprate in future in line with prices. Another might be to offer a compensating cut in Class 2 so as to leave total NIC income from the self employed unchanged (though the burden would fall more heavily on those with higher profits). A third would be to maintain the UEL/UPL link, despite the criticism, on the grounds that the self employed at present pay only about half the NICs they should pay on an actuarial basis and that fewer than 400,000 of the 3 million or so self employed (those with profits above £16,900) would be affected.

If the UPL were to be raised in line with the UEL, we would probably need to delay this until April 1990. An October 1989 increase would mean having to apportion profits between the first half of 1989-90 and the second.

f. **Higher marginal rate for those earning £75-£115**

At present, the marginal rate for this group (about 2.8 million employees) is 7 per cent. Option 4 would increase it to 9 per cent. The defence might be that they would pay 2 per cent less on their first £75 of earnings and less in NICs overall. And we might point to the far larger (8 per cent) cuts in the basic rate of tax since 1979 and the intention to take this further: in this context, a 2 per cent rise in the marginal NIC rate does not look too awful.

g. **Burden on employers**

Employers might well react adversely to their own NICs being left unchanged (including the steps) while employees gain from £2 billion or so of cuts. But, unlike the 1985 reforms which included abolition of the employers' UEL, we would not be increasing employers' NICs to pay for cuts in employees' NICs. So

we may be able to ride this out. An October change would be unpopular because of the administrative burden (for many large employers) of reprogramming computers, while those relying on DSS tables might find them more complicated.

Option 5

5. To recap, employees' marginal NICs would be changed as follows:

Weekly earnings(£)	Present system(%)	Option 5(%)
0-43	0	0
43-75	5	0
75-115	7	7
115-325	9	9
325-351	0	9

6. The key features would be removal of the employees' 5 per cent band and an increase in the LEL to £75 a week - which would still be a step. The step at £115 would become a threshold so that those earning more than this would pay only 7 per cent on the first £115. The cost would be roughly £2 billion in a full year and so about £1 billion in 1989-90 with an October start.

7. Table 3 attached sets out the distributional effects and Table 4 the impact on the tax/NICs burden. Table 3 shows that most of the 15 million employees affected (ie those in the £115-325 bracket) would gain £2.30 a week. This is the effect of paying 7 per cent on the first £115 of earnings instead of 9 per cent. The largest gains are at the bottom end, because of the removal of the 5 per cent band.

8. Option 5 raises the following issues:

a. **1.8 million employees taken out of NICs**

Employees earning less than £75 would no longer be earning entitlement to contributory benefits, which would increase

reliance on (cheaper) means-tested benefits. Earnings of some of those affected would, in time, rise above the LEL again, because of career progression etc. But others may never earn consistently about the LEL. In particular, roughly half the group are married women, many of whom are part-time and who may not see their earnings rise sufficiently to overtake the new LEL; they would become dependent on their husbands' contributions for the basic pension and SERPS. When the change had fully worked through, in 30-40 years time, these married women would see the value of their basic pension cut by 40 per cent ie they would get the dependency addition to their husbands' basic pension (currently £24.75 a week) instead of a full basic pension in their own right (£41.15).

b. **Bigger step at £75**

a £5.25pw jump.

Employees crossing the step at £75 would move from paying zero NICs on £74 to 7 per cent on £75. At present, the jump is from 5 per cent on £74 to 7 per cent on £75. This would be hard to defend, even though we could point to elimination of the two other employee steps, at £43 and £115.

c. **No gainers in the £75-£115 band**

It would be difficult to defend NIC reductions for those both below and above this band but not within it. The way round this would be to lower the 7 per cent rate, perhaps to 5 per cent, but this would add substantially to the cost because the 2 per cent cut would feed through to all those earning above the £115 threshold.

d. **Self employed**

Option 5 could provide significant gains for many self employed, in two ways. First, the increase in the LEL for employees could point to an increase in the Small Earnings Exception (SEE) for the self employed. At present, self employed with profits upto £2,350 a year (1989-90) may seek an exemption from Class 2 payments (which give title to benefits). An increase fully in line with the LEL would take the SEE upto around £4,100, and some 450,000

additional self employed could then seek NIC exemption. This would raise issues similar to those for employees ((a) above). But, given that the employers LEL would not be increased under this option, there would be a case for increasing the SEE by less than this. Second, the upward shift in the LEL/UEL band could be mirrored in a similar shift in the LPL/UPL band. But these changes could be expensive. An increase in SEE to £4,100 could, for example, reduce Class 2 income by upto £100 million a year.

e. **Employers**

Similar considerations apply as in Option 4.

Alternatives

9. We have looked briefly at one other option (Option 6). This would give the following marginal NIC rates for employees (employers again unchanged):

Weekly earnings(£)	Present system(%)	Option 6(%)
0-43	0	0
43-75	5	5
75-115	7	7
115*-325	9	9
325-348	0	9

* £115 would be threshold not a step.

10. Employees on upto £115 would see no change (except that those just below £115 would not have the employee step ahead of them). Those in the £115-£348 bracket would pay 7 per cent on the first £115 of earnings and 9 per cent thereafter, thus gaining £2.30 a week (2 per cent of £115). It would cost roughly £1½ billion in a full year.

11. The case for Option 6 is that it would help the income group not helped by the 1985 reforms. Having cut NICs by 2 per cent or 4 per cent for those on upto £115 in the 1985 reforms, we would

now be focussing help on those above the reduced rate bands. Those helped would be on less than ½ average earnings at the bottom end to about 1¼ average earnings at the top. These would be predominantly full time employees. This option would be cheaper than options 4 or 5, but leave the £43 and £75 steps in place.

Assessment

12. I do not see Option 5 as a strong runner, because it would take so many people out of the NIC system, introduce a higher initial step, and produce no gains for the £75-£115 group while helping both those below and above.

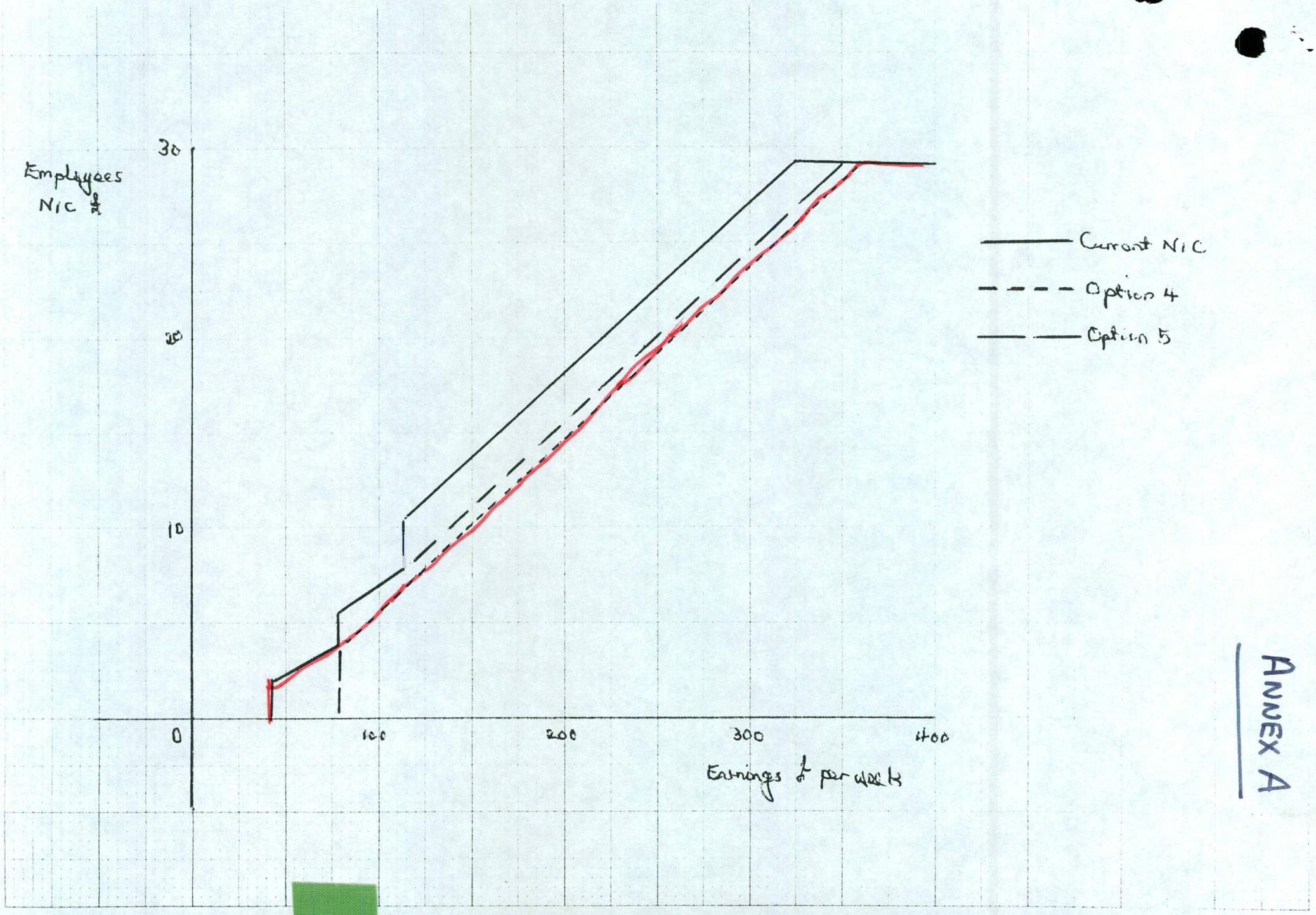
13. A key question on Option 4 is whether we could live with the SERPS effects, of increasing the UEL. If not, an alternative would be not to increase the UEL from £325. This would have the effect of spreading the £3 a week gains to all employees (roughly 2½ million) above the UEL, at a cost of around £400 million a year. About half of this would be recouped, in that an unchanged UEL would avoid increases in contracted-out rebates. So the net cost would rise to roughly £2½ billion in a full year. But the measure would lose much of its focus on the low paid.

14. Option 6 might be of interest if you wanted something a bit cheaper and felt you could defend helping not the lowest paid, who gained from the 1985 reforms, but those in the bracket above that.

15. All of the costings in this note are very broad-brush. I would strongly recommend that, if you wanted to pursue one of these options, we should straightaway engage GAD who could produce more accurate estimates (only one or two people need be involved). We should also want to consult a small number of people in DSS on legal/administrative questions, as soon as Mr Moore has been squared.

JM

J P MCINTYRE

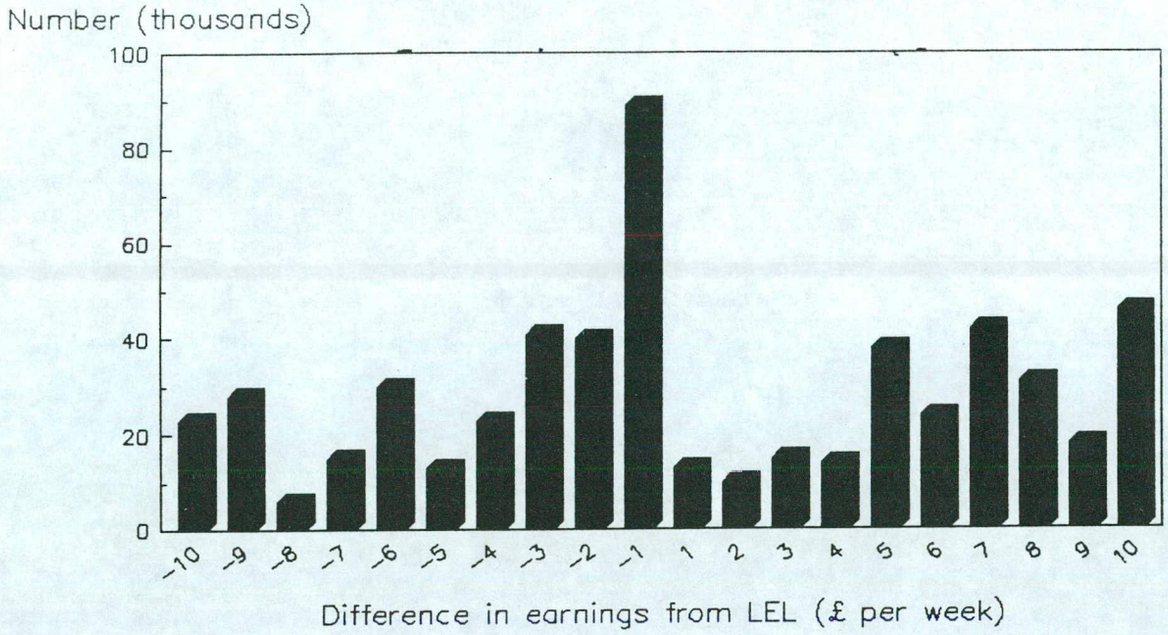


ANNEX A

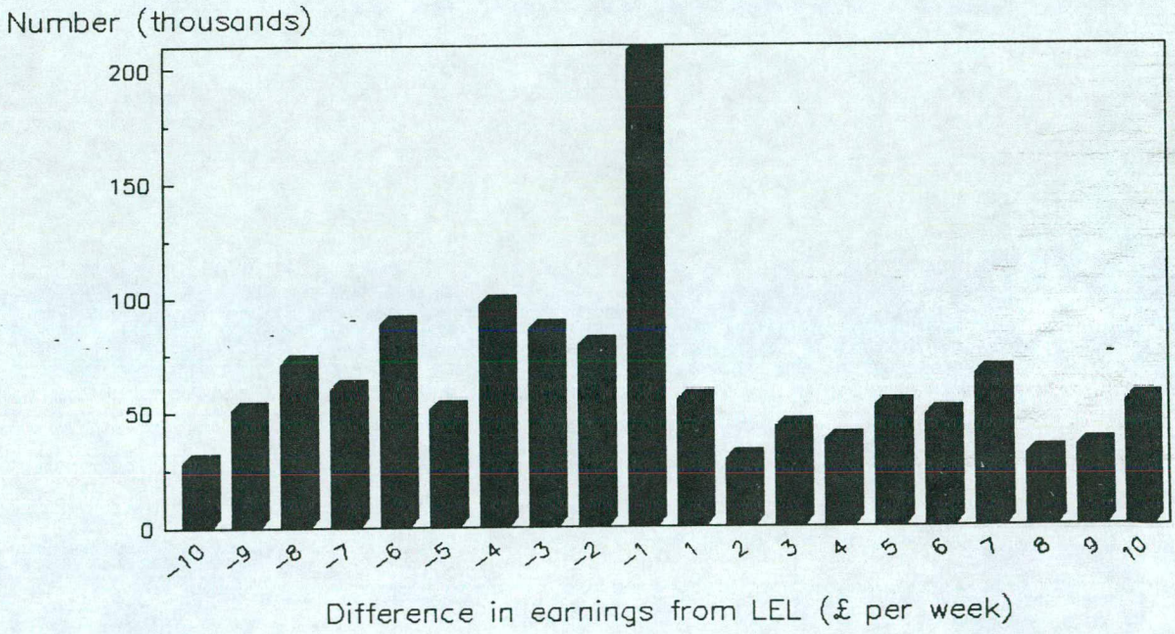
ANNEX A

ANNEX B
CHART 1

Distribution of earnings of heads of tax units
about LEL at time of interview for 1985 FES



Distribution of earnings of married women
about LEL at time of interview for 1985 FES



ANNEX B

CONFIDENTIAL

TABLE 1

Distribution of gains NICs Option 4

Earnings £ per week	Multiple of average earnings[1]	Current NIC[2] 1989-90	Option 4 NIC[2] 1989-90	Gain £	Gain as % of earnings
50		2.50	2.50	0.00	0.0
75		5.25	3.75	1.50	2.0
100		7.00	6.00	1.00	1.0
125		11.25	8.25	3.00	2.4
137	0.5	12.33	9.33	3.00	2.2
150		13.50	10.50	3.00	2.0
175		15.75	12.75	3.00	1.7
205	0.75	18.45	15.45	3.00	1.5
225		20.25	17.25	3.00	1.3
250		22.50	19.50	3.00	1.2
273	1	24.57	21.57	3.00	1.1
300		27.00	24.00	3.00	1.0
325		29.25	26.25	3.00	0.9
350		29.25	28.50	0.75	0.2
375		29.25	29.22	0.03	0.0
410	1.5	29.25	29.22	0.03	0.0

(1) Full time adult males all occupations.

(2) Contracted in.

TABLE 1

CONFIDENTIAL

TABLE 2

Percentage of earnings paid in income tax and NIC Option 4

Multiples of average earnings[1]	1/2	3/4	1	1 1/2
Single				
1978-79	23.5	28.9	31.5	33.3
1988-89	24.1	27.4	29.1	28.9
1989-90 Indexation only	24.2	27.5	29.1	28.9
Indexation and Option 4[2]	22.0	26.0	28.0	28.9
Married with one earner no children				
1978-79	16.0	23.8	27.8	30.8
1988-89	18.5	23.7	26.3	27.0
1989-90 Indexation only	18.7	23.8	26.3	27.0
Indexation and Option 4[2]	16.5	22.3	25.2	27.0
Married with one earner and 2 children				
1978-79	2.5	14.6	20.9	26.2
1988-89	7.1	16.1	20.5	23.2
1989-90 Indexation only	8.1	16.7	21.0	23.5
Indexation and Option 4[2]	5.9	15.2	19.9	23.5

(1) Full time adult males all occupations.

(2) From October.

N.S.

TABLE 2

CONFIDENTIAL

TABLE 3

Distribution of gains NICs option 5

Earnings £ per week	Multiple of average earnings[1]	Current NIC[2] 1989-90	Option 5 NIC[2] 1989-90	Gain £	Gain as % of earnings
50		2.50	0.00	2.50	5.0
74		3.70	0.00	3.70	5.0
75		5.25	5.25	0.00	0.0
100		7.00	7.00	0.00	0.0
125		11.25	8.95	2.30	1.8
137	0.5	12.33	10.03	2.30	1.7
150		13.50	11.20	2.30	1.5
175		15.75	13.45	2.30	1.3
205	0.75	18.45	16.15	2.30	1.1
225		20.25	17.95	2.30	1.0
250		22.50	20.20	2.30	0.9
273	1	24.57	22.27	2.30	0.8
300		27.00	24.70	2.30	0.8
325		29.25	26.95	2.30	0.7
350		29.25	29.20	0.05	0.0
375		29.25	29.29	- 0.04	- 0.0
410	1.5	29.25	29.29	- 0.04	- 0.0

(1) Full time adult males all occupations

(2) Contracted in.

TABLE 3

CONFIDENTIAL

TABLE 4

TABLE 4

Percentage of earnings paid in income tax and NIC Option 5

Multiples of average earnings(1)	1/2	3/4	1	1 1/2
Single				
1978-79	23.5	28.9	31.5	33.3
1988-89	24.1	27.4	29.1	28.9
1989-90 Indexation only	24.2	27.5	29.1	28.9
Indexation and Option 4(2)	22.5	26.4	28.3	28.9
Married with one earner no children				
1978-79	16.0	23.8	27.8	30.8
1988-89	18.5	23.7	26.3	27.0
1989-90 Indexation only	18.7	23.8	26.3	27.0
Indexation and Option 4(2)	17.0	22.7	25.5	27.0
Married with one earner and two children				
1978-79	2.5	14.6	20.9	26.2
1988-89	7.1	16.1	20.5	23.2
1989-90 Indexation only	8.1	16.7	21.0	23.5
Indexation and Option 4(2)	6.4	15.6	20.2	23.5

(1) Full time adult males all occupations.

(2) From October.

PRESENTATION

6

chex.pj/jc/24.2.3

BUDGET CONFIDENTIAL AND PERSONAL

FROM: MRS JUDITH CHAPLIN
24th February 1989

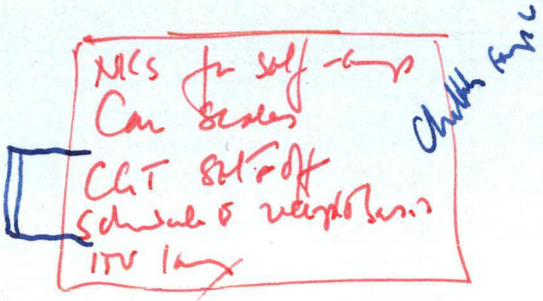
CHANCELLOR

I have been through the Budget Speech with Moira Wallace and made a number of drafting points. These vary from making it clearer why certain measures are being introduced to the actual words and phrases. Andrew too has redrafted the section on business tax. She will be putting all these comments together this evening and sending you the draft.

2. Although I will not have seen that final draft, I am concerned that it will still be far from satisfactory. She is having difficulty getting the bull points of the measures to stand out above the general description. It will therefore still need a great deal of rewriting and I am sorry that it has to come to you before that has been done.

3. On the general framework the section on business taxes, which I had feared would be dull, seems to me to have a good story. It has a major deregulation and simplification story - the close company legislation, the VAT deregulation, Schedule E and to some extent the small companies limit and the CGT offset for unincorporated businesses. The ITV levy doesn't really fit in that package; do we need it in the Budget Speech at all? Deep discounted bonds don't fit either, but they could just about stay there.

4. I have made major suggestions about the start of the section on savings and investment, which at the moment is very weak and has "two strands" one of which is very weak. It seems to me better to move from the independent taxation to PEPs and all the other employee share schemes, including ESOPs, and leading up to stamp duty. The problem is that the CGT gifts and deferral abolition does not sit well in there. It could be shifted forward into the business section, in that it does not affect businesses although that would slightly spoil the good story there.



5. A theme of the whole Budget, which I don't think we have brought out sufficiently yet, is that it is a Budget which is removing a number of tax restrictions on what people do, so that they can make decisions based on what is right for them personally or economically rather than what is best from a tax point of view. This point would cover the pension changes, the earnings rule, stamp duty, close companies and, most important, NICs. Together they constitute major tax reform.

JUDITH CHAPLIN

BUDGET (89)

Press Notices

TAX RELIEF FOR ABANDONMENT + NUCLEAR PROVISIONS

8

Burnish.

Ch.

I suggest that – as last year – you:

1) Agree the order of the PNs (as attached to Mr Flanagan's note behind the first divider);

2) Go thro'
   (i) C+E
   (ii) Revenue notices seriatim,

inviting the relevant Minister to comment.

24/2

PRESS NOTICES

7

fp.nh/sf/48 **BUDGET SECRET** COPY 1 OF 32 COPIES

FROM: S J FLANAGAN
DATE: 23 February 1989

1. **MR CULPIN**
2. **CHANCELLOR**

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Dame Anne Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Riley
Mr Sedgwick
Mr A C S Allan
Mr Gieve
Mr Gilhooly
Mr Macpherson
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call

Sir Anthony Battishill)
Mr Beighton)IR
Mr Isaac)
Mr Painter)

Mr Unwin)C&E
Mr Jefferson Smith)

It will be helpful to settle the order of press notices. This list has been agreed with Customs & the Revenue. Are you content with it?

RC
23/2

BUDGET DAY PRESS NOTICES

Revenue and Customs are separately submitting drafts of their press notices. This minute covers draft press notices by Treasury, DTp and Home Office, and suggests an order for the complete package of notices.

2. A list of all the press notices we expect to issue on Budget day, in the order in which we suggest they should be packaged, is at **Annex A.**

FLANAGAN TO CX 23 FEB

3. We have not attempted to group the press notices by theme - such as business - across departments. There is not much to choose between ordering by theme and ordering by type of tax, but splitting by department makes assembling the individual packages of press notices much more straightforward. We would propose to put an index to all the notices on top of the package.

4. The omission from the list is NICs. In 1985, when NICs were last changed in the Budget, there was a summary in a Treasury press notice on "The Budget and Employment" (which also covered training, legislative restraints on the labour market, and income tax changes), and a more detailed press notice from the DHSS. You may want to consider how to handle NICs press notices this year. A similar point arises on the pensioners' earnings limit.

5. A draft Treasury press notice on capital markets deregulation, prepared by FIM, is at **Annex B**, together with a Bank of England press notice on the same subject. Unlike other Government Departments' Budget day press notices, Treasury does not issue the Bank's notices on its behalf. We understand that there will also be a Bank notice on the ECU Treasury Bill tender, but we have not yet received a draft.

6. The draft DTp press notice on VED is at **Annex C**. A draft Home Office press notice on the ITV levy is at **Annex D**.

S J FLANAGAN

ANNEX A

Inland Revenue

Income Tax

1. Budget 1989: Income Tax
2. Income tax rates and personal allowances for 1989-90: PAYE
3. Income tax: company cars
4. Simpler system of assessment for earnings
5. Payroll giving scheme for charities: tax relief limit to be doubled
6. Heritage and conservation charities: membership subscription paid by deed of covenant to qualify for tax relief
7. Income tax: gifts between husband and wife and other settlements
8. Relocation costs: changes in the tax treatment

Savings

9. Stamp duty on shares to be abolished
10. PEPs improved
11. Pensions: tax rules simplified
12. Life Assurance
13. Unit Trusts
14. Deep discounted and index linked bonds; changes in the tax rules
15. Improved tax reliefs for employee participation
16 Higher tax free limits for Approved Employee Share Schemes
17 Employee Share Ownership Plans
18 Employee's Material interest tests
19. Profit-related pay.

Business

20. Corporation Tax rates [and thresholds]
21. Abolition of close company apportionment
22. Trading losses and capital gains - new relief
23. Extened relief for pre-trading expenditure
24. Advance Corporation Tax
25. Sub-contractor tax scheme: consultation on reduced voucher requirements.
26. Business Expansion Scheme

27. Capital allowances
28. Foreign exchange gains and losses: consultation on tax treatment
29. Swaps: consultative document and extra-statutory concessions

Capital gains tax

30. Reform of CGT rules for gifts
31. Gifts to housing associations
32. Capital gains: non residents with branches and agencies and dual resident companies
33. Offshore Umbrella funds
34. Stock lending: extention to Lloyd's under writers
35. CGT: miscellaneous proposals.

Miscellaneous

36. Inheritance Tax
37. Taxes management: measures to modernise the compliance system.

Treasury

1. Capital markets deregulation.

Customs and Excise

1. Measures to promote unleaded petrol
2. Charities and the handicapped
3. Car tax relief for vehicles leased to the disabled
4. "Pro-business omnibus"
5. Changes in arrangements for bad debt relief
6. Simplification of VAT registration requirements plus increases in thresholds
7. Review of default surcharge
8. restriction of duty paid blending of made wine
9. Determination of original gravity of beer
10. Research and development cars.

Transport

1. Vehicle Excise Duty.

Home Office

1. ITV Levy.

ANNEX B

DRAFT PRESS RELEASE

Capital Markets Deregulation

In his Budget's speech today the Chancellor announced a number of measures to deregulate the sterling capital market:

- Abolition of the new issues queues for bonds and equities; from tonight it will no longer be necessary for issuers to obtain the Bank of England's consent to the timing of sterling issues.

- The establishment of a unified regime for sterling issues of up to 5 years, by bringing the short-term corporate bond regime into line with that for sterling commercial paper.

- An extension of the categories of institution that can issue sterling paper of less than 5 years, to include private companies, companies listed on non-UK Stock Exchanges, sovereign and parastatal bodies.

- A simplification of the tax regime for sterling corporate bonds, abolishing the distinction between qualifying and non-qualifying corporate bonds. In future all sterling corporate bonds will be exempt from capital gains tax.

- Extension of the tax regime for deep discount bond issues by companies to cover issues by the UK Government, overseas sovereigns and parastatals. This will mean that the tax treatment of deep discount bonds in the hands of the investor will be independent of type of issuer.

Take together these changes constitute a major liberalisation in the operation of London's capital markets, giving issuers greater flexibility, and giving investors wider choice, and more straightforward tax treatment.

Notes for Editors

Abolition of the queue will be achieved by a general consent under the Control of Borrowing Order 1958. This will also have the effect of removing restrictions on the issue of deep discount bonds by foreign sovereigns and parastatals. The tax changes outlined above will provide a coherent regime for such issues.

There are currently two separate regulatory regimes under the Banking Act for sterling commercial paper (less than 1 year maturity) and short-term corporate bonds (1-5 years maturity). The Chancellor proposes to lay new Banking Act Exemption Regulations creating a unified regime. Details of the new arrangements are set out in a Market Notice published today by the Bank of England. Issues of this type of securities are also subject to regulation under the Companies Act, which is due to be replaced later this year by regulations under Part V of the Financial Services Act. Until regulations under Part V are in place there will still, in practice, be some differences between the regime for instruments of under 1 year, and those of over one year.

Details of the tax changes on deep discount bonds and non-qualifying corporate bonds are set out in Inland Revenue Press Releases [titles]

HM Treasury
February 1989

CONFIDENTIAL

STERLING ISSUES

Draft Press Notice

1 In his Budget speech earlier today, the Chancellor of the Exchequer announced that [a General Consent is being issued under the Control of Borrowing Order 1958]. With immediate effect, new issues in sterling, other than those by local authorities, no longer require timing consent from the Bank of England.

2 The Bank has been simultaneously reviewing the present arrangements for the issue of different types of sterling instruments and has decided to make a number of changes with a view to simplifying and liberalising the overall framework for such issues. The new arrangements, which take effect immediately, are set out in the attached notice.

3 The Bank's intention is to review further the arrangements for issues of up to 5 years' maturity, including that for short-term corporate bonds, once Part V of the Financial Services Act 1986 has been implemented.

CONFIDENTIAL

STERLING ISSUES

Notice issued by the Bank of England, 14 March 1989

1 This notice sets out the arrangements which will apply to the issue of instruments in sterling. It replaces the following of the Bank's notices:

(i) Sterling commercial paper (notice of 29 April 1986);

(ii) Capital market issues in sterling (notice of 27 July 1987).

The separate frameworks for the issue of short-term corporate bonds (notice of 19 March 1985) and London Certificates of Deposit (notice of 26 November 1986) continue to apply.

2 The main effects of these new arrangements are:

(i) to amend the terms of the exemption from the Banking Act 1987 to widen the range of potential issuers of sterling commercial paper;

(ii) to remove the restrictions on banks and building societies issuing anything other than CDs in maturities of 5 years and below;

(iii) to remove the minimum maturity of five years currently set for bond and FRN issues provided that, where necessary, they meet the [prospectus] requirements of the Companies Act 1985 and the deposit taking provisions of the Banking Act 1987; and

(iv) to abolish the requirement to obtain timing consent and establish revised arrangements for capital market issues.

STERLING COMMERCIAL PAPER

3 The exemption from the Banking Act 1987 allowing issues of sterling commercial paper to be made without contravening the prohibition on deposit taking in Section 3 of that Act will be revised. As a result sterling commercial paper will be made available to a broader group of issuers, including a wider range of companies, as well as to banks and overseas public sector bodies.

4 Issues of sterling commercial paper may now be made by the following:

(a) Companies

Companies, both United Kingdom and overseas, which have:

(i) net assets as defined in Section 264(2) of the Companies Act 1985 of at least £25 million [previously £50 million]; and

(ii) shares (ordinary or preference) or debt [previously excluded] listed on either the International Stock Exchange or an overseas stock exchange where disclosure requirements equivalent to those existing on the International Stock Exchange are in place [as determined by the the Bank of England in consultation with the International Stock Exchange].

Private (limited) companies may also issue sterling commercial paper, so long as they meet the net assets requirement set out above, [and have made arrangements with the International Stock Exchange for the regular disclosure of similar information to that required if their shares or debt were listed].

(b) Banks and building societies

Banks authorised under the Banking Act 1987, and building societies incorporated under the Building Societies Act 1986. These issuers are not required to meet the net assets and listing/disclosure requirements set out in (a) above.

(c) Overseas public sector bodies

Overseas national or regional governments, supernationals or overseas government-owned or government guaranteed bodies whose debt is listed on a stock exchange as described under (a) above.

(d) Other

Issuers not falling into any of these groups may issue sterling commercial paper if it is guaranteed either by a company meeting the net assets and listing/disclosure requirements set out under (a) above or by a bank authorised under the Banking Act 1987 or by a building society incorporated under the Building Societies Act 1986.

5 The conditions of exemption from the Banking Act 1987 for such issues of sterling commercial paper are as follows:

(a) Description

The sterling commercial paper must carry:

(i) if issued by a bank authorised under the Banking Act 1987 or a building society incorporated under the Building Societies Act 1986, a statement to that effect, giving the name of the issuer, and that the paper is sterling commercial paper issued in accordance with Section 3 of the Banking Act 1987; or

(ii) if issued by an institution not authorised under the Banking Act 1987 or incorporated under the Building Societies Act 1986 a statement to that effect, giving the name of the issuer, and that the paper is sterling commercial paper issued in accordance with regulations made under Section 4 of the Banking Act 1987.

If any issue of sterling commercial paper is guaranteed, it must carry a statement to that effect, giving the name of the guarantor and whether or not the guarantor is an institution authorised under the Banking Act 1987 or incorporated under the Building Societies Act 1986.

(b) Disclosure

Issuers of sterling commercial paper under paragraph 4 above must make a representation to the purchaser, in a statement reproduced on the securities, to the effect that the issuer or guarantor:

(i) is in compliance with the relevant listing/disclosure obligations specified in paragraph 4(a) above; and

(ii) since its last publication of information in compliance with these obligations, having made all reasonable enquiries, has not become aware of any change in its circumstances which could reasonably be regarded as significantly and adversely affecting its ability to meet its obligations on the paper as they fall due.

(c) Maturity and minimum amount

Sterling commercial paper must have a maturity of not less than 7 days, but not more than one year, and be issued and transferable in minimum amounts of £500,000.

(d) Monitoring

Issuers must notify the Bank of England:

[(a) at the commencement or extension of any sterling commercial paper programme, of the total amount of paper they propose to issue under the programme, details of its maturity and as full as possible a description of the intended uses of the funds raised; and

(b) within one week after the end of each calendar month, of the amount of sterling commercial paper outstanding as at that end-calendar month and of the amounts of paper issued and redeemed since the previous report, distinguishing in each case between paper issued by or guaranteed by a bank authorised under the Banking Act and paper not so guaranteed.]

Management of sterling commercial paper issues

6 Where an issuer engages an intermediary to manage the issue, the intermediary must be a firm with an established capacity to act in that role in the UK. It must either be fully authorised under the Financial Services Act 1986 or exempted from it by virtue of Section 43 of that Act. Intermediaries not meeting these conditions are invited to discuss with the Bank the terms on which they might manage issues of sterling commercial paper in the UK.

7 Enquiries on paragraphs 3-6 above of this Notice and on related matters should be addressed to the Wholesale Markets Supervision Division of the Bank (Telephones 01-601 or).

CAPITAL MARKET ISSUES IN STERLING

8 The following changes are being made to the Bank's existing guidelines for capital market issues in sterling, set out in the Bank's Notice of 27 July 1987, which is now withdrawn:

(i) A General Consent will be issued by the Treasury under The Control of Borrowing Order 1958. New issues in sterling, except those by local authorities, will no longer require prior timing consent from the Bank, provided that:

(a) The Bank is notified of the main details of any new issue in sterling [before/at the time] it is made; and

(b) the lead management structure meets the requirements set out in paragraph 9 below.

These requirements apply to all capital market issues in sterling (both debt and equities, including securities carrying a sterling option or a sterling-related element).

(ii) There will no longer be any objection to issues of bonds or FRNs with a maturity of less than five years, provided that they observe relevant legal requirements including the deposit-taking provisions of the Banking Act 1987 and the provisions of Part III of the Companies Act 1985 [and Part IV of the Financial Services Act 1986]. Issues may carry calls or puts operative at any time during their life.

(iii) The ceiling of £200 million per issue on the size of issues by foreign public sector borrowers was removed on 26 September 1988, as was the requirement for an interval to be observed between successive issues by a single foreign public sector borrower.

(iv) There is no longer any objection to foreign public sector borrowers making issues of deep discount (including zero coupon) and index-linked stocks. The tax arrangements applying to such issues were announced by [the Inland Revenue on 14 March 1989]. It remains the position that approval will not be given for issues of this type by UK local authorities.

Lead Management

9 To promote the orderly development of the sterling capital market, all capital market issues in sterling must be managed in the UK, under the lead management of a UK-based firm approved by the Bank as having the capacity in the UK to act as an issuing house.

Foreign-owned firms with such a capacity will be eligible to lead manage sterling issues if in the Bank's view there are reciprocal opportunities in their domestic capital markets for UK-owned firms to lead manage issues. Firms who do not meet the guidelines for lead management are able to participate in sterling issues in a co-management position.

Notification of New Issues

10 Enquiries on paragraphs 8 and 9 above of this Notice and on related matters should be addressed to the Senior Manager (Sterling Capital Markets) in the Bank's Gilt-Edged Division (telephone numbers: 01-601 4766 and 01-601 4835), which stands ready to respond to any questions on these capital market guidelines and to give guidance on other matters which may arise in relation to capital market issues in sterling.

FOREIGN CURRENCY INSTRUMENTS

11 Instruments denominated in foreign currency and issued in the UK are not subject to market regulation by the Bank of England. Issuers of such instruments must satisfy themselves that they meet the deposit-taking provisions of the Banking Act 1987 and that they meet any requirements of the appropriate overseas authorities.

Bank of England
14 March 1989

PRESS NOTICE NO:

DATE: 14 MARCH 1989

THE BUDGET 1989: VEHICLE EXCISE DUTY

Paul Channon, Secretary of State for Transport, commenting on the Chancellor's statement this afternoon, said:-

> "The Chancellor has proposed for the fourth year running that Vehicle Excise Duty (VED) rates for the vast majority of vehicles should be held at their present levels. Once again, owners of private cars and motorcycles as well as most goods vehicles will pay the same VED in 1989-90 as they did in 1986-87. And there will be some important measures to simplify the VED structure and make it more equitable".

The Chancellor's main proposals on VED are:

- Rates for cars, motor cycles and most goods vehicles unchanged;

- Rates for about 170,000 rigid goods vehicles over 12,000 kgs gross weight are increased by about 10% (£20-£200). This will bring the tax excess borne by these vehicles more in line with that of articulated vehicles of similar weight. There are consequential rises in VED for the heaviest "Farmers" and "Showman's" rigid vehicles. Rates of duty for the light vehicles have been amalgamated to simplify the tax structure.

- The rate for the new Special Types tax class introduced last year increases from £1600 to £3100, the maximum rate of duty paid by conventional heavy goods vehicles. The need for further increases will be kept under review.

- The number of tax bands for "Hackney Carriages" (taxis, buses and coaches) has been reduced to five from more than sixty, and there will be increases in rates of duty for taxis, which will now pay the same as a private car, and for buses and coaches to ensure that each new band covers its track costs.

- Trade Licences are increased from £85 to £100 for vehicles over 450 kg unladen weight and, from £17 to £20 for motorcycles thus completing the phased increases started in 1986.

- In keeping with the theme of simplification, Agricultural Machines, Digging Machines, Mobile Cranes, Works Trucks and Mowing Machines will now be grouped together as "Special Machines" and will have many of the existing restrictions on their use removed.

The Chancellor also proposed three other changes:-

- The term 'Registration book' is changed to 'Registration Document'.

- The uses to which recovery vehicles can be put are more clearly defined.

- From 30 September people convicted of failing to return a licence obtained with a dishonoured cheque will be required to pay a penalty equivalent to the duty payable for the time they held the licence.

NOTES TO EDITORS

1. Vehicle Excise Duty is administered by the Department of Transport, but decisions on duty rates are the responsibility of the Chancellor of the Exchequer.

2. Rates of VED for most lorry classes are unchanged in this Budget. All lorries will continue to more than cover their road track costs in VED and fuel duty in 1989/90.

3. The main annual rates of VED from 15 March 1989 are attached, with revised rates shaded. Full details of all the rates (including the concessionary and 6 monthly rates) are on form V149 available from Post Offices and Vehicle Registration Offices (Local Vehicle Licensing Offices in Northern Ireland) from tomorrow, 15 March.

4. The "Hackney Carriage" tax class comprises taxis, buses and coaches. The tax structure was cubersome, with over sixty tax rates, and buses and coaches as a class did not cover their road track costs. The tax bands have been reduced to five and the increases will ensure that each band covers its track costs. Taxation continues for the present to be by seating capacity, as follows:

Seating capacity	Under 9	9-16	17-35	36-60	Over 60
VED rate	£100	£130	£200	£300	£450

5. Vehicles licensed in 'Hackney Carriage' class will not be required to pay the new rates until their present licence expires. Renewal forms (V11) issued from 1 April will specify the new rates. Vehicles can be relicensed at the Post Office in the usual way.

6. Vehicles with more than 8 seats currently licensed PLG, but used wholley or partly for hire and reward, will have to change to the 'Hackney Carriage' tax class and pay the appropriate rate of

duty when their present licence falls due for renewal. Operators of these vehicles will have to relicence at a Vehicle Registration Office or Local Vehicle Licensing Office in Northern Ireland.

7. The increases for "Special Types" is in line with the Government's policy that all vehicles should cover from VED and fuel duty their road track costs. A survey in 1988 confirmed that "Special Types" have road costs at least as high as the heaviest conventional HGV. This increase brings them to the same rate of VED. The new rate will not be payable until present licences falls due for renewal. The Department of Transport will continue to monitor the track costs of these vehicles and consider the need for further increases.

8. Amalgamating the old Agricultural Machine, Digging Machine, Mobile Crane, Works Truck and Mowing Machine classes (470,000 vehicles) is a major simplification that will benefit operators immediately. It will allow use in any of the old classes without the need to relicence. Most restrictions on what can be carried or hauled have also been removed, though some remain on Digging Machines, Mobile Cranes and Works Trucks. The licence fee remains unchanged. Tractors used to cut grass and hedges on the public road, including many operated by Local Authorities will now be classed as Agricultural Machines, benefit from the lower licence fee and be able to run their vehicles on rebated diesel fuel. Operators of such vehicles can relicence in the new class immediately by applying to the nearest Vehicle Registration Office, using form V10.

9. On Recovery Vehicles, the change prohibits the carriage of any load not associated with a vehicle being recovered, other than necessary fuel or equipment.

PRESS ENQUIRIES: 0792 782318 Out of Hours: 01 276 5999

PUBLIC ENQUIRIES: Vehicle Enquiry Unit: 0792 72134

ANNEX D

CONFIDENTIAL

DRAFT HOME OFFICE PRESS NOTICE

ADDITIONAL PAYMENTS BY INDEPENDENT TELEVISION CONTRACTORS - THE LEVY

The Chancellor of the Exchequer announced in his Budget Speech today that the levy on ITV contractors would be changed. The new legislation will take effect from 1 January 1990 and is expected to raise around £50 million a year more than present arrangements.

The new levy will be in two parts - a levy on net advertising revenue of [10.5 per cent] and one on profits of [22.5 per cent]. Both will allow a "free slice" not subject to levy - £15 million on revenue and £2 million on profits. The levy on profits will be assessed after allowing for payment of revenue levy.

Today's announcement follows the Home Secretary's statement on 13 December 1988 that:

> "Following consultation with the IBA, we have decided that the levy for the period 1 January 1990 to 31 December 1992 will be raised from both the net advertising revenue and from the profits of the independent television contractors. It is intended that the overall yield of the levy during this period should be broadly of the same amount as would have arisen under the arrangements which existed prior to 1986. The structure of the new levy will be such that about three quarters of the total yield is expected to arise from net advertising revenue and the remainder from profits.

CONFIDENTIAL

"The purpose behind these changes is to encourage cost-consciousness amongst the independent television contractors and to ensure an adequate return to the Government for use of a scarce resource during the contract extension period."

The decisions announced today give effect to those objectives.

[14 MARCH 1989]

CONFIDENTIAL

BACKGROUND

Recent history

Between 1964 and 1973 the levy was solely on net advertising revenue (NAR). In 1973 the free slice was £2 million (equivalent to £10 million at 1988-89 prices) and larger revenues were taxed progressively with those over £16 million paying 25 per cent.

In 1974 this levy was replaced by one on domestic profits at 66.7 per cent. The free slice was occasionally increased, reaching £650,000 in 1982. Since ITV companies also paid corporation tax on post-levy profits, this approach gave them little incentive to control costs.

In 1986 the rate on domestic profits was changed to 45 per cent and a new levy of 22.5 per cent introduced on overseas profits. The aim was to raise the same amount of tax while increasing the incentive to control costs. The free slice on both was raised to £850,000.

In 1988 the Public Accounts Committee, in its 43rd report of the 1987-88 Session, reported that the new system was failing to raise as much as the pre-1986 levy system would have done. Ministers subsequently announced that, for the 1990-92 contract extension period, the levy would be based three quarters on net advertising revenue and one quarter on profits, with the objectives both of securing broadly the same yield as would have arisen under the pre-1986 system and of continuing to encourage cost-consciousness.

Assumptions

To calculate what the yield of the levy under the pre-1986 system would have been the following assumptions have been made. Net advertising revenue increased by £370 million (35 per cent after allowing for inflation) between 1985 and 1987. A further 8.5 per cent real increase occured in 1988. Smaller increases, of between 4.5 per cent and 2.5 per cent a year are expected in 1989 and subsequent years as competition from satellite television arrives.

Domestic costs increased by £225 million (14 per cent in real terms) between 1985 and 1987. Substantial one-off restructuring costs were incurred in 1988, though their exact size is not yet known. Further restructuring costs are expected in 1989. Real terms increases of 3 per cent a year are assumed for underlying costs from 1987.

On this basis the pre-1986 system would have raised around £200 million a year in 1990-92. The new levy structure will do the same. This compares with a yield of around £100 million in 1987-88 and a forecast of £150 million a year for 1990-92 if the existing levy structure has been retained.

The performance of ITV companies' profits will depend on how well they control costs and maximise revenue. But on the basis of our assumptions, total post-levy annual profits will double in real terms between 1985 and 1990-92.

If net advertising revenue fails, contrary to expectations, to increase in line with inflation Ministers will review the proposed levy structure.

CONFIDENTIAL

Fourth Channel subscription

Subscriptions to Channel 4 and SC4 will be taken into account when assessing revenue levy. They amount to around 17 per cent of NAR and will be treated as an additional free slice.

CUSTOMS & EXCISE

1

INLAND REVENUE

2

BUDGET LIST ONLY: COVERING BUDGET SECRET
AND BUDGET CONFIDENTIAL PAPERS

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INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

[Attachments comprise: list of IR press notices
: copies of same]

Copy No 1 of 37

FROM: D DENTON
EXT: 6302
DATE: 23 FEBRUARY 1989

MR A C S ALLAN

BUDGET DAY PRESS NOTICES

1. Further to my note of 15 February, I attach:

   (a) an updated list of the press notices expected to issue on Budget Day; and

   (b) drafts of all (but one) of these. (The exception is Starter 264 (capital gains: avoidance on sales of subsidiaries). We are hopeful that we shall get

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cc. PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir Terence Burns
Mr Anson
Dame Anne Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Culpin
Mr Riley
Mr Gilhooly
Mr Matthews
Mr Pickford
Mr Sedgwick
Mr Macpherson
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call

Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Bush
Mr McManus
Mr Cayley (cover note only)
Mr McNicol
Miss McFarlane
Mr Denton
Mr Shaw (Rm 44, New)
Mr Willmer
PS/IR

DENTON TO ACSA 23 FEB

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sufficiently far forward with the proposals to issue a press notice on Budget Day. Mr Cayley will minute Ministers directly on this in due course.)

2. The main income tax release follows the traditional format and uses the GAD earnings assumption in Tables 8 onwards. But it needs to be reconsidered in the light of the NIC package (Option 4 is used pending Ministers final decisions). The current format describes the NIC package in the text and includes the effects in the appropriate tables (Tables 6, 7, 9, 10). We should be grateful to know whether Ministers would like:-

- the costs and effects of the NIC package described in the text;

- any new tables showing effects on those contracted out of SERPS;

- lower income ranges (ie for non income taxpayers) to show effects of NIC package.

The Press Release assumes that DSS will produce a Press Release on the NIC package.

3. Although Divisions have done their best to get as far advanced as possible with the texts, a number of the press notices will need further work (for example, the life assurance draft is to be discussed with the Financial Secretary next Monday). Moreover, due to absence from the Office this week on official business, the Deputy Chairmen have not yet had an opportunity to consider some of these first drafts. Subject Divisions will send forward up-dated drafts for approval as soon as these are ready.

4. Some drafts have already been put forward to the Financial Secretary for consideration. These are highlighted in the list. For completeness, and ease of reference, copies have been included (suitably annotated) in the attached bundle.

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5. The main changes from the first list (other than adjustments to titles) are as follows:-

(a) Items dropped : Consequentials of reduction in basic rate.

: Electricity privatisation (as the tax implications are unlikely to be settled by Budget Day - a press notice on "Taxation of employee priority shares in a public offer" issued yesterday).

: PRT - incremental investment allowance (proposal dropped).

: Criminal penalties for disclosure of taxpayer information (announcement brought forward - press notice issuing today).

: European Economic Interest Groupings (considered better to issue on Finance Bill publication day - because Company Law Statutory Instrument may not have been published by Budget Day).

(b) Items added : Offshore umbrella funds (initially contemplated that this might be aggregated with the other unit trust proposal).

6. Because of the tight deadline we have been working to I am afraid that the order of drafts in the bundle is not quite the same as that in the list.

D. Denton.

D DENTON

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List at 23 February 1989

INLAND REVENUE BUDGET DAY PRESS NOTICES

1. The Budget 1989: Income tax
2. Income tax rates and personal allowances for 1989/90: PAYE
3. Income tax: company cars
4. Simpler system of assessment for earnings
5. Payroll giving scheme for charities: tax relief limit to be doubled
6. Heritage and conservation charities: membership subscriptions paid by deed of covenant to qualify for tax relief in certain circumstances
7. Income tax: gifts between husband and wife and other settlements
8. Changes in the tax treatment of relocation payments
9. Stamp Duty on shares to be abolished
10. Personal Equity Plans improved
11. Pensions: tax rules simplified
12. Life Assurance
13. Removal of tax disadvantages faced by unit trusts
14. Deep discounted securities; new tax rules
15. Improved tax reliefs for employee participation
16. Approved All-Employee Share Schemes: limits to go up
17. Employee Share Ownership Plans
18. Relaxation of employees' material interest tests
19. Improvements to the relief for Profit-Related Pay (PRP)
20. Corporation Tax rates
21. Abolition of close company apportionment
22. Trading losses and capital gains - new relief
23. Extended relief for pre-trading expenditure
24. Advance Corporation Tax

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25. Sub-contractor Scheme: consultation on reducing requirements*

26. Business Expansion Scheme

27. Capital allowances

28. Foreign exchange gains and losses - consultation on tax treatment*

29. Interest and currency swaps*

30. Reform of capital gains tax rules for gifts*

31. Capital taxes: gifts of land to Housing Associations*

32. Capital gains tax: non-residents with UK branch or agency and dual resident companies*

33. Offshore umbrella funds

34. Stock lending: extension to Lloyd's underwriters

35. Capital gains: miscellaneous proposals*

36. [Capital gains: avoidance on sales of subsidiaries]

37. Inheritance tax

38. Taxes Management: measures to modernise the compliance system*

* Denotes a draft (in this set) which has already been put forward to Ministers earlier this week.

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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

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.

3

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 with unconventional engines 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 halved for the motorist who does 18,000 business 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 all 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.

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.

4

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.

5

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.

6

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.

INLAND REVENUE

Press Release

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[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.

INLAND REVENUE

Press Release

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[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 and

- the job 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.

Withdrawal of relief for additional housing cost payments

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 the job 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 IRI, 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

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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.

9

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 PRESS NOTICE

[3x]

PERSONAL EQUITY PLANS IMPROVED

The Chancellor proposes in his Budget a major package of improvements to Personal Equity Plans (PEPs). The main features are:-

- the overall (annual) investment limit is to be increased from £3,000 to £4,800;
- the annual limit for investment in authorised unit trusts and investment trusts is to be raised from £540 (or up to £750 in some circumstances) to £2,400;
- the scheme will be better targeted with a new requirement that unit or investment trusts within PEPs must invest mainly in UK equities;
- a facility will be introduced to allow new issue shares, including future privatisation issues, to be brought within plans;
- significant simplifications are to be made to the administration of the scheme.

The starting date for the changes will be 6 April 1989, but unit and investment trusts will be given until 5 April 1990 to meet the requirement to invest mostly in UK equities.

As a transitional measure, plan managers will be able to continue on the basis of the existing rules, if they wish, until 31 December 1989.

The Government believes that these changes will give a significant boost to PEPs. They will make them more attractive to investors - particularly smaller investors - by allowing them considerably greater flexibility. At the same time the simplifications will help keep plan managers' costs - and their charges to investors - to a minimum.

10

/DETAILS OF ...

AJW3 AJW83

DETAILS OF THE PROPOSALS

Increase in the amount that can be invested

1. The overall investment limit is the annual maximum limit for subscription to a plan. To make full use of the limit, the plan manager must invest substantially in UK shares on the investor's behalf. When the increase in limit takes effect on 6 April, it will have been doubled from £2,400 to £4,800 since the scheme was introduced two years ago.

Unit trusts and investment trusts within PEPs

2. At present, the annual limit for investment in authorised unit trusts and investment trusts operates on the basis of a fairly small limit (currently £540) where a plan invests wholly in unit or investment trusts. A larger limit (up to £750) is possible provided the investment in the unit or investment trust forms no more than a quarter of the overall PEP investment for the year. But there is no stipulation as to what the unit or investment trust may invest in.

3. For the future, the investment limit is to be raised significantly to £2,400: the rule described above will be simplified so that the new limit applies regardless of whether or not the unit or investment trust holding forms part of a larger portfolio within a plan.

4. At the same time the Government want to continue the present targeting of the relief. So, after a 12-month transitional period, investment through a PEP in such trusts will be limited to those trusts which themselves invest at least 75 per cent in UK equities. This maintains the original intention of the scheme to encourage investment in British industry.

New issues and privatisation shares

5. The PEP regulations at present require that investment in plans must be in cash: shares already held cannot be transferred into a plan. This rule is to be relaxed to allow individuals who wish to subscribe for new issue shares, including privatisation issues, to do so outside their PEP. Then, when the allocation has been announced, they will be able to transfer all or part of their allocation into their plan, so that they can benefit from tax-free dividends, and tax-free capital gains. The value of the shares (at the offer price) will count towards the overall investment limit, and investors will have 30 days from the day the share allocation is announced to make up their minds.

6. The following example shows how the new provision could work:-

1989-90

Amount of investment permitted overall	£4,800
within which unit/investment trust limit	£2,400

/Miss A

Miss A takes out a PEP on 29 April 1989. She invests:-

Equities	£1,000	
Unit trust	1,200	
Investment trust	1,200	
Total		£3,400
Amount still available for investment in equities		£1,400

In June 1989, Miss A applies for 1,000 new issue shares at an offer price of 200p each.

If, when the shares are allocated, she receives the full 1,000 shares at a cost of £2,000, she may transfer a maximum of 700 shares into her plan at a value of £1,400. She may not then make any further subscription, or transfer any further new issue shares into the plan until 6 April 1990.

If, when the shares are allocated, she receives only 500 shares, she may transfer all 500 shares into her plan at a value of £1,000. If she wishes, she can make a further subscription of up to £400 for further equities (or transfer other new issue shares to the same value) into her plan before 5 April 1990.

7. It will be for plan managers to decide whether or not to offer this new facility. Even where a plan manager at present offers PEPs investing only in unit or investment trusts, he will be able to offer a facility for investors to bring in new-issue equities - up to the overall investment limit - over and above the unit or investment trust holding. The plan manager will be able, if he wishes, to offer a custodial facility for the new shares: he will simply hold them, and claim back tax credits on behalf of the investor, until the investor wants to sell them.

Greater simplicity and flexibility

8. The proposed simplifications are as follows:-

- The "minimum holding period" is to be abolished. Thus, there will no longer be a rule that all plans must be held for at least a full calendar year in order to qualify for the tax reliefs.

- The maximum permitted investment will be worked out on the basis of the fiscal year (6 April to 5 April), rather than on the calendar year basis. There will be optional transitional provisions for those already holding PEPs.

- The "cash holding rules" are to be abolished. At present these rules place limits on the amount of cash, as opposed to shares, that can be held in a plan. For the future, there will be no specific rules on how much cash can be held, and for how long. Instead, all interest arising on such cash will be subject to composite rate tax in the same way as bank or building society deposits.

- The Inland

- The Inland Revenue will no longer require plan managers to submit PEP application forms for approval.

- The amount of information required from plan managers by the Inland Revenue will be reduced.

- The rule which prevents switching from an investment in shares to an investment in authorised unit trusts or investment trusts within a plan is to be relaxed. A provision will be introduced which will allow limited switching from shares into unit or investment trusts: it will be a condition that the value of the holding in unit and investment trusts immediately after the switch is not more than half the value of the whole PEP portfolio.

Cost

9. The cost of the proposals is expected to be £5 million in 1989-90, and £10 million in 1990-91, rising to perhaps £30 million after 5 years.

Amendment of Regulations

10. The detailed rules for personal equity plans are set out in statutory regulations. The Chancellor's proposals will therefore be introduced as amending regulations rather than in the Finance Bill. The regulations are due to be made [today].

NOTES FOR EDITORS

Personal Equity Plans

1. Personal Equity Plans (PEPs) were introduced in the 1986 Budget to encourage investment in shares in UK companies. Dividends arising on shares and units held in a plan are entirely free of income tax; and there is no capital gains tax charge. Until now, it has been a requirement that - to qualify for the tax benefits - investments must be retained in the plan for at least a complete calendar year after the year the investment is made; but this requirement is now to be abolished.

2. Investors do not need to keep records, or declare their dividends and gains on their tax returns. So PEPs do not give rise to any involvement with the Inland Revenue. The administration is carried out by authorised plan managers. Investors may put a lump sum into a plan or invest a regular amount. They may subscribe to an "own-choice" plan (where the investor decides what shares or units to buy) or a "managed" plan (where the plan manager makes the investment decisions).

/Take-up ...

Take-up of PEPs

3. Since the scheme started in 1987, it is estimated that over 375,000 plans have been taken out, with a total investment [approaching £700 million].

Other changes

4. On 11 January 1989 the Government announced a change which enabled plan managers to claim back from the Inland Revenue on behalf of investors tax credits on all dividends, regardless of whether the dividends are passed on to the investor or reinvested in the plan. Previously, only dividends reinvested in the plan were entitled to the relief.

The Treasury regulations are to be amended to reflect this change. In the meantime, the Inland Revenue have implemented the change by extra-statutory concession.

5. When the Treasury regulations are amended to implement the changes announced today, they will also be amended to remove some investor-protection measures which are now adequately covered in the rules of the Securities and Investments Boards (or those of the other self-regulatory bodies with which PEP managers have to be registered).

Compliance cost assessments

6. 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

12

/*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

DRAFT

REMOVAL OF TAX DISADVANTAGES FACED BY UNIT TRUSTS

The Chancellor proposes in his Budget to introduce from 1 January 1990 a new tax regime for unit trusts which are freely marketable within the European Community under the UCITS directive. This will enable them to compete more effectively with their continental counterparts.

The new system builds on the existing corporation tax regime for most authorised unit trusts. Its main features are:

- Reduction of the corporation tax rate to the basic rate of income tax. So removing any UK tax charge on a trust which cannot be credited to unitholders.
- Relief for expenses of management and interest paid
- Simplicity

The change will reduce the tax bill on unit trust~~s investment~~ by £20m a year.

DETAILS

1. The UCITS directive

Under a European Community directive, collective investment vehicles that are UCITS (Undertakings for Collective Investment in Transferable Securities) will be able to market their units or shares throughout the whole of the Community from 1 October 1989, in each case subject only to compliance with local marketing regulations. Most UK authorised unit trusts will be UCITS.

2. Present tax arrangements

Authorised unit trusts (other than gilt trusts which invest only in UK interest bearing securities) are taxed like companies. They are liable to mainstream corporation tax on the income they receive. And they have to pay advance corporation tax on the income they have available for distribution. The unitholder gets a dividend to which a tax credit is attached. Under the normal corporation tax rules, the trust is allowed to deduct management expenses and interest paid in arriving at its taxable income.

Gilt trusts pay income tax at the basic rate on their income, but get no relief for management expenses or interest paid. Amounts available for distribution are treated as received by unitholders as income on which basic rate tax has already been paid.

MAIN FEATURES OF THE PROPOSED NEW SYSTEM FOR UNIT TRUSTS

3. All unit trusts that are UCITS to be covered

This means gilt trusts that are UCITS will cease to be dealt with under an income tax regime. The switch will take place for the first distribution period of the trust starting after 31 December 1989. As a result of this switch gilt trusts will be able to get tax relief for expenses of management and for interest paid.

4. Lower rate of corporation tax

The income of unit trusts that are UCITS will be charged to corporation tax at a rate equal to the basic rate of income tax as from 1 January 1990. This means that the only UK tax payable by the trust will be fully offsettable (by repayment or credit) against the unitholders' tax liability. The main beneficiaries will be trusts investing a proportion of their money in bonds or fixed interest securities where before the Budget the trust paid tax at 35% on the income but the unitholder only received a credit of 25%.

5. Corporate unitholders

Companies who invest in unit trusts will be liable to corporation tax on the income they receive, but they will get credit at the basic rate of income tax for the tax paid by the trust. The main corporate investors in unit trusts are life assurance companies. Their rate of corporation tax will also fall to the same as the basic rate of income tax from 1 January 1990. So their tax liability on unit trust income will be covered by the tax credited as paid. Small companies paying the reduced rate of corporation tax will be in the same position. Other companies will ~~ahve~~ have to pay the difference between the full rate of corporation tax and the basic rate of income tax credited as paid on the unit trust income.

NOTES FOR EDITORS

1. The new system will start from 1 January 1990 to tie in with the commencement of the proposed new regime for life assurance companies. This is to avoid the need for administratively costly transitional provisions in the very short period between 1 October 1989 and 1 January 1990.

2. Authorised unit trusts that are not UCITS and investment trusts are not included in the new regime since they cannot be marketed in Europe and because comparable European vehicles cannot be marketed in the UK by virtue of the UCITS directive.

3. Most European countries apply a "transparent" regime for collective investment schemes. The taxayer is taxed as if he held a pro rata share of the underlying asset, but does effectively get tax relief for management expenses. The proposed

tax regime effectively achieves the same result, but avoids the complexities of transparency. In particular, it avoids the need for unit trusts to identify the extent to which distributions are derived from different types of income and provide details ~~of~~ to each unitholder.

4. The UCITS directive is the European Communities Council directive of 20 December 1985 (85/611/EEC) as amended by directive 88/220/EEC of 22 March 1988.

5. Compliance Cost Assessment

Assessments of the compliance costs of proposals affecting businesses are available. A copy of the Compliance Cost Assessment for the unit trusts proposal 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.

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.

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".

16

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.

BUDGET CONFIDENTIAL

17

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
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

- 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.

DRAFT BUDGET DAY PRESS RELEASE

18

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 (to) 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

19

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 employer's 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.

20

[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

21

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

22

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

23

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

24

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 either a major change in the company's business within 3 years, or

- 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 supplement.

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.

TEXT SENT TO IFST FOR COMMENT 21/2

BUDGET CONFIDENTIAL

DRAFT PRESS RELEASE

SUBCONTRACTOR SCHEME: CONSULTATION ON REDUCING REQUIREMENTS

The Chancellor proposes in his Budget consultations on possible changes to the special regime for subcontractors in the construction industry. These changes are intended to reduce the burden of paperwork on the industry and the Inland Revenue while keeping safeguards against tax evasion.

2. The Inland Revenue are [today] issuing a consultative document. Subject to the results of consultation, the changes would come into force from April 1990. Views are sought by 31 May 1989.

25

[3. This is only a first step. The Chancellor proposes that later this year there should be consultation on a wider range of changes, in particular to the rules for certificates exempting subcontractors from deduction at source.]

DETAILS

4. Ministers have reviewed the subcontractor deduction and exemption scheme following an efficiency scrutiny last year. Views are now sought on how to reduce the administrative burden of the scheme while retaining, and if possible improving, its effectiveness in controlling tax fraud. The consultative document is available from The Reference Room, Somerset House, Strand, London WC2R 1LB, price £1.10]. It covers the following proposals.

Voucher requirements

5. At present, most subcontractors can be paid for their services without any immediate deductions from the payments. They are issued by the Inland Revenue with pre-printed books of vouchers. In order to be paid gross by a contractor, a subcontractor should give the contractor a completed voucher for every payment. There are different procedures for large companies.

6. The consultative document suggests that:

- the first and last payments under a contract should remain supported by vouchers, but that no voucher be provided for intervening payments until the running total exceeds, say, £2,500.

- vouchers be provided by the subcontractor by the time of payment rather than within a week after payment

- vouchers be sent by the contractor to the Inland Revenue monthly rather than weekly

- there be a limit, say of £10,000, on the amount a single voucher may cover: so larger payments would need more than one voucher

- the Inland Revenue should be notified by the contractor of the first payment under a contract made to a subcontractor which is a large company with a '714C' certificate.

Deduction scheme paperwork

7. Subcontractors who are not exempt from the scheme have an amount, currently at 25%, deducted from payments made to them by contractors. Many

subcontractors receive frequent small payments, each with a form showing the amount deducted. Each form has to be sent to, and processed by, the Inland Revenue. At present, amounts paid under a contract may, if the subcontractor agrees, be shown on a single form, provided a form is given at the end of the year. Views are sought on making aggregation compulsory, so an uncertificated subcontractor might demand a form no more frequently than quarterly, where he was being paid under a single continuing contract.

Direct issue of certificates and vouchers

8. The consultative document proposes that all certificates and vouchers be posted direct to the subcontractor who has asked for them, rather than being routed through the local tax office.

Activities covered by subcontractor scheme

9. The legislation sets out activities which are, or are not, construction activities for the purposes of the scheme. There have been suggestions that there are anomalies, for example in the treatment of tree-felling or of removal of spoil from building sites. The consultative document seeks views on any aspects of the present definitions that could be clarified.

Compliance costs

10. Overall, these proposals should result in a significant reduction of paperwork, in line with the Government's commitment to deregulation. The consultative document specifically asks for views on the compliance costs of these proposals.

[Further steps

11. Ministers intend that a further discussion document be prepared this summer. This would cover

proposals for inclusion in the 1990 Finance Bill, principally on options for changing the rules for exemption from the tax deduction scheme and on options for reducing the rate of deduction.]

NOTES FOR EDITORS

1. There is a special regime for subcontractors in the construction industry. This regime does not extend to householders and others commissioning small works, but otherwise applies widely to self-employed subcontractors and those engaging them.

2. In general, contractors must make a deduction on account of tax, currently at 25 per cent, from payments to subcontractors. This deduction is set against the subcontractor's tax liability under the normal Schedule D or Corporation Tax rules. However, subcontractors who are running a construction business and can demonstrate a good tax record may be issued with a certificate exempting them from deduction. Individuals, partners and small firms with exemption certificates are issued with books of vouchers. When a contractor makes a payment to a subcontractor , he should ensure that the payee correctly holds a valid exemption certificate. He should also make every effort to obtain a voucher. The voucher is pre-printed with the subcontractor's name and the voucher number. The subcontractor should fill in his certificate number, his business address, the name of the contractor and the gross payment; and date and sign the voucher before handing it to the contractor.

3. The contractor should then, every week, forward all vouchers he has collected to the Inland Revenue's Liverpool Computer Centre. Data processing then allows cross-checks of all the work done by a subcontractor, and all the work a contractor has paid for.

4. The subcontractor scheme was introduced in 1971 to deter and detect substantial tax evasion endemic in parts of the construction industry. The last major revision of the scheme was in 1975. Since then, the number of subcontractors has increased sharply. The number of individuals with certificates has trebled. Well over six million "715" vouchers a year are now submitted.

5. The consultative document specifically asks for comments on compliance costs of the proposals, both relative to each other and to the present regime. Meanwhile, a draft Compliance Cost Assessment for these proposals can be obtained from:

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

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.

26

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 outside 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 unpaid director, and may receive fees for professional and similar services to the company other 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

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

[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.

27

DETAILS OF THE PROPOSALS

1. Pre-consolidation changes

(a) Exclusion of double allowances

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) Contributions to expenditure

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.

28

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 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).

29

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).

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.

30

/4. These changes

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) Business Assets

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 either

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

or

/ - if the donor

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

or

- 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) Heritage Property and Maintenance Funds

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) Political Parties

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) An Immediate IHT Charge

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.

31

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;

32

(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
DRAFT PRESS RELEASE

[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.

33

DRAFT

STOCK LENDING: EXTENSION TO LLOYD'S UNDERWRITERS

The Chancellor proposes in his Budget to change the law so that Lloyd's underwriters can be approved to lend stock to market makers without tax penalty.

The change will give Lloyds members the opportunity to earn fees by stock lending. It will also improve the liquidity of the market in some stocks (particularly the gilts market) by providing a new source of stock available for borrowing by market makers.

DETAILS

Stock lending

1. Market makers in securities may need to sell securities which they do not possess in order to meet demand fro the securities. They may then borrow the securities from an institutional holder in order to deliver them to the purchasers, returning equivalent securities to the institution later.

2. If there were no special rules, the transfer of the securities from the institutional holder to the market maker and the later return of them would be disposals for tax purposes and give rise to a capital gains tax charge (or a corporation tax charge on profits in the case of a financial trader.) However, the Board of Inland Revenue [or, in the case of gilts, the Bank of England] may approve arrangements for lending stock under which the transfers are ignored for capital gains tax and corporation tax on profits.

34

Application to Lloyd's

3. It has not, hitherto, been possible to approve arrangements in which Lloyd's underwriters lend stock to

market makers. This is because of the way the present tax rules apply to their capital gains tax and accrued income scheme liabilities. Under these rules, to match the administrative arrangements of Lloyd's, all securities held by a syndicate in a premium trust fund are treated for the purposes of capital gains tax and the accrued income scheme as disposed of at the end of each accounting period (the calendar year). But stock which had been lent to a market maker would no longer itself be held in the premiums trust fund and would therefore be outside this deemed disposal for capital gains tax and accrued income scheme. If arrangements for stock lending were approved the rules for calculating gains on stock lent out over the end of the year would not work properly.

4. The Chancellor therefore proposes to include stock lent under approved lending arrangements within the deemed disposal rules for Lloyd's underwriters. There will be no charge on the stock when it is lent or returned but there will be a charge on it at the end of the year. Any fee received by the underwriter will be taxable. This will enable stock lending arrangements involving Lloyds to be approved which will in turn make it possible for Lloyd's underwriters to take part in stock lending business. [Timing]

5. At the same time the Chancellor proposes to correct a couple of minor errors in the legislation empowering the Inland Revenue to make regulations affecting the administrative arrangements for taxing Lloyd's.

NOTES FOR EDITORS

The mechanism under which the Board of Inland Revenue can approve arrangements for stock lending are of long standing. They will shortly be the subject of regulations to be made under powers contained in Section 61 of the Finance Act 1986.

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.

35

/Annual exempt

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.

BUDGET CONFIDENTIAL

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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 otherwise. 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 inheritance 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:

- disclaimer of benefits under wills, intestacies or Scottish legal rights; or

- Court Orders making adequate provision for the deceased's dependants; or

- written variations by the beneficiaries themselves 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 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

38

- 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

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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.

Compliance cost assessments

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