TREASURY

FILE NUMBER PO - CH/NL/0794 Part A

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FILE TITLE

PO - CH/NL/0794 Part A

Budget 1986

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1986

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T.R.1.

2-14

CONFIDENTIAL

papers please

FROM: D N WALTERS
DATE: 8 JANUARY 1986

MES 8/1

1. **MR SCHOLAR**

2. **CHANCELLOR OF THE EXCHEQUER**

Content

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Wilson
Mr Butler
Mr Cassell
Mr Sinclair
Mr Dyer
Mr Cropper
Mr Culpin

DATE OF THE BUDGET

Mr Allan's minute of 16 September (attached) advised that you were content to plan for March 17 as Budget day with fall back options of March 10 and March 24.

2. Apart from 1985 (when Budget day was announced early in order to ensure that the timing of the sale of British Aerospace shares could take full account of the Budget timetable) it has been the normal course since 1980 to announce the date of the Budget in the first business statement after the Christmas recess. If you wish to follow this precedent this year, the date of the Budget will be announced on Thursday 15 January.

3. It is helpful for Budget planning purposes to have the date of the Budget firmly on the record, and, given the practice of recent years, it is likely that, if we were to delay the announcement this year, the Leader of the House would come under increasing pressure in successive weeks to reveal the Budget date. It would seem sensible, therefore, to follow recent practice and make an announcement on 15 January.

4. If you agree, and are content that March 17 remains the best option, we will need to ensure that that date is still suitable for No 10, the Chief Whip and the Leader of the House. I attach a draft letter which your Private Secretary might send.

+ St Patrick's Day.

5. I should record that March 17 is a Bank holiday in Northern Ireland. We have consulted Customs, the Inland Revenue and the Bank of England about whether this raises any practical problems. No insurmountable difficulties are foreseen.

D N Walters

D N WALTERS

2-14

CONFIDENTIAL

DRAFT LETTER FROM PRINCIPAL PRIVATE SECRETARY

Please type.

D Norgrove Esq
No 10 Downing Street
LONDON SW1

1987 BUDGET DAY

As you know, we have been planning on the assumption that Budget day this year will be on March 17.

It has become customary to announce the date of the Budget in the first business statement after the Christmas recess - ie this year on Thursday 15 January.

I should be grateful to know if the Prime Minister - and the Lord Privy Seal and Chief Whip, to whose private secretaries I am copying this letter - is content for it to be announced in the business statement on that day that Budget day will be March 17. If so I would be grateful if Stephen Wood would put the necessary arrangements in hand.

~~[ACSA]~~
A C S ALLAN
Principal Private Secretary

LD/121

CONFIDENTIAL

FROM: A C S ALLAN
DATE: 16 SEPTEMBER 1986

MR PRATT

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Sir G Littler
Mr F E R Butler
Mr Cassell
Mr Evans
Mrs Lomax
Mr Moore
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Turnbull
Miss Sinclair
Mr Culpin
Mr Mowl
Miss O'Mara
Mr Dyer
Mr Cropper
Mr Ross Goobey
Mr Tyrie

PS/IR
PS/C&E
Mr Beighton - IR
Mr Wilmott (C&E)
Mr Graham
(Parliamentary Counsel)

DATE FOR THE 1987 BUDGET

The Chancellor has seen your minute of 10 September and agrees that a post-Easter Budget can be ruled out; and that 17 March is the most attractive option, with 10 March and 24 March as alternatives.

ACSA

A C S ALLAN

2-25

CONFIDENTIAL

PMP

FROM: D N WALTERS
DATE: 14 JANUARY 1986

MHS 14/1

1. **MR SCHOLAR**

2. **MR ALLAN**

cc Mr Culpin
Miss O'Mara
Miss Sinclair

1987 BUDGET: DATE OF ANNOUNCEMENT

I attach a letter for your signature to Stephen Wood advising him that it is not the Chancellor's intention to ask the Lord Privy Seal to announce the date of the Budget in the customary first business statement following the return of the House after Christmas. It also suggests a line to take should Mr Biffen be asked.

D N Walters

D N WALTERS

Ch
OK?
AA

OK

CONFIDENTIAL

FROM: A M W BATTISHILL

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

24 July 1986

CHANCELLOR OF THE EXCHEQUER

NEXT YEAR'S BUDGET

I told you we were preparing a summary note of some of the more important issues affecting next year's Budget and Finance Bill. This is now attached. Ministers may find it useful background to next Tuesday's meeting.

2. This is not a substitute for the Starters List in the Autumn. It only deals with the more significant or complex issues. Notes on the usual run of technical matters will go to the Chief Secretary later in the year. Most of the present items will already be familiar to you.

3. Particularly in the light of this year's experience it is imperative to try to get ahead quickly in one or two of the more complex areas. Decisions, if they can be made, to discard some items could also be useful. For the rest, some kind of steer on priorities would be very helpful.

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cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
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Mr Scholar
Mr Monger
Mr Cropper
Mr Tyrie
Mr Ross-Goobey
Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton

4. On a number of the issues there are separate submissions. For example, on Keith, on a reduced rate band and (coming shortly) on pensions. Particular issues aside, identifying the main areas for attention next year will help to ensure that we have the right people in place early on.

5. More detailed notes on these, and any other matters, can follow after the holidays.

A M W BATTISHILL

A. PERSONAL TAXATION

1. REDUCED RATE BAND

Main purpose - to lower the starting rate of income tax and the marginal rate for people on lower incomes. (Mace, 23 January 1986).

Guidance needed and timing considerations

Decision needed by end of July because start on planning work required soon - for employers and Revenue - if option to be kept open for 1987/88. (Mace, 21 July 1986).

Revenue and resource implications

Exchequer cost very large for worthwhile RRB (eg even a £1500 band at 15% costs as much as 4% off BR); staff cost up to 900; in addition existing 1988 and 1989 manpower targets would suffer because of diversion of DP resources from COP/CODA.

Length and type of legislation

Legislation would be about 3-4 pages.

2. MAIN INCOME TAX RATES AND ALLOWANCES

Guidance needed and timing considerations

Apart from RRB, no decisions required now.

But it would help us to produce a more closely focused "sighting shots" note if, now (or anytime before work on the note begins in earnest in mid autumn) some broad steer could be given on the approach the Chancellor thinks he is most likely to want to follow.

Main points on which steer helpful are - on assumption of tax cuts -

a Rates v allowances

b Extent of "clawback" from highest incomes

c If there are real allowance increases, whether elderly should be restricted to same cash gains as taxpayers of working age (as in 1985).

3. TRANSFERABLE ALLOWANCES (marker only - not 1987 Starter)

Consultation finishes 30 September 1986, and public stance thereafter will need to be decided.

Legislation in this Parliament has been ruled out, but implications for TAs will be taken into account in submissions on personal taxation.

B. SCHEDULE E: RECEIPTS BASIS

In practice most pay (Schedule E income) is taxed on the "receipts" basis, but some 3% of taxpayers (mainly directors and people earning bonuses and commission) are on much more complicated "earnings" or "accounts" basis. Proposal is to switch the statutory basis from "earnings" to "receipts" so that everyone is taxed on pay received in the income tax year. (Prescott, 10 January 1986, discussed as possible 1987 starter; previous FST commented "a very interesting proposition" which could only be contemplated with no prior publicity or consultation.) Linkage with PRP (See Section C) as PRP needs to be put on statutory receipts basis.

Timing considerations

For legislative and operational reasons decision desirable early in Autumn - change would take effect from 6 April 1987.

Revenue and resource implications

Revenue neutral over transitional period; thereafter yield of about £100m per annum. Staff cost of about 50 for three years; eventual staff saving of 220 to 380.

Length and type of legislation

Provisional estimate, 5 to 10 pages. (If consultation and therefore anti-avoidance provisions needed, longer.)

C. PROFIT RELATED PAY

Green Paper consultation period ends 17 October 1986.

Guidance needed and timing considerations

We are already starting to work up the legislative and administrative implications, and will continue in the Autumn, consulting official Treasury and DE as necessary. To keep open option of legislation in 1987, followed by early implementation, this work will need to continue so long as Ministers have not definitely decided not to proceed.

Revenue and resource implications

Revenue cost very uncertain; depends on number of employees participating and amount of pay which becomes profit related. Only small proportion of cost likely to arise in 1987/88. Additional staff requirement similarly very uncertain; might be of the order of 100.

Length and type of legislation

Legislation likely to be quite lengthy; part might go into Regulations at cost of likely delay to implementation date.

D. MINIMUM TAX

Some individuals with very high - six figure - gross incomes pay little or no income tax. They do this by using all the existing reliefs and incentive provisions. The use of these reliefs is all quite proper. But the question remains whether taxpayers with very high incomes ought not to pay some reasonable level of tax as a minimum as in the US and Canada. Ministers decided not to act in 1986 (Mr Isaac's minutes of 10 and 30 January 1986 refer).

Guidance needed and timing considerations

Depending on the type of scheme chosen the technical details could be complex. The scheme would have to extend to trusts and probably money-box companies. An early start on preparatory work would be highly desirable.

Revenue and resource implications

We have mounted a small survey of really high earners (Mr Johns' minute of 4 July) to help assess the scale. Until this is completed and the scheme is settled estimates are necessarily tentative but the yield is unlikely to be more than about £m100. There would be some manpower cost but probably not great.

Length and type of legislation

It is impossible to estimate the length of legislation at this stage, but primary legislation would definitely be required, and it could be complex.

E. INTEREST

1. MORTGAGE INTEREST RELIEF

Possibility of raising upper limit for relief.

Guidance needed and timing considerations

Timing not a problem, but there are revenue implications in other areas (see below)

Revenue and resource implications

The cost of mortgage interest relief is one item affecting the estimate of income tax yield. If the M.I.R. ceiling remains unchanged, at the current level of basic rate the 1987/88 cost of M.I.R. could be £b0.50 more than the present (unpublished) forecast of 1986/87 cost (£b4.25). But changes in the governing factors could well alter this estimate (the current forecast for 1986/87, for example, is £b1.25 lower than the pre-Budget forecast, mostly because interest rates are lower than were then expected).

If basic rate were to be reduced for 1987/88, the picture would be different, but that difference would be reflected in the costing of reducing the basic rate.

If Ministers wished to increase the M.I.R. ceiling by £5000, the cost - subject to the same uncertainties as above - would be £m130.

Length and type of legislation

Altering M.I.R. ceiling would require less than half a page.

2. COMPOSITE RATE TAX

The Economic Secretary in considering setting the CRT rate on a current rather than (as now) a preceding year basis.

Guidance needed and timing considerations

Note of 16 July from Mr O'Connor. EST's response awaited. Possibility of announcement in December 1986.

Revenue and resource implications

Significant cost if basic rate reduced, eg £m250 if to 27 per cent.

Length and type of legislation

Probably half a page or less.

F. <u>PENSIONS</u>

i. Tax regime for 'personal pensions'.

ii. Ministers also likely to want to consider -

a. scope for common regime for occupational pensions and retirement annuities

b. scope for rationalisation of existing rules

c. whether to take action on loanbacks and pension mortgages.

<u>Guidance needed and timing considerations</u>

Need for early decision on whether common regime (ii.(a) above) to be regarded as realistic starter. Would require considerable detailed work and major legislative reform. Papers on this aspect within next few days.

<u>Revenue and resource implications</u>

Some, but not yet quantifiable.

<u>Length and type of legislation</u>

Likely to be quite lengthy (but could be mainly in Regulations).

G. KEITH

Proposals for consultative document this Autumn and partial legislation in 1987 (pay and file, PAYE directors, subcontractors, perhaps penalties for incorrect returns). (Corlett to EST 3 July.)

Parallel PRT provisions on similar timetable - submission once Ministers have reacted to 3 July note.

Guidance needed and timing considerations

Window rapidly closing for publication of consultative document in sufficient time (October) to permit reasonably wide consultation this year. Urgent decision needed by middle of next week on whether -

i. to issue consultative document in Autumn

ii. shape of document broadly right

iii. to plan for mini-package of legislation for 1987

iv. mini-package proposal on right lines.

Revenue and resource implications

PAYE component in 1987 mini-package should accelerate revenues into 1988/89 from later years.

No significant staff implications.

Length and type of legislation

Proposed first year mini-package about 20 pages in Bill plus 4 pages Regulations.

H. CHARTIES

i. Consultations to be held with charity movement on what, if any, further action needed against tax abuses (Chancellor's statement 4 June; CST, Standing Committee, 17 June). In particular (a) accumulation, (b) order of set-off of charitable/non-charitable expenditure against taxable income (Corlett 27 June paragraph 12).

ii. Review role of Charity Commission (Chancellor to Hurd, 17 July).

Guidance needed and timing considerations

No decisions on above needed at this stage. Consultations to start in Autumn. But helpful to have confirmation that no further major initiatives in mind.

Revenue and resource implications

Not known at this stage, but probably small.

Length and type of legislation

Depends on decisions, but unlikely to be more than 1-2 pages.

I. STAMP DUTY/STAMP DUTY RESERVE TAX

i. Some tidying up of 1986 package inevitable.

ii. Possible consequentials of Big Bang and introduction of Financial Services Act regulatory regime (insofar as not anticipated in 1986 Bill).

iii. Major outstanding point from 1983 consultative document is modernisation and simplification of company restructuring reliefs (though scale of this package much reduced by 1986 reforms).

Need for guidance and timing considerations

Drafting will be technically difficult - especially now that there are 2 taxes to amend. Helpful to know early as possible whether Ministers likely to want further major structural reforms, such as company restructuring (iii. above). Papers on i. and ii. will be submitted if and when action seems necessary - but unlikely to be until late Autumn at earliest.

Revenue and resource implications

Negligible.

Length and type of legislation

i. and ii. Tidying up and consequentials.

Say 3 pages.

iii. Further action on company restructuring.

Say 3-4 pages.

J. CAPITAL GAINS TAX

1. INDEXATION OF CAPITAL CERTAIN FINANCIAL ASSETS

Indexation can create offsetable losses on financial instruments where there are no nominal losses (building society share accounts can be exploited in this way). Treasury Ministers agreed that the whole area of capital certain assets should be reviewed. Possibility of wide ramifications.

Why guidance needed and timing considerations

Internal consultations (IR, Treasury and Bank) in progress. External consultations inappropriate. But study raises wide structural issues (could indexation be discontinued? If so, would this create an opportunity for integrating CGT with IT and CT? Rate and incidence implications). This could involve major structural change and the disappearance of CGT as such. Early guidance on these broader possibilities would be helpful.

Revenue and resource implications

Action on capital certain items alone would pre-empt revenue losses and would not have any significant resource implications. For wider structural changes the effects can only be speculative at this stage.

Length and type of legislation

For capital certain items, depends on solution adopted (may be no more than one or two pages). For major structural change, many pages of Finance Bill could be required.

2. GROUPS AND CAPITAL LOSSES

To permit group relief for capital losses and to regulate the utilisation of capital losses which have not arisen within the group. The latest round of consultations with representative bodies began in 1983 but was suspended because of developments in litigation (Ramsay) and the review of capital gains tax. Further consultations highly desirable before legislation.

Why guidance needed and timing considerations

Need to consult on complex provisions if on the agenda.

Revenue and resource implications

Not likely to be significant.

Length and type of legislation

Some 20 pages in the Finance Bill (mostly Schedule).

3. ENTERPRISE MEASURES

a. Disincorporation

To alleviate tax penalties on business disincorporation. One of the initiatives in a recent White Paper on "Building Businesses ... Not Barriers". Prior to White Paper, Treasury Ministers took the view that the pressure for change was lessening with reduction in CT rate.

Why guidance needed and timing considerations

Consultative process under way. Many areas of tax code involved (direct and indirect). Non-tax changes may also be required. Presumption created of 1987 legislation (though Treasury Ministers resisted any commitment).

Revenue and resource implications

Unlikely to be substantial either way.

Length and type of legislation

Depends on coverage; could be 10 to 15 if fully covered.

b. Venture capital

Reliefs designed to encourage venture capital operations in the UK. Ministers sympathetic but the difficulty has been the uncertainty of the British Venture Capital Association on the tax changes they would like to see made. FST to meet BVCA on 22 July.

Why guidance needed and timing considerations

Consultation at official level with BVCA desirable. Likely to be protracted; needs to be started soon. Legislation my not be simple.

Revenue and resource implications

Revenue implications uncertain. Resource implications unlikely to be significant.

Length and type of legislation

Could be a substantial Finance Bill item (10 - 12 pages) but depends on scheme.

K. BUSINESS TAXATION

1. CT RATES

a. Main CT Rate

(35%) for FY 1986 set in 1984. Could be reduced/increased in Budget 1987 but presume Ministers not wish increase.

Rate for FY 1987 need not be announced until Budget 1988, affecting revenue for 1988/89. But rate for FY 1987 could be announced in Budget 1987. Industry welcomed 1984 advance notice of rates for later years.

A 1% reduction in the CT rate for FY 1987 would cost nil in 1987/88, £m260 in 1988/89 and £m420 in 1989/90 (full year cost).

b. Small Companies Rate and Income Limits

Same considerations. But in view of link with basic rate, Chancellor may wish to consider advance announcement for FY 1987 if basic rate reduced.

Income limits for small companies rate: £100,000 and £500,000. Set in 1983 for FY 1982 et seq. Ministers might wish to review.

Submission seeking decisions later in year.

2. RELIEF FOR PRE-TRADING R & D EXPENDITURE

At present relief given if company trading; or for expenditure incurred within 3 years of trade commencing, but only against the future profits of that trade. Last year, DTI pressed for wider relief - including sideways against other income - whether trading begins or not. Will be recommended in (September) report of official Advisory Committee on Applied Research and Development.

Might encourage more R & D including risk sharing via "R & D consortia". Could attract venture capital funds. But a major breach in principle that tax relief only for expenditure connected with a trade. Knock-on effect on other types expenditure. Vulnerable to abuse. Potential tax shelter for banks. EC implications if confined to R & D in UK.

Guidance needed and timing considerations

Further submission planned end October/early November.

Revenue and resource implications

Guesstimates (if abuse contained): £m10 pa plus further £m10 - £m15 pa for oil companies.

Length and type of legislation

Complex 3+ pages at least. May be scope for Regulations.

3. LIFE ASSURANCE COMPANIES

Ministers authorised long-term review (FST, 12 February 1985) of structure of life company taxation. Pro - system antiquated and reform could yield substantial revenue. Against - reform would be controversial (policy holder impact) and complex.

Guidance needed and timing considerations

Submission to Ministers in September if 1987 legislation a possible starter. Fundamental restructing probably has to be ruled out for 1987 Bill. Limited reforms possible for 1987 but could still be controversial and complex.

Revenue and resource implications

Yield very large (£m hundreds, even from limited reform). But no yield till 1988/89 at earliest (with 1987 legislation). Staffing impact - small.

Length and type of legislation

Probably 3 pages at minimum with Regulations in addition.

Other Insurance Companies

Non-legislative changes. Stricter application of existing law on treatment of reserves should yield £100m plus from 1987/88 onwards - see Spence submission of 22 July.

4. LLOYDS

Review of structure of Lloyds taxation - basis of assessment and Special Reserve Fund. Changes necessary to cope with effect of new system of detailed scrutiny of syndicate accounts, following Lloyds scandals and settlement (Revenue submission 31 January 1986: EST approved review 12 February 1986).

Guidance needed and timing considerations

Discussions with Lloyds continuing. Progress report submission early September. Options for 1987 Bill will be minimal changes or major restructuring (controversial if includes abolition of Special Reserve Fund; though some may favour tough line). Decision necessary by November if radical restructuring in 1987 Bill.

Revenue and resource implications

Yield from legislative changes - probably small (and may be loss). Staff saving - up to 20. Main need for change is to stop existing system from collapsing. But tightening up on applying existing law (settlement etc) should give additional yield (at present unquantifiable but potentially substantial) from 1986/87 onwards.

Length and type of legislation

At least 5 pages (less for minimal package) plus Regulations.

L. OIL

1. VALUATION

Companies do not agree OTO's interpretation of PRT valuation rules. Literal interpretation of existing rules by Courts could give nonsensical result (and tax confidentiality and obstacle to appeal proceedings). OTO therefore in weak negotiating position. Need statutory rule less open to challenge by companies. Depending on solution chosen, could be contentious.

Guidance needed and timing considerations

No further guidance needed now. Report to Ministers 29 May 1986 recommended legislation. FST agreed further work should be undertaken aimed at possible announcement in say October if legislation to take effect from 1 January 1987.

Revenue and resource implications

Yield: £m tens per annum.

Length and type of legislation

Likely to be fairly short. No scope for Regulations for main measure (may be scope for later change in detail).

2. ARM'S LENGTH PRICES

Companies returning low priced sales for PRT purposes. Evidence that they may be deliberately exploiting Brent forward market as means of ensuring only taxed on lowest AL prices from series of deals in same crude. Possibility of legislation to rule as unacceptable some prices returned as AL and replace them with (say) valuations. Legislation may be contentious. Possible international implications.

Guidance needed and timing considerations

As for 1.

Revenue and resource implications

Yield: £ms tens per annum.

Length and type of legislation

Not yet quantified perhaps 2 pages.

3. POSSIBLE MEASURE TO MEET COMPANY REPRESENTATIONS ON NEED FOR RELAXATION OF FISCAL REGIME

Representations received from Industry calling for relaxation in regime to counter effect of falling oil prices. Note to FST, 12 June 1986. Ministers said not convinced of need but invited industry to make a case. Industry pressing hard for some relaxation in regime. Department of Energy may well support call for early repayment of APRT.

Guidance needed and timing considerations

No further guidance needed now. Department of Energy to submit analysis of industry case to NSFR working party by early September. Then report to Ministers on working party's conclusions/recommendations. If Ministers decide change necessary, possible announcement in say October.

Revenue and resource implications

Cost would depend on case for help.

Length and type of legislation

Would depend on measure, but front-runner (early repayment of APRT) not likely to be long.

4. ONSHORE REGIME

Official North Sea working party currently reviewing fiscal regime (devised with mainly offshore in mind) to assess if appropriate in current economic conditions for onshore.

Guidance needed and timing considerations

No further guidance needed now. Aim to report to Ministers by end-September if possible (ie before publication of BGC sale prospectus), but may well be premature to take decisions then unless review clearly points to no change.

Revenue and resource implications

Not known. Cost/yield unlikely to be more than £m10s.

Length and type of legislation

Not known.

5. SECTION 16 OTA 1975

Guidance required

A very specific problem, but Ministerial steer on it could be helpful as background to more general review of whether tax relief needed to help companies, especially smaller ones, over difficulties caused by oil price drop.

Revenue and resource implications

Potential cost of £50-100m in first year. No internal resource implications.

Length and type of legislation

Probably a couple of pages (if a related consortia problem also addressed). Not suitable for Regulations.

CONFIDENTIAL

FROM: A M W BATTISHILL

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

Already rec'd top copy

28 July 1986

CHANCELLOR OF THE EXCHEQUER

NEXT YEAR'S BUDGET

I told you we were preparing a summary note of some of the more important issues affecting next year's Budget and Finance Bill. This is now attached. Ministers may find it useful background to tomorrow's meeting. You have asked that it should be revised as appropriate in the light of that meeting, as a basis for further consideration over the Summer months, and with a view to a further meeting in the Autumn.

2. This is not a substitute for the Starters List in the Autumn. It only deals with the more significant or complex issues. Notes on the usual run of technical matters will go to the Chief Secretary later in the year. Most of the present items will already be familiar to you.

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Possibility of raising upper limit for relief.

Guidance needed and timing considerations

Timing not a problem, but there are revenue implications in other areas (see below)

Revenue and resource implications

The cost of mortgage interest relief is one item affecting the estimate of income tax yield. If the M.I.R. ceiling remains unchanged, at the current level of basic rate the 1987/88 cost of M.I.R. could be £b0.50 more than the present (unpublished) forecast of 1986/87 cost (£b4.25). But changes in the governing factors could well alter this estimate (the current forecast for 1986/87, for example, is £b1.25 lower than the pre-Budget forecast, mostly because interest rates are lower than were then expected).

If basic rate were to be reduced for 1987/88, the picture would be different, but that difference would be reflected in the costing of reducing the basic rate.

If Ministers wished to increase the M.I.R. ceiling by £5000, the cost - subject to the same uncertainties as above - would be £m130.

Length and type of legislation

Altering M.I.R. ceiling would require less than half a page.

2. COMPOSITE RATE TAX

The Economic Secretary in considering setting the CRT rate on a current rather than (as now) a preceding year basis.

Guidance needed and timing considerations

Note of 16 July from Mr O'Connor. EST's response awaited. Possibility of announcement in December 1986.

Revenue and resource implications

Significant cost if basic rate reduced, eg £m250 if to 27 per cent.

Length and type of legislation

Probably half a page or less.

F. PENSIONS

i. Tax regime for 'personal pensions'.

ii. Ministers also likely to want to consider -

a. scope for common regime for occupational pensions and retirement annuities

b. scope for rationalisation of existing rules

c. whether to take action on loanbacks and pension mortgages.

Guidance needed and timing considerations

Need for early decision on whether common regime (ii.(a) above) to be regarded as realistic starter. Would require considerable detailed work and major legislative reform. Papers on this aspect within next few days.

Revenue and resource implications

Some, but not yet quantifiable.

Length and type of legislation

Likely to be quite lengthy (but could be mainly in Regulations).

G. KEITH

Proposals for consultative document this Autumn and partial legislation in 1987 (pay and file, PAYE directors, subcontractors, perhaps penalties for incorrect returns). (Corlett to EST 3 July.)

Parallel PRT provisions on similar timetable - submission once Ministers have reacted to 3 July note.

Guidance needed and timing considerations

Window rapidly closing for publication of consultative document in sufficient time (October) to permit reasonably wide consultation this year. Urgent decision needed by middle of next week on whether -

i. to issue consultative document in Autumn

ii. shape of document broadly right

iii. to plan for mini-package of legislation for 1987

iv. mini-package proposal on right lines.

Revenue and resource implications

PAYE component in 1987 mini-package should accelerate revenues into 1988/89 from later years.

No significant staff implications.

Length and type of legislation

Proposed first year mini-package about 20 pages in Bill plus 4 pages Regulations.

H. CHARTIES

i. Consultations to be held with charity movement on what, if any, further action needed against tax abuses (Chancellor's statement 4 June; CST, Standing Committee, 17 June). In particular (a) accumulation, (b) order of set-off of charitable/non-charitable expenditure against taxable income (Corlett 27 June paragraph 12).

ii. Review role of Charity Commission (Chancellor to Hurd, 17 July).

Guidance needed and timing considerations

No decisions on above needed at this stage. Consultations to start in Autumn. But helpful to have confirmation that no further major initiatives in mind.

Revenue and resource implications

Not known at this stage, but probably small.

Length and type of legislation

Depends on decisions, but unlikely to be more than 1-2 pages.

I. STAMP DUTY/STAMP DUTY RESERVE TAX

i. Some tidying up of 1986 package inevitable.

ii. Possible consequentials of Big Bang and introduction of Financial Services Act regulatory regime (insofar as not anticipated in 1986 Bill).

iii. Major outstanding point from 1983 consultative document is modernisation and simplification of company restructuring reliefs (though scale of this package much reduced by 1986 reforms).

Need for guidance and timing considerations

Drafting will be technically difficult - especially now that there are 2 taxes to amend. Helpful to know early as possible whether Ministers likely to want further major structural reforms, such as company restructuring (iii. above). Papers on i. and ii. will be submitted if and when action seems necessary - but unlikely to be until late Autumn at earliest.

Revenue and resource implications

Negligible.

Length and type of legislation

i. and ii. Tidying up and consequentials.

Say 3 pages.

iii. Further action on company restructuring.

Say 3-4 pages.

J. CAPITAL GAINS TAX

1. INDEXATION OF CAPITAL CERTAIN FINANCIAL ASSETS

Indexation can create offsetable losses on financial instruments where there are no nominal losses (building society share accounts can be exploited in this way). Treasury Ministers agreed that the whole area of capital certain assets should be reviewed. Possibility of wide ramifications.

Why guidance needed and timing considerations

Internal consultations (IR, Treasury and Bank) in progress. External consultations inappropriate. But study raises wide structural issues (could indexation be discontinued? If so, would this create an opportunity for integrating CGT with IT and CT? Rate and incidence implications). This could involve major structural change and the disappearance of CGT as such. Early guidance on these broader possibilities would be helpful.

Revenue and resource implications

Action on capital certain items alone would pre-empt revenue losses and would not have any significant resource implications. For wider structural changes the effects can only be speculative at this stage.

Length and type of legislation

For capital certain items, depends on solution adopted (may be no more than one or two pages). For major structural change, many pages of Finance Bill could be required.

2. GROUPS AND CAPITAL LOSSES

To permit group relief for capital losses and to regulate the utilisation of capital losses which have not arisen within the group. The latest round of consultations with representative bodies began in 1983 but was suspended because of developments in litigation (Ramsay) and the review of capital gains tax. Further consultations highly desirable before legislation.

Why guidance needed and timing considerations

Need to consult on complex provisions if on the agenda.

Revenue and resource implications

Not likely to be significant.

Length and type of legislation

Some 20 pages in the Finance Bill (mostly Schedule).

3. ENTERPRISE MEASURES

a. Disincorporation

To alleviate tax penalties on business disincorporation. One of the initiatives in a recent White Paper on "Building Businesses ... Not Barriers". Prior to White Paper, Treasury Ministers took the view that the pressure for change was lessening with reduction in CT rate.

Why guidance needed and timing considerations

Consultative process under way. Many areas of tax code involved (direct and indirect). Non-tax changes may also be required. Presumption created of 1987 legislation (though Treasury Ministers resisted any commitment).

Revenue and resource implications

Unlikely to be substantial either way.

Length and type of legislation

Depends on coverage; could be 10 to 15 if fully covered.

b. Venture capital

Reliefs designed to encourage venture capital operations in the UK. Ministers sympathetic but the difficulty has been the uncertainty of the British Venture Capital Association on the tax changes they would like to see made. FST to meet BVCA on 22 July.

Why guidance needed and timing considerations

Consultation at official level with BVCA desirable. Likely to be protracted; needs to be started soon. Legislation my not be simple.

Revenue and resource implications

Revenue implications uncertain. Resource implications unlikely to be significant.

Length and type of legislation

Could be a substantial Finance Bill item (10 - 12 pages) but depends on scheme.

K. BUSINESS TAXATION

1. CT RATES

a. Main CT Rate

(35%) for FY 1986 set in 1984. Could be reduced/increased in Budget 1987 but presume Ministers not wish increase.

Rate for FY 1987 need not be announced until Budget 1988, affecting revenue for 1988/89. But rate for FY 1987 could be announced in Budget 1987. Industry welcomed 1984 advance notice of rates for later years.

A 1% reduction in the CT rate for FY 1987 would cost nil in 1987/88, £m260 in 1988/89 and £m420 in 1989/90 (full year cost).

b. Small Companies Rate and Income Limits

Same considerations. But in view of link with basic rate, Chancellor may wish to consider advance announcement for FY 1987 if basic rate reduced.

Income limits for small companies rate: £100,000 and £500,000. Set in 1983 for FY 1982 et seq. Ministers might wish to review.

Submission seeking decisions later in year.

2. RELIEF FOR PRE-TRADING R & D EXPENDITURE

At present relief given if company trading; or for expenditure incurred within 3 years of trade commencing, but only against the future profits of that trade. Last year, DTI pressed for wider relief - including sideways against other income - whether trading begins or not. Will be recommended in (September) report of official Advisory Committee on Applied Research and Development.

Might encourage more R & D including risk sharing via "R & D consortia". Could attract venture capital funds. But a major breach in principle that tax relief only for expenditure connected with a trade. Knock-on effect on other types expenditure. Vulnerable to abuse. Potential tax shelter for banks. EC implications if confined to R & D in UK.

Guidance needed and timing considerations

Further submission planned end October/early November.

Revenue and resource implications

Guesstimates (if abuse contained): £m10 pa plus further £m10 - £m15 pa for oil companies.

Length and type of legislation

Complex 3+ pages at least. May be scope for Regulations.

3. LIFE ASSURANCE COMPANIES

Ministers authorised long-term review (FST, 12 February 1985) of structure of life company taxation. Pro - system antiquated and reform could yield substantial revenue. Against - reform would be controversial (policy holder impact) and complex.

Guidance needed and timing considerations

Submission to Ministers in September if 1987 legislation a possible starter. Fundamental restructing probably has to be ruled out for 1987 Bill. Limited reforms possible for 1987 but could still be controversial and complex.

Revenue and resource implications

Yield very large (£m hundreds, even from limited reform). But no yield till 1988/89 at earliest (with 1987 legislation). Staffing impact - small.

Length and type of legislation

Probably 3 pages at minimum with Regulations in addition.

Other Insurance Companies

Non-legislative changes. Stricter application of existing law on treatment of reserves should yield £100m plus from 1987/88 onwards - see Spence submission of 22 July.

4. LLOYDS

Review of structure of Lloyds taxation - basis of assessment and Special Reserve Fund. Changes necessary to cope with effect of new system of detailed scrutiny of syndicate accounts, following Lloyds scandals and settlement (Revenue submission 31 January 1986: EST approved review 12 February 1986).

Guidance needed and timing considerations

Discussions with Lloyds continuing. Progress report submission early September. Options for 1987 Bill will be minimal changes or major restructuring (controversial if includes abolition of Special Reserve Fund; though some may favour tough line). Decision necessary by November if radical restructuring in 1987 Bill.

Revenue and resource implications

Yield from legislative changes - probably small (and may be loss). Staff saving - up to 20. Main need for change is to stop existing system from collapsing. But tightening up on applying existing law (settlement etc) should give additional yield (at present unquantifiable but potentially substantial) from 1986/87 onwards.

Length and type of legislation

At least 5 pages (less for minimal package) plus Regulations.

L. OIL

1. VALUATION

Companies do not agree OTO's interpretation of PRT valuation rules. Literal interpretation of existing rules by Courts could give nonsensical result (and tax confidentiality and obstacle to appeal proceedings). OTO therefore in weak negotiating position. Need statutory rule less open to challenge by companies. Depending on solution chosen, could be contentious.

Guidance needed and timing considerations

No further guidance needed now. Report to Ministers 29 May 1986 recommended legislation. FST agreed further work should be undertaken aimed at possible announcement in say October if legislation to take effect from 1 January 1987.

Revenue and resource implications

Yield: £m tens per annum.

Length and type of legislation

Likely to be fairly short. No scope for Regulations for main measure (may be scope for later change in detail).

2. ARM'S LENGTH PRICES

Companies returning low priced sales for PRT purposes. Evidence that they may be deliberately exploiting Brent forward market as means of ensuring only taxed on lowest AL prices from series of deals in same crude. Possibility of legislation to rule as unacceptable some prices returned as AL and replace them with (say) valuations. Legislation may be contentious. Possible international implications.

Guidance needed and timing considerations

As for 1.

Revenue and resource implications

Yield: £ms tens per annum.

Length and type of legislation

Not yet quantified perhaps 2 pages.

3. POSSIBLE MEASURE TO MEET COMPANY REPRESENTATIONS ON NEED FOR RELAXATION OF FISCAL REGIME

Representations received from Industry calling for relaxation in regime to counter effect of falling oil prices. Note to FST, 12 June 1986. Ministers said not convinced of need but invited industry to make a case. Industry pressing hard for some relaxation in regime. Department of Energy may well support call for early repayment of APRT.

Guidance needed and timing considerations

No further guidance needed now. Department of Energy to submit analysis of industry case to NSFR working party by early September. Then report to Ministers on working party's conclusions/recommendations. If Ministers decide change necessary, possible announcement in say October.

Revenue and resource implications

Cost would depend on case for help.

Length and type of legislation

Would depend on measure, but front-runner (early repayment of APRT) not likely to be long.

4. ONSHORE REGIME

Official North Sea working party currently reviewing fiscal regime (devised with mainly offshore in mind) to assess if appropriate in current economic conditions for onshore.

Guidance needed and timing considerations

No further guidance needed now. Aim to report to Ministers by end-September if possible (ie before publication of BGC sale prospectus), but may well be premature to take decisions then unless review clearly points to no change.

Revenue and resource implications

Not known. Cost/yield unlikely to be more than £m10s.

Length and type of legislation

Not known.

5. SECTION 16 OTA 1975

Guidance required

A very specific problem, but Ministerial steer on it could be helpful as background to more general review of whether tax relief needed to help companies, especially smaller ones, over difficulties caused by oil price drop.

Revenue and resource implications

Potential cost of £50-100m in first year. No internal resource implications.

Length and type of legislation

Probably a couple of pages (if a related consortia problem also addressed). Not suitable for Regulations.

PCWP

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

From: B H Knox

18 August 1986

MINISTER OF STATE

cc Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Mr Monger
Mr Scholar
Miss Sinclair
Mr Cropper

PRE-BUDGET RESTRICTIONS

1. When we imposed restrictions on the clearances of cigarettes in the run-up to this year's Budget (Mr Jefferson Smith's notes of 21 and 28 February), we undertook to assess the extent of any problems caused by the forestalling of goods liable to excise duties and to make recommendations for action in later years. I attach a paper which examines the scale of forestalling in recent years, gives an account of revenue implications and effects on the excise industries, and discusses the desirability and feasibility of restriction schemes.

2. The paper is, I fear, necessarily long, so I summarise our conclusions as follows.

Internal circulation:

CPS, Mr Jefferson Smith, Mr T Jenkins, Mr Whitmore, Mr McGuigan, Mr Wilmott.

(a) There is scope for forestalling most excise commodities, but in practice it has only been observable to any significant extent in the last five years in cigarettes and spirits. There has been smaller scale forestalling of wine and derv.

(b) Revenue grounds alone are insufficient to necessitate action against forestalling, though in the absence of action, revenue losses can be recouped only by adjusting Budget increases upwards to compensate.

(c) The potential degree of disruption to the UK cigarette industry and the opportunities for importers to exploit the pre-Budget situation makes it desirable that there should be no higher level of forestalling than in recent years. Without restrictions, an increase is likely.

(d) It would be possible to impose similar restrictions to this year, albeit with some possibility of legal challenge to our powers, which we are advised we could resist, and the likelihood of complaints of discrimination (particularly by importers, wholesalers and retailers). We should give long notice of any intention to impose restrictions.

(e) Even if it were desirable to restrict quantities of alcoholic drinks cleared (which we doubt) it would not be practicable because of the way in which we now control the warehouse trade. But we can make it more difficult to forestall by (i) bringing forward the time of duty changes on Budget day and (ii) curtailing the temporary debonding of warehouse space.

(f) On present form it is unnecessary, and it would nearly always be undesirable, to restrict clearances of road fuels. In the run-up to next year's Budget we shall however be closely monitoring (i) temporary changes in the size of import guarantees and (ii) actual deliveries of road fuels.

3. We therefore seek your agreement:

(a) to the imposition of restrictions for cigarettes and hand-rolling tobacco, on the lines set out in paragraph ~~19~~ 22 of the paper;

(b) to a public announcement to that effect;

(c) to refusing temporary debonding facilities directed at forestalling on drinks duties;

(d) to making any duty changes for alcoholic drinks effective from 6 pm on Budget day; and

(e) to refusing temporary pre-Budget increases in guarantees for oils unless there are clear trade needs;

(f) to informing the drinks and oil industries of these measures.

Bryce Knox

B H KNOX

PRE-BUDGET RESTRICTIONS

Note by HM Customs & Excise: August 1986

Introduction

1. Following the imposition of restrictions on the clearances of cigarettes in the run-up to this year's Budget, we undertook to assess the extent of the problems caused by the forestalling of goods liable to excise duties, and, in the light of this, to recommend what action, if any, should be taken in 1987 and subsequent years. In the course of our assessment we have taken soundings of some of the industries concerned. This paper looks at the revenue cost of forestalling and the extent to which it has occurred in recent years, discusses the effects of forestalling on the excise industries, and examines the feasibility and desirability of restriction schemes.

Revenue effects of forestalling

2. Although most excise goods are susceptible of forestalling, we have been able to detect its incidence to any marked degree only for cigarettes, spirits, wine and derv. The tables at Annexes 1 to 4 give details of the levels of forestalling and an estimated cost to the revenue from 1982 to 1986. The latter is derived from multiplying the estimated quantity forestalled by the subsequent increase in duty. Although this is the only straightforward way of attributing a revenue cost to forestalling, it is very artificial. This is not only because an allowance for forestalling is made in the Budget forecast (and therefore, implicitly, in the Chancellor's Budget judgement), but also because the cost is a function of the duty increases decided on for a given year. Thus for cigarettes the cost appears generally higher than for spirits, very largely as a consequence of successive Budget decisions on these two commodities: it is to correct for this effect that Annexes 1 to 3 include a cost for 1986 based on revalorisation.

3. Whether or not these costs can be regarded as real, they have to be seen in their overall revenue and Budget contexts. In no case in the years in question has the cost of forestalling exceeded one per cent of the total revenue raised from each commodity. We are rarely able to forecast individual revenues to within such fine tolerances, so the uncertainty in Budget decision-making attributable to forestalling is in all cases less than that caused by the inherent difficulty of predicting the various economic variables. Indeed our high-yielding duties are mostly rounded, for Budget purposes, to the nearest £50 million: generally more than the maximum apparent cost for a particular commodity. Apart from the disadvantage of having to go for an increase higher than would be required in the absence of forestalling, there is no significant difficulty about adjusting duty increases upwards so as to counteract any expected loss of revenue. We conclude therefore that revenue grounds alone are insufficient to necessitate restrictive action on forestalling.

Forestalling in 1986

4. The information so far available suggests that in 1986:

(a) Some 9000 million cigarettes were forestalled at a cost to the Exchequer of approximately £40 million. This represents about 0.9 per cent of the revenue from cigarettes or a little over 1p on the rate of tax. The imposition of quantitative restrictions on clearances appears to have kept forestalling at the 1985 level.

(b) There was (attempted) forestalling of spirits to the extent of about 100,000 hectolitres of alcohol. There was no cost to the Exchequer since the duty on spirits was not increased in the Budget.

(c) There was (attempted) forestalling of wine of fresh grape to the extent of about 75,000 hectolitres. Again there was no cost to the Exchequer, since the duty on wine was not increased.

(d) There was no forestalling of beer (where the opportunity of forestalling is limited by its short shelf-life and the duty-point early in the production process).

(e) There was minimal forestalling of oils (although, because of breakdowns and routine maintenance in UK refineries, the picture is obscure): perhaps 60 million litres of derv, at a cost of about £0.7 million.

Forestalling in 1982-85

5. As the table at Annexe 1 shows there has been forestalling of cigarettes in each year since 1982. The number of cigarettes forestalled has varied from 5 billion to 9 billion while the revenue cost has ranged from £6 million in 1983 to £40 million in 1986. The high revenue cost in 1986 was due mainly to the large increase in duty imposed in the Budget; a similar level of forestalling in 1985 cost £22 million. The trend in cigarette forestalling is probably upwards.

6. The quantity of spirits forestalled each year since 1982 has been fairly constant, around 100,000 hectolitres of alcohol. The revenue cost has, of course, varied with the duty increases, from nil in 1986 to £9 million in 1982. The table at Annexe 2 shows that 1986 followed a similar pattern to earlier years.

7. Forestalling of wine of fresh grape has fluctuated over the years, with a maximum of 100,000 hectolitres in 1985. The cost to the revenue has not exceeded £1 million.

8. There is no evidence to suggest that there was forestalling of petrol or beer in earlier years. However there may well have been some forestalling of derv. But the quantities, up to 50 million litres, and the revenue involved, £0.2 million to £0.5 million, have been insignificant.

Effect of forestalling on the excise indutries

9. The main UK tobacco manufacturers have little net advantage from forestalling and would prefer to maintain a steady level of clearance, avoiding the cost of building up stocks in advance and finding storage for them. Nonetheless, in recent years they have felt increasingly obliged to cater for large pre-budget clearances

in order to combat loss of market share to competitors. One influence is the increasing clout of large purchasers such as the supermarket chains; another is competition from importers, who have made rapid inroads into the UK market over the past two years.

10. The success of the importers is largely due to the willingness of foreign manufacturers with spare production capacity to supply cigarettes at little or no profit. Forestalling helps importers to undercut the major UK manufacturers: one importer is reported to have supplied a grocery chain with 10 months' stock at pre-budget prices despite the application of restrictions. Because both UK manufacturers and importers are primarily concerned with increasing their market share their forestalling is aimed at maintaining pre-budget prices for as long as possible. The same is probably true of most retailers; but wholesalers, and some retailers, who work on small margins for much of the year, have come to rely on forestalling as an opportunity to make a regular abnormal gain without which their businesses might cease to be viable. Forestalling has therefore become endemic throughout the tobacco industry. Its effect on the UK market is not clear, but almost certainly the lack of restrictions on pre-Budget clearances has favoured importers, who with free access to cheap foreign stock, can quickly establish new bridgeheads in the market. This is at the expense of UK manufacturers, who can build up defensive stocks only at the cost of disrupting production schedules or finding additional storage.

11. In the alcoholic drinks industry the level of trade varies during the year but there are always two peak periods: the first prior to Christmas and the New Year, the second in the weeks preceding the Budget. The drinks trade used to clear as much stock as possible before the Budget with the intention of selling post-Budget at a price which reflected the higher rate of duty. However competitive pressures are now such that traders are, to a large extent, forced to maintain pre-Budget prices for as long as possible. As a result consumers feel less pressure to stock up before the Budget.

12. The highest rate of liquor duty is that on spirits. In recent years increases have been less than those required for revalorisation, with no increase at all this year. The consequential uncertainty in the trade as to what advantage

might be gained from forestalling is likely to have been a constraining factor, and to continue to be so.

13. Forestalling is not of great economic importance to the oil industry as a whole. The major oil companies have no wish to see the disruption to their refinery and pipeline schedules which would come from significant pre-Budget peaking in deliveries, though some of the smaller importers have developed a practice of importing cargoes, principally of derv, and paying duty on them, just before the Budget. (It may be that this is facilitated by our willingness to approve temporary increases in duty deferment guarantees in the pre-Budget period. See paragraph 21.) There is also some pre-Budget stocking up by garages and commercial users of derv with bulk storage. Overall, however, this has in past years resulted in forestalling of no more than a few days' supplies overall, mainly of derv.

14. This year, with the dramatic fall in oil prices, there were pre-Budget rumours of double figure increases in the road fuel duties and there were indications of forestalling. After informal reminders from us about the legal machinery of restrictions which was in reserve, restraint was exercised by the major companies. The precise effect is masked by a reduction in UK production of road fuels, and a matching increase in imports early in 1986, forced by UK refinery breakdowns and shutdowns for maintenance, but the result seems to have been a much smaller measure of forestalling than first contemplated by the companies. In the event, with a falling oil market, a smaller Budget increase than rumoured, and extra handling and storage charges, a number of companies burned their fingers, and this experience is likely to have a moderating effect next year.

<u>Feasibility and desirability of restrictions</u>

15 . The tobacco industry is fairly compact, with a limited number of duty points; there are no major practical problems in applying restrictions to it. Some companies have voiced doubts about the legal validity of our powers for restrictions on imports, on the grounds of incompatibility with the Treaty of Rome; we are advised however that there is a good prospect of successfully resisting any legal challenge, particularly if the period of restrictions is

reasonably short. This year's restrictions were effective in keeping forestalling within bounds and were not challenged in the courts (although there was a threat of this); something similar should therefore be feasible in the future. A reasonably generous scheme would be unlikely to be challenged in law by a major trader.

16. What is almost certainly not feasible is either to stop forestalling entirely, or to devise a scheme for its containment which the whole industry would regard as equitable. The 1986 restrictions allowed a generous basic allocation (12 weeks average clearances in an 8 week period) and supplementary allocations to cater for special factors (eg new launches, existing commitments, expanding market share). Nevertheless they were regarded by the manufacturers as giving an unjustified advantage to importers, who benefited most from supplementary allocations. On the other hand, without supplementary allocations the importers would undoubtedly have complained bitterly that the restrictions had been used to nullify the gains they were making through commercial enterprise. More recently, in our discussions with the trade, we have been told that any scheme which restricted deliveries to below the level of trade demand would damage small retailers particularly; in view of the pressure from large chains, small retailers may well find themselves without leading brands. Longer notice will reduce the force of these arguments but complaints of discrimination must be expected from one side or the other.

17 . However, failure to impose restrictions will also be seen as discriminatory, and inconsistent with our action this year and the line we have taken in our discussions with the industry. In those discussions we promised to give as much notice as possible of any future restrictions, so that the industry will become aware at an early stage whether there are to be any next year. If there are not, we can be fairly sure that forestalling of cigarettes will be on a greater scale than in 1986. The treatment of hand-rolling tobacco should be on all fours with that of cigarettes because it is eminently substitutable. But there is no need for restrictions on pipe tobacco or cigars.

18. In the past we have imposed quantitative restrictions on the clearance of alcoholic drinks from bond before an expected duty rate change: but the last occasion was in December 1976, (prior to the use of the Regulator). Since then official control of the liquor trade has changed drastically and there has been a very substantial reduction in our resources devoted to warehousing, though there are many more duty points than in the tobacco industry. There have also been significant changes in the structure of the drinks trade. Two are particularly relevant here: first, the retailing of drink in supermarkets, which has been refined to the point where products are supplied by brand owners holding stocks in a warehouse from which the goods cleared on the instructions of the supermarket management; and, second, the continuing development of vertically integrated groups which encompass all stages from production and importation to retail sale in a single organisation. However, there remain many smaller firms who, in order to compete with these larger organisations, have to be flexible in their purchasing and marketing arrangements. The present size, structure and diversity of the trade, coupled with dependence on warehousekeepers for operation of the duty accounting system, make it impracticable to establish and police a demonstrably fair or reliable anti-forestalling quota system. But, given the limited extent of forestalling which we have identified, we doubt that it is either necessary or desirable to impose restrictions anyway.

19. Given the concentration of the oil industry, particularly with the smaller number of duty points under the new warehousing regime, restrictions are certainly feasible. But we would regard them as positively undesirable. Motorists, both private and business, are susceptible to "folk panics" about shortages of petrol; and if all drivers kept their tanks topped up (as opposed to the average of half full) the extra demand for fuel would be equivalent to a week's supply. If storage in garage tanks is also taken into account, the announcement of restrictions on road fuels could well lead to a sudden surge in demand of at least two weeks normal consumption. So, if there were not to be embarrassing and controversial shortages, a restrictions scheme would have to incorporate at least this much leeway. This considerably exceeds present levels of forestalling. For these reasons we consider that restrictions on oil are not warranted.

Other measures

20. Apart from imposing restrictions, there are a few lesser measures which we can take to curtail, or at least to alert ourselves to, forestalling in alcoholic drinks and hydrocarbon oils. On the alcoholic drinks side we do, at present, allow traders to reduce the size of their bonded warehouses temporarily, to create additional duty-paid storage areas, and we accept the payment of duty on goods within the areas to be debonded. There are legitimate reasons for such flexibility, but the trade have made considerable use of this facility as a means of forestalling at minimum cost to themselves (because the goods are not moved). There seems no valid reason why we should continue to assist duty avoidance in this way. We can also limit the opportunity for forestalling and ease control problems by advancing from midnight to 6 pm the time at which new Budget rates of duty come into effect on Budget Day. This would bring alcoholic drink into line with hydrocarbon oil; and you will recall that in Standing Committee this year, the Opposition had a little dig at the number of different operative times and dates for duty changes.

21. Oil warehouse approval policy does not permit casual de-bonding and re-bonding of bulk storage, so no change in policy is required on that score. But we can look out for signals of attempted forestalling. As regards duty deferment guarantees, we shall give careful scrutiny to any applications for temporary increases in guarantees in the pre-Budget period, with a view to refusing them unless there are clear trade needs (for example refinery breakdown, as this year). We shall also specially monitor actual deliveries of road fuels against existing guarantee limits for smaller importers, and aggregate road fuel deliveries in the pre-Budget period.

Conclusions and recommendations

22. The case for imposing restrictions on tobacco products is not overwhelming: the revenue costs (whether real or artificial) of forestalling are relatively small, and any restriction scheme is bound to lead to complaints and possibly legal challenge. But having imposed restrictions in 1986 on the grounds that forestalling seemed likely to be considerably higher than in 1985 (about 4 weeks extra stocks, which we regarded as barely acceptable), we would have difficulty in justifying no restrictions in 1987 when forestalling would probably go higher

still (perhaps 6 or 7 weeks extra stocks). On balance we think it desirable to impose restrictions on clearances of cigarettes and hand-rolling tobacco for a limited period (6 or 7 weeks) before the date of any budget change; and to allow a fairly generous basic allocation (9 or 10 weeks average clearances) but supplementary allocations only for very exceptional factors (eg a major fire destroying stocks already cleared). This would leave the industry untrammelled in January and allow an acceptable level of forestalling in February and March, but it should ensure that the overall level of forestalling does not exceed that of the last two years. This is a limited objective but we believe it to be a reasonable one and proportionate to the scale of the problem. Any more restrictive scheme would strengthen the argument that restrictions are discriminatory and would increase the prospect of legal challenge. We should announce our decision to the trade in October to give them enough time to make preparations.

23. The level and effects of forestalling on the alcoholic liquor duties are, in our view, insufficient to justify major action to prevent it. In any event current conditions preclude imposing effective pre-Budget restrictions on clearances. But we suggest two measures which should make forestalling more difficult: we should withdraw the facility of temporary debonding prior to a Budget unless we are satisfied that there is a genuine need unconnected with possible duty rate changes; and the time when the duty rate on alcoholic liquors changes come into effect should be altered from midnight to 6 pm on Budget Day (in line with that for hydrocarbon oils).

24. Because forestalling of oils occurs to only a limited extent at the moment we see no need for restrictions (which could in any case be an example of the cure being worse than the disease). We shall nonetheless be monitoring more closely duty deferment guarantees and actual deliveries in the run-up to the next Budget.

ESTIMATED COST OF FORESTALLING : CIGARETTES

	1982	1983	1984	1985	1986(1)(2)
Quantity forestalled ('000 million)	7	5	5	9	9
Budget duty increase (£ per thousand cigarettes) (3)	£2.00	£1.20	£3.99	£2.40	£4.43
Revenue cost	£14m	£6m	£20m	£22m	£40m
Total revenue (4)	£3058m	£3403m	£3728m	£4007m	£4230m
Revenue cost as % of total revenue	0.5%	0.2%	0.5%	0.5%	0.9%

NOTES:

(1) To be revised when the final figures become available.

(2) If the duty increase had been limited to that required for simple revalorisation, the revenue "cost" would fall to £17m, total revenue to £4070m, and the cost as a percentage to 0.4%.

(3) Total increase in duty : specific plus 21% for ad valorem.

(4) For cigarettes only in subsequent financial year. For 1985-86 and 1986-87 we have assumed that 90 per cent of total tobacco duty receipts are in respect of cigarettes.

ESTIMATED COST OF FORESTALLING : SPIRITS

	1982	1983	1984	1985	1986(1)(2)
Quantity forestalled ('000 hectolitres of alcohol)	100	100	120	100	100
Budget duty increase (£ per litre of alcohol)	£0.87	£0.72	£0.29	£0.29	Nil
Revenue cost	£9m	£7m	£3m	£3m	Nil
Total revenue (3)	£965m	£1701m	£1242m	£1501m	£1600m
Revenue cost as % of total revenue	0.9%	0.4%	0.2%	0.2%	Nil

NOTES: (1) To be revised when final figures become available.

(2) If the duty had been increased by the revalorisation factor, the "cost" would have been £9m, or 0.6% of a total duty take of £1645m.

(3) In subsequent financial year; Budget estimate used for 1986.

ESTIMATED COST OF FORESTALLING : WINE OF FRESH GRAPES

	1982	1983	1984	1985	1986(1)
Quantity forestalled ('000 hectolitres)					
- table wine	30	40	-30	40	40
- other	30	40	30	60	35
	60	80	0	100	75
Budget duty changes (£ per hectolitre)					
- table wine	£11.60	£6.20	-£22.50	£7.50	Nil
- other (2)	£15.00	£8.00	£11.60	£11.50	Nil
Revenue cost	£1m	£0.5m	£1m	£1m	Nil
Total revenue (3)	£452m	£613m	£596m	£629m	£640m
Revenue cost as % of	0.2%	0.1%	0.2%	0.2%	Nil

NOTES: (1) If the duties had been increased by the revalorisation factor, the "cost", arbitrarily assuming forestalling would have involved equal quantities of table and of fortified wines, would have been £0.4m, or 0.1% of £665m.

(2) Based on the middle duty band, which accounts for most of this category.

(3) In subsequent financial years; Budget estimate used for 1986.

ESTIMATED COST OF FORESTALLING : DERV

	1982	1983	1984	1985	1986(3)
Quantity forestalled (million litres)	35	55	30	50	60
Budget duty increase (p per litre)	1.34	0.57	0.66	0.67	1.24
Revenue cost	£0.5m	£0.3m	£0.2m	£0.3m	£0.7m
Total revenue (1)	£987m	£1074m	£1190m	£1210m(2)	£1430m
Revenue cost as % of	0.05%	0.03%	0.02%	0.03%	0.05%

NOTES: (1) In subsequent financial year; Budget estimate used for 1986.

(2) Assumning derv accounted for 19 per cent of total revenue for oils, rebated and unrebated.

(3) Provisional.

PUP

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

FROM: K KUKIEWICZ

DATE: 21 August 1986

PS/MINISTER OF STATE

cc: PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Monger
Mr Scholar
Miss Sinclair
Mr Cropper

PRE-BUDGET RESTRICTIONS

Please note that there was an error in Mr Knox's note of 18 August. 3(a) of the covering note should read 'on the lines set out in paragraph 22 of the paper'.

Kate Kukiewicz

K KUKIEWICZ

Internal distribution:

CPS Mr Jefferson Smith Mr T Jenkins Mr Whitmore
Mr McGuigan Mr Wilmott

CONFIDENTIAL

cc PPS/~~CHX~~.

PWP.

FROM: R PRATT
DATE: 28 August 1986

MISS SINCLAIR
MR MOWL
MR PAINTER (Inland Revenue)
MR WILMOTT (Customs and Excise)
MR GRAHAM (Parliamentary Counsel)

cc: Sir Peter Middleton
Mr Scholar
Mr Turnbull
Mr Evans
Mrs Lomax
Mr Moore
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Culpin
Miss O'Mara
Mr Dyer

DATE OF THE 1987 BUDGET

I attach a first shot at a submission to the Chancellor about possible dates for the 1987 Budget.

2. In the past two years a great deal of thought has been given to the possibility of an April Budget with the aim of allowing account to be taken of the preceding year's PSBR outturn. The lateness of Easter next year makes that option very unattractive. Easter day is 19 April with the Parliamentary recess likely to be from 17 to 24 April inclusive.

3. Hence the attached draft submission considers 5 options - 10, 17, 24, and 31 March and 7 April. The illustrative Finance Bill timetables are based on the following constraints and conventions:

(i) Second reading - within 25 sitting days of the Budget.

(ii) Bill to House - at least 10 days after Budget day.

(iii) Bill publication - not less than seven days before second reading and with the period covering two weekends.

(iv) Committee of the Whole House - at least a working week (ie not including recess) after the second reading and lasting 4 days.

(v) Standing Committee - 13 days allowed (15 days has been the maximum requirement since 1971)

(vi) Report Stage - Two weeks after conclusion of committee stage.

(vii) Report Stage / Third Reading } More than two days has not been required since 1981.

(viii) Lords - usual practice of penultimate or final week of July.

(ix) Royal assent - by 5 August.

4. Whichever of the pre Easter Budget day options is pursued there would appear to be little difficulty in constructing a suitable programme. However, for the reasons given in the draft paper, 31 March and 7 April appear less attractive options. For the other three dates the arguments are finely drawn but on balance 17 March looks just to have the edge.

5. I should be grateful if recipients could, as appropriate,:

(1) Comment on the timetables attached to the draft submission from the point of view of both acceptability and the assumed constraints;

(2) verify the other factual information provided;

(3) give views on the relative attractiveness of the alternative dates;

(4) advise on whether any non-Budget events not covered might affect the timetable (eg 1st order PQs).

6. Responses by 5 September would be appreciated.

Richard Pratt

R. PRATT

FROM: R PRATT
DATE: 28 August 1986

CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Cassell
Mr H Evans
Mrs Lomax
Mr D Moore
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr Culpin
Mr Mowl
Miss O'Mara
Mr Dyer
Mr Cropper
Mr Ross Goobey
Mr Tyrie

PS/IR
PS/C&E
Mr Painter (IR)
Mr Wilmott (C&E)
Mr Graham
(Parliamentary Counsel)

DATE FOR THE 1987 BUDGET

I attach a note which, as is usual for this time of the year, sets out the considerations affecting next year's Budget date.

2. Because Easter is very late next year, the choice is slightly different from that in the last two or three years. A post Easter Budget would be the latest for at least the last 15 years; would cause formidable Finance Bill problems and, therefore, virtually rules itself out. On the other hand, there are five serious possibilities for a pre-Easter Budget, ranging from 10 March to 7 April.

3. The disadvantages of having Budget day after the beginning of the financial year (as April 7 would be) or on the same day as a

State visit (March 31) make the later two dates rather less attractive than 10 March, 17 March and 24 March. There is little to choose between these last three, but the earlier dates allow more flexibility for managing a truncated Finance Bill timetable in the event of a summer election and the later date gives time to assimilate information about the February PSBR figures into the drafting of the FSBR.

4. On balance March 17 - the equivalent date to Budget day in 1985 and 1986 - perhaps has the edge. While no final decision is necessary at this stage, it would be helpful for planning purposes if you were to let us know if you agree that,

(1) A post Easter budget can be ruled out;

(2) March 17 is the most attractive option in 1987, with March 10 and March 24 as alternatives.

RICHARD PRATT

THE DATE OF THE 1987 BUDGET

This note examines the options for the 1987 Budget date.

<u>A Budget after Easter</u>

Since Easter is very late next year (Sunday 19 April), the earliest day for a post Easter Budget would be Tuesday April 28. Apart from the post election Budget in 1979, we have not had a Budget as late as this for at least 15 years, (see Annex A) and the difficulties it would present for the Finance Bill management would be formidable. Annex B shows illustrative Finance Bill timetables. An April 28 Budget day would require advance security printing of the Finance Bill, and a later end to Standing Committee than in any year since at least 1971. These and the other disadvantages of a post Easter Budget (paragraphs 3 and 4 below), appear to outweigh the advantage that would be gained by greater knowledge of the PSBR outturn for 1986-87. This option therefore looks a very doubtful starter for 1987.

<u>Budget day before Easter</u>

2. The late Easter expands the range of possible pre Easter dates, with any of the 5 weeks between March 10 and April 7 serious possibilities (April 14 would not leave time for Budget debates before the recess). As Annex B shows there are no real Finance Bill management problems with any of these dates.

3. The general arguments for the earlier or later of these dates are well rehearsed. An~~y~~ early Budget gives more time for preparing the Finance Bill and brings forward the impact of tax changes (whether income tax cuts on pay packets, or excise duties on Government receipts). It is helpful for income tax changes to be made before the beginning of the tax year as otherwise deductions at source from

interest and ACT on dividends are collected at the wrong rate for the first few weeks of the year. More specifically in 1987, the possibility of an election may add more weight to the arguments for an early Budget day in order to give more flexibility in managing a truncated Finance Bill procedure (in 1983, Budget day was on 15 March).

4. On the other hand, a later Budget allows more time for pre Budget planning and (depending on the precise timing) means that more information may be available about the February outturns for public finances , as well as about RPI and money supply. Annex C shows how the dates on which we have this information compare with the deadlines for Budget decisions.

5. We also need to bear in mind a State visit from 31 March to 3 April, and the possibility of international engagements, particularly IMF, in April.

The Options Considered

6. Although an April 7 Budget day would come after our first internal estimate of the 1986-87 CGBR, there would be no time to make more than minor changes to the FSBR, and no opportunity to alter any tax measures. There is thus little practical advantage to set against the disadvantages of such a late Budget which would fall after the beginning of the financial year, and could result in TCSC enquiries etc interfering with international commitments.

7. March 31 offers little advantage over March 24, if it is assumed that February PSBR figures are not sufficiently reliable a guide to final year outturn to justify changes to actual Budget decision. In both cases, knowledge of the February PSBR, the money supply and RPI figures would be known internally in time to allow account to be taken of them in the FSBR. Since March 31 suffers from the general disadvantage of later Budgets and happens to fall on the first day of a State visit (requiring the Prime Minister and other Ministers' attendance) it is perhaps less attractive an option.

8. There is little to choose between the remaining three dates - 10, 17 and 24 March. March 10 would be early by historical standards; would shave a week off this year's pre Budget planning period, and would allow no real knowledge of the February PSBR before Budget day. But it would give the maximum flexibility in managing a truncated Finance Bill timetable in the event of a election. The converse applies to March 24.

9. On balance March 17 seems a reasonable compromise, and would be the equivalent date to the Budget Days in 1985 and 1986.

CENTRAL UNIT

ANNEX 2

YEAR	EASTER SUNDAY	BUDGET DAY	BILL PUBLISHED	2ND READING	COMMITTEE				REPORT		3RD READING	LORDS	PAGES		DAYS BUDGET TO 3RD READING	COMMENTS
					WHOLE HOUSE		STANDING									
					BEGAN	DAYS	DAYS	ENDED	BEGAN	DAYS			BILL	ACT		
1971	11 APR	30 MAR	20 APR	28 APR	11 MAY	4	7	21 JUN	5 JUL	3	7 JUL	21 JUL	119	130	99	
1972	1 APR	21 MAR	11 APR	20 APR	9 MAY	6	15	28 JUN	10 JUL	3	19 JUL	26 JUL	204	223	120	
1973	22 APR	6 MAR	23 MAR	2 APR	10 APR	2	7	23 MAY	10 JUL	1	11 JUL	24 JUL	92	116	127	
1974	14 APR	26 MAR	26 APR	9 MAY	16 MAY	5	8	2 JUL	16 JUL	3	22 JUL	30 JUL	93	122	118	POST-ELECTION
1974	—	12 NOV	10 DEC	17 DEC	15 JAN (1975)	3	12	18 FEB (1975)	4 MAR (1975)	4	10 MAR (1975)	13 MAR (1975)	130	157	108	WINTER BUDGET
1975	30 MAR	15 APR	29 APR	8 MAY	15 MAY	3	8	3 JUL	16 JUL	2	17 JUL	31 JUL	110	122	93	
1976	18 APR	6 APR	15 APR	3 MAY	11 MAY	3	13	1 JUL	13 JUL	3	19 JUL	27 JUL	144	179	105	
1977	10 APR	29 MAR	19 APR	28 APR	9 MAY	3	8	23 JUN	14 JUL	3	25 JUL	28 JUL	78	88	128	
1978	26 MAR	11 APR	20 APR	27 APR	8 MAY	3	10	27 JUN	5 JUL	4	13 JUL	31 JUL	91	108	93	
1979	—	12 JUN	21 JUN	27 JUN	3 JUL	5	—	—	18 JUL	1	18 JUL	24 JUL	22	22	36	POST-ELECTION
1980	6 APR	26 MAR	17 APR	8 MAY	2 JUN	3	10	3 JUL	16 JUL	2	17 JUL	31 JUL	142	176	113	
1981	19 APR	10 MAR	3 APR	13 APR	30 APR	5	11	30 JUN	14 JUL	3	20 JUL	24 JUL	195	218	132	
1982	11 APR	9 MAR	26/30 MAR	6 APR	22 APR	4	11	24 JUN	12 JUL	2	13 JUL	20 JUL	189	256	126	
1983	4 APR	15 MAR	31 MAR	14 APR	25 APR	4	—	—	—	—	11 MAY	12 MAY	164	79	56	PRE-ELECTION
1984	22 APR	13 MAR	29 MAR	10 APR	30 APR	3	13	26 JUN	10 JUL	2	11 JUL	25 JUL	223	262	120	
1985	7 APR	19 MAR	16 APR	29 APR	7 MAY	2	9	18 JUN	9 JUL	2	10 JUL	23 JUL	199	242	113	
1986	30 MAR	18 MAR	16 APR	29 APR	6 MAY	2	10	19 JUN	8 JUL	2	17 JUL	25 JUL	200		121	

BUDGET OPTIONS 1987

	(1) 10/3/87	(2) 17/3/87	(3) 24/3/87	(4) 31/3/87	(5) 7/4/87	(6) 28/4/87.
MARCH 2						
9	10 - BUDGET DAY.					
16		17 - BUDGET DAY.				
23	27 - BILL TO HOUSE.		24 - BUDGET DAY.			
30	APRIL 3 - BILL PUBLISHED.	3 - BILL TO HOUSE.		31 - BUDGET DAY.		
6		10 - BILL PUBLISHED.	9 - BILL TO HOUSE.		7 - BUDGET DAY.	
13	13 - 2nd READING.		16 - BILL PUBLISHED.			
20	17 EASTER RECESS 24	EASTER RECESS	EASTER RECESS	EASTER RECESS	EASTER RECESS	EASTER RECESS
27	27 - COMMITTEE OF WHOLE 30 HOUSE. BANK HOLIDAY.	28 - 2nd READING.		24. BILL TO HOUSE. MAY 1 - BILL PUBLISHED.	24. BILL TO HOUSE. MAY 1 - BILL PUBLISHED.	28 - BUDGET DAY.
MAY 4	5		5 - 2nd READING.			8 - BILL TO HOUSE.
11	STANDING COMMITTEE.	11 - COMMITTEE OF WHOLE 14 HOUSE.	11 - COMMITTEE OF WHOLE 14 HOUSE.	11 - 2nd READING.	11 - 2nd READING.	15 - BILL PUBLISHED.
18		19.	19.	18 - COMMITTEE OF WHOLE 21 HOUSE.	18 - COMMITTEE OF WHOLE 21 HOUSE.	
25	25 WHITSUN RECESS 29	WHITSUN RECESS	WHITSUN RECESS	WHITSUN RECESS	WHITSUN RECESS	WHITSUN RECESS
JUNE 1		STANDING COMMITTEE.	STANDING COMMITTEE.	2. STANDING COMMITTEE.	2 STANDING COMMITTEE.	1 - 2nd READING.
8	9					8 - COMMITTEE OF WHOLE 11 HOUSE.
15						16
22	23. - REPORT STAGE + 24. 3rd READING.	23.	23.			STANDING COMMITTEE.
29				30.	30	
JULY 6		7 - REPORT STAGE + 8 3rd READING.	7 - REPORT STAGE + 8 3rd READING.			9
13				14 - REPORT STAGE + 15 3rd READING.	14 - REPORT STAGE + 15 3rd READING.	
20	21 - HOUSE OF LORDS.	21 - HOUSE OF LORDS.	23 - HOUSE OF LORDS.	23 - HOUSE OF LORDS.	23 - HOUSE OF LORDS.	23. - REPORT STAGE + 24. 3rd READING.
27						27 - HOUSE OF LORDS.
AUGUST 3						
10						

DEADLINES FOR BUDGET DECISIONS.

	DATES FOR KEY STATISTICS.	BUDGET DAY 10 MARCH 1987	BUDGET DAY 17 MARCH 1987	BUDGET DAY 24 MARCH 1987	BUDGET DAY 31 MARCH 1987	BUDGET DAY. 7 APRIL 1987.
FEBRUARY 22						
23		VAT + MOST EXCISE.				
24		INCOME TAX BASIC RATE.				
25						
26						
27						
28						
MARCH 1			VAT + MOST EXCISE			
2		INCOME TAX ALLOWANCE	INCOME TAX BASIC RATE.			
3	CGBR - 1st ESTIMATE (FEBRUARY)					
4						
5						
6		FSBR				
7						
8				VAT + MOST EXCISE.		
9			INCOME TAX ALLOWANCE	INCOME TAX BASIC RATE.		
10	PSBR - PROV. ESTIMATE (FEBRUARY).	BUDGET DAY.				
11	RPI - KNOWN IN HMT					
12	PSBR - FIRM ESTIMATE (FEBRUARY)					
13	RPI - PUBLISHED.		FSBR.			
14						
15					VAT + MOST EXCISE.	
16				INCOME TAX ALLOWANCE	INCOME TAX BASIC RATE	
17	PSBR - PUBLISHED (FEBRUARY)		BUDGET DAY.			
18						
19	PROV. MONEY.					
20				FSBR		
21						
22						VAT + MOST EXCISE.
23					INCOME TAX ALLOWANCE	INCOME TAX BASIC RATE
24				BUDGET DAY.		
25						
26						
27					FSBR.	
28						
29						
30	FULL MONEY.					INCOME TAX ALLOWANCE
31					BUDGET DAY.	
APRIL. 1						
2	CGBR - 1st ESTIMATE (MARCH).					FSBR
3						
4						
5						
6						
7						BUDGET DAY

[illegible]

Annotated agenda

1. **Abolition of taxes**

Mr [illegible] of 8 September

~~(Paper - Mr Monger's minute of 4 September)~~

(a) Should we decide not to pursue abolition (this year) of the following, given the cost and/or undesirable side effects

VED (but think further about a switch from VED to derv, see below)

Car tax (£1.1 bn revenue would have to be recouped from 20p per gallon increase in petrol/derv or £50 increase in VED

Heavy Fuel Oil (because of the Frigg effect)

Gas oil (increased last year)

LPG and aviation gasoline (to protect petrol duty yield by discouraging substitution)

Stamp duty

Life assurance policy duty (yield £65m) - see below on insurance company taxation

Income tax additional rate (protecting higher rate income tax yield by eliminating the incentive to shelter income in trusts)

Income tax Schedule B on woodlands

Any elements in corporation tax or inheritance tax

~~The rest - ie major oil duties, most betting duties, all main direct taxes etc~~

(b) Do we wish to pursue abolition of:

Bingo duty (yield £60m)

On course betting duty (yield £20m)

Matches and Mechanical lighters (yield £10m each)

Capital duty (yield £150m)

Unit trust duty (yield £30m)

Capital gains tax
- assimilation with income tax?
- exemption of specific assets?
- exemption of gains or assets before eg 1982?

2. **Income tax issues**

Car benefits (IR to draft)

Mortgage Interest Relief

Revenue, on a contingent basis, are preparing a paper on timing, implementation etc constraints on:

- restriction of relief to the basic rate;
- restriction of the relief to the residence, not the individual

as a possible quid pro quo for an increase in mortgage interest relief ceiling.

Paper to be ready by [ ] (vis FST)?

Tax relief for personal employees

(Papers Mr Isaac 20/8/86, Chief Secretary 5/9/86; Minister of State 8/9/86; Mr Cropper 5/9/86) K Allen [illegible] (further IR paper to come)

- Do the disadvantages in terms of tax principle, practical anomalies and cost outweigh the gains to employment
- How strong is the case for pursuing the matter as part of a drive against the black economy?

Minimum Tax

(Paper Mr Isaac 30/1/86

This is a Starter for 1987, with a more selective list of tax shelters than in 1986. Inland Revenue conducting a survey of higher paid taxpayers to determine what use is made of tax shelters.

Paper coming forward in October/November, via FST. Any information to report now? Can we establish a timetable for this work?

Divorce maintenance - IR to draft

Composite Rate Tax

(Papers O'Connor 16/7/86) (+ further paper from Inland Revenue

Existing preceding year basis introduced at the request of the banks to ensure that rates were known in advance.

Building Societies are now concerned that a substantial basic rate cut could leave too narrow a margin between composite rate and basic rate.

Extra cost, of charging to current year system at the same time as a basic rate cut, could be £250m-£500m.

- Is it necessary to take action to avoid too narrow a gap between basic rate and composite rate?
- If so, is it better to make an announcement on Budget day of the composite rate, on the basis of projections about the tax status of depositors, or would there be any advantage in an announcement of a rate to take effect later in the year.
- If a change from preceding year is a Starter, is there any need to take action to ensure that the windfall to deposit takers is passed on to depositors in the event of a basic rate cut?

3. **Pensions**

Inland Revenue to come with consultative document on personal pensions for issue in October/November.

- Need to have clear position on free-standing Additional Voluntary Contributions (AVCs) before consultative documents issued.
- Free-standing AVCs would require some alignment of contributions/fixed benefit rates for pensions.

4. **Corporation Tax issues**

International

Payment dates

Capital losses for groups

Disincorporation

IR to draft

Venture capital

Pre trading R & D

Dual resident companies

~~Life Assurance Companies~~

5. **US tax reform**

Appraisal from UKTSD Washington awaited

Analysis of the proposals, eg on Capital Gains Tax, and if any read-across from the UK - IR paper to come

6. **Lloyds**

(Mr Spence of 30.1.86, 6.8.86 and 14.8.86; EST of 13.8.86; Mr Cropper of 9.9.86; Mr Allan 11.9.86)

Revenue (Mr Spence of 6 August) have proposed new arrangements for taxation of Lloyds, treating syndicates rather than names as the tax unit. Mr Cropper has suggested delaying these changes, on political grounds, until after the General Election. Decision required soon if to be included in 1987 Finance Bill.

7. **Keith**

(Papers

- Is it accepted that Inland Revenue Keith cannot be implemented in full in 1987?
- If so, does the division into more manageable packages - A, B and C make sense?
- For 1987 should Inland Revenue work up the details of package A. Or will the impact of Customs Keith from October onwards make it inappropriate to implement Revenue Keith, without a longer period of consultation.
- If so, should Inland Revenue work on the basis of a long consultation period leading to implementation in 1988 with either nothing in 1987 Finance Bill, or, simply implementation of pay and file.

8. **Insurance Premium Tax**

(Papers Mr Knox of 27/8/86; Mr Norgrove of 1/9/86; Mr Wilmott of 15/9/86; Mr Allan of 17/9/86)

Is there a case for taxing this sector at this time?

Are the attractions of this tax - eventual yield (NB low initial yield), low rpi effect, insurance a relatively lightly taxed sector - outweighed by the problems - effect on business, need to apply to existing contracts, avoidance?

Is further work required? May the DTI be consulted? If so should Customs report further, say, by end October (via MST)?

9. **Blocked VAT Input Tax**

(Papers Sir A Fraser 30/7/86)

The draft 12th Directive proposes extensions to the blocking of input tax (ie preventing firms reclaiming VAT paid on particular expenses). The original estimate of the yield was £750m. But £500m came from blocking VAT on petrol which the UK previously opposed because of the impact on business costs. The proposal in the latest draft of the directive would now yield £150m (because only 50% of motoring expenses would be blocked).

The 6th Directive prevents any extension of blocked input tax in advance of agreement on the 12th.

- Does the effect on business costs, in any case, confirm earlier decisions to rule out blocking VAT on petrol?
- Should any further work be done on the remaining items in the EC directive - eg on entertainment, business travel and luxuries?

Further report required by, say, [ ] (via MST)?

10. **Stamp Duty Issues**

Removal of stamp duty on PEPs

- would ~~means~~ that investment in PEPs could be completely tax free
- feasible, but could be expensive in terms of revenue foregone. Some administrative cost for Revenue
- implications for plan managers' systems would need to be considered.

31 day rule covered in Mr Draper's note of [ ]

C

11. **Credit Card Tax**

(Papers Mr Norgrove 15/9/86, Mr Allan 4/9/86, Mr Willmott 19/9/86)

- Tax on credit cards (including charge cards) considered in run-up to 1986 Budget but not pursued. Yield figures being revised, but unlikely to exceed £100 million (1% on turnover), £45 million (10p on each transaction) or £20 million (10p on each monthly account).
- Case for looking again at wider tax on consumer credit? Considered in 1984 but postponed till next Parliament, largely because of time-lag in revenue yield. May now be possible to accelerate this to some extent although first-year yield still low. (A ½% duty would yield about £100m if mortgages were excluded, and £350m if they were included, net PSBR gain). ?

? ~~Case for looking again at balance-sheet taxes?~~

B

12. **Charities**

(Papers - Corlett 27 June)

No concessions on VAT and charities, although there could be an increase in the ceiling for payroll giving

- What is the outcome of the further consultations with the charity movement?
- What further work is necessary?

13. **Switch from VED to derv for lorries**

(Papers Romanski 31.7.86; S of S Transport 31.7.86; Kuczys 4.8.86; Romanski 20.8.86; Norgrove 28.8.86; Ch/EX 28.8.86; S of S Transport 8.9.86)

For 1987, it is proposed to switch the balance of lorry taxation from VED to derv. While there may be a small shift from car VED to petrol, the outcome will be to diminish the differential between derv and petrol duties.

S of S Transport proposes £100m shift (approximately 22 per cent of total lorry VED revenue and equivalent to a derv pump price rise of 6.5p per gallon) and is concerned that too great a shift will reduce flexibility to align total lorry taxation with road track cost.

Officials are working on the maximum size of the shift.

- What size of shift does the present work suggest?
- When will the work be complete?

14. **Profit related pay** - (IR to draft)

Typist
2 tapes.

Side 1 → 2 of top 1. Side 1 of 2nd tape.

PWP

SECRET

Tax: Forward Planning

Annotated agenda

1. **Abolition of taxes**

(Mr Monger of 4 September: paragraph references shown seriatim below)

(a) decide now not to abolish (this year): Can rush through this.

paragraphs 5-7 VED (but think further about a switch from VED to derv, see item 15 below)

8-10 Car tax (to recoup £1.1 bn loss revenue through petrol taxation increase of 20p per gallon needed; or £50 increase in VED)

12 Heavy Fuel Oil (because of the Frigg effect)

13 Gas oil (increased last year)

14 LPG and aviation gasoline (to protect petrol duty yield by discouraging substitution)

24 Stamp duty (see also item 10 below) - cost £1520m (or £650m if shares only)

26 Life assurance policy duty (yield £65m) (see also items 6(ii) and 14 below on insurance taxation issues)

28 Income tax additional rate (protecting higher rate income tax yield by eliminating the incentive to shelter income in trusts)

29 Income tax Schedule B on woodlands

33-34 Any elements in corporation tax or inheritance tax

3,23 The rest - ie major oil duties, all main direct taxes etc

(b) Do we wish to pursue abolition of:

15 Bingo duty (yield £60m) — ?

16-20 On-course betting duty (yield £20m) — possible?

21 Matches and Mechanical lighters (yield £10m each) — trivial but potential factory closure in Liverpool

25 Capital duty (yield £150m) and unit trust duty (yield £30m) — v little public awareness so worth money?

30-32 Capital gains tax (see also item 3(i) below) - assimilation with income tax

take as separate item.

2. **US/G5 tax reform - general issues**

(Paper from Washington - Mr R I G Allen's letter of 17 September, Mr Johns of 18 ~~19~~ September, and Mr Scholar of 19 September)

Do these papers suggest any themes worth pursuing which are not raised specifically elsewhere in this annotated agenda?

— worth restricting what could no doubt be a long & interesting discussion of US package itself

3. **Capital Gains Tax**

(i) **Reform of CGT**

(Mr Cayley of 17 September under cover of Mr Isaac of 17 September)

Key topic

Examines options for integration of CGT with income tax and removal of indexation. Do Ministers wish to pursue any of these possibilities? (FST)

(ii) **Capital losses for groups**

IR will submit paper in early October - on question whether there should be legislation to provide group relief for capital losses and counter capital loss buying. (FST)

Keep up momentum But no action now

(iii) **Disincorporation**

Should there be legislation to ease tax rules for disincorporation? IR will submit paper in early October. (FST)

(iv) **Venture Capital**

IR are exploring with BVCA the tax consequences of setting up onshore venture capital funds. A further meeting will be held at the start of October after which IR will report to Ministers. (FST)

4. **Income Tax Issues**

(i) **Minimum Tax**

(Mr Isaac 30 January 1986)

V slow progress

This is a starter for 1987, with a more selective list of tax shelters than in 1986. IR conducting a survey of higher paid taxpayers to determine what use is made of tax shelters. Consultation will probably be necessary; paper coming forward in October. (FST)

(ii) **Tax relief for personal employees**

(Mr Isaac of 20 August, Chancellor of 29 August, Chief Secretary of 5 September, Minister of State of 8 September, Mr Cropper of 5 September)

- Do the disadvantages in terms of tax principle, practical anomalies and revenue and administrative cost outweigh the gains to employment?
- Would this be a cost-effective measure against the black economy? (FST)

These two could be considered together

(iii) **Child Care Allowance**

(Chancellor of 29 August; Mr Mace of 19 September; IR paper [by weekend])

- What would be the aims of the relief?
- Would the likelihood of achieving them outweigh the substantial revenue and administrative costs and the danger of increasing pressure for further reliefs for work-related personal expenditure? (FST)

(iv) **Mortgage Interest Relief**

IR, on a contingent basis, are preparing a paper on timing, implementation etc constraints on:

- restriction of relief to the basic rate;
- restriction of the relief to the residence, not the individual

as a possible quid pro quo for an increase in mortgage interest relief ceiling.
Paper expected last week in September. (FST)

or bargaining counter against doing it at all.

(v) **Benefits-in-kind - £8,500 threshold**

IR paper in preparation

Abolition of threshold means extra revenue, but higher staff and compliance costs. Raising threshold could bring worthwhile staff and compliance savings, but at a revenue cost. Decided last year to continue existing policy of allowing threshold to "wither on the vine". Has the balance of the advantages and disadvantages changed, and can the threshold be abolished for car and fuel benefits only? (FST)

(vi) **Maintenance Payments**

Suggestion that maintenance payments might be made tax-neutral would produce staff savings. But could have significant distribution effects. Revenue paper now being prepared. (FST)

(vii) **Composite Rate Tax**

(Mr O'Connor 16 July)

Existing preceding year basis introduced at the request of the banks to ensure that rates were known in advance. Building Societies now concerned that a substantial basic rate cut could leave too narrow a margin between composite rate and basic rate. IR paper shortly, via EST.

5. **Pensions**

Tax regime for new personal pensions being designed - inter-departmental working group (Revenue, Treasury, DHSS, Government Actuary). (Messrs Corlett and Munro of 30 July)

Very tight

- timing acceptable: submission round end of October with view to consultation document in November?
- need to have clear position on free standing Additional Voluntary Contributions (AVCs) before consultative document issued (via FST).

must make sure Revenue do consider this properly

6. **Business Tax issues**

(i) **Payment dates** — papers in separate folder because of Channel IV request

(Mr Reed of 2 September, Chancellor of 8 September, FST of 15 September)

ALSO: CGT pr ben

Avoidance by delaying date when CT becomes payable (eg Habitat case). Further submission shortly. (FST)

(ii) **Life Assurance Companies**

Agreed 29 July meeting major reforms probably for next Parliament. Only limited measures possible for 1987 Bill. Submission in October will cover both long-term reform and possible candidates for 1987. (FST)

(iii) **Pre trading R & D**

Discussions between IR and DTI in progress. Report to Ministers due end October/early November. (FST)

7. **International**

(i) **International (General)**

Potential revenue-raising measures on international side in CT sector. Review underway - IR paper in early October. (FST)

(ii) **Dual Resident Companies**

A device enabling a company to get a deduction for one loss in two countries - usually US/UK. Possibility of legislation in 1987. Last submission to the FST 7 August 1986. Further submission shortly. (FST)

8. **Lloyds**

(Mr Spence of 30 January 1986, 6 and 14 August, EST of 13 August, Mr Cropper of 9 September, Mr Allan of 11 September)

Revenue (Mr Spence of 6 August) reported on discussions with Lloyds for new tax arrangements, treating syndicates rather than names as the tax unit. Mr Cropper has suggested delaying changes, on political grounds, until after the General Election. Decision required soon if to be included in 1987 Finance Bill. Revenue submission by end October will set out options and assess consequences of deferring legislation beyond 1987. (EST)

Decided not for 1987?

9. **Keith**

(Mr Corlett of 3 July)

EST has discussed this with IR: can ask him to report

- Is it accepted that Inland Revenue Keith cannot be implemented in full in 1987?
- If so, does the division into more manageable packages - A, B and C make sense?
- Should full consultative document (including draft clauses) still be published in November?
- Should it give an indication of what might be in 1987 Finance Bill?
- Should this be package A (including pay and file)? Or should it be cut down to pay and file plus directors' fees? (EST)

10. **Stamp Duty Issues**

- Is it agreed that no further structural changes be introduced this year, to allow Reserve Tax to settle down?
- Leave open possibility of rate or threshold changes?
- If life assurance duty to be retained (see 1) do we want to consider exempting re-insurance?

- 31 day rule covered in Mr Draper's minute of 12 September

Removal of stamp duty on PEPs ?

- Would mean that investment in PEPs could be completely tax free
- feasible, but could be expensive in terms of revenue foregone. Some administrative cost for Revenue
- Implications for plan managers' systems would need to be considered. (EST)

11. **Charities**

(Mr Corlett of 27 June, 19 September)

no immediate action, await reviews.

No concessions on VAT and charities, although there could be an increase in the ceiling for payroll giving.

How are arrangements going for further consultations with charity movement? (FST)

see Clive's minute.

12. **Profit related pay**

Too early for decisions?

- Consultation ends 17 October - many responses still to come.
- Is it too early for a preliminary view on
  - whether tax relief should go ahead
  - if so, whether any major change is necessary to scheme outlined in Green Paper
  - if not, what policy stance on PRP should there be? (MST)

13. **Credit Card Tax**

(Mr Norgrove of 15 September, Mr Allan of 17 September and Mr Wilmott of 19 September)

Can ask MST to report a meeting.

- Tax on credit cards (including charge cards) considered in run-up to 1986 Budget but not pursued. Yield figures being revised, but unlikely to exceed £100 million (1% on turnover), £45 million (10p on each transaction) or £20 million (10p on each monthly account).
- Case for looking again at wider tax on consumer credit considered in 1984 but postponed till next Parliament, largely because of time-lag in revenue yield. (A ½% duty would yield about £100m in a full year, ie perhaps in 1988-89, if mortgages were excluded, and £350m if they were included). (MST)

MST had a meeting which went wider than credit card tax & into this: you indicated you didn't feel this was worth reopening.

14. **Insurance Premium Tax**

(Mr Knox of 27 August, Mr Norgrove of 1 September, Mr Wilmott of 15 September, Mr Allan of 17 September)

Are the attractions of this tax - eventual yield (NB low initial yield), low rpi effect, insurance a relatively lightly taxed sector - outweighed by the problems - effect on business, need to apply to existing contracts, avoidance?

Is further work required? May the DTI be consulted? If so should Customs report further, say, by end October (via MST)?

15. **Switch from VED to derv for lorries**

(Mr Romanski and S of S Transport of 31 July, Chancellor of the Exchequer of 4 August, S of S Transport of 8 August, Mr Romanski of 20 August, MST of 28 August, Chancellor of the Exchequer of 28 August)

For 1987, it is proposed to switch the balance of lorry taxation from VED to derv. While there may be a small shift from car VED to petrol, the outcome will be to diminish the differential between derv and petrol duties.

S of S Transport proposes £100m shift (approximately 22 per cent of total lorry VED revenue and equivalent to a derv pump price rise of 6.5p per gallon) and is concerned that too great a shift will reduce flexibility to align total lorry taxation with road track cost.

Officials are working on the maximum size of the shift. Further submission in October/November. (MST)

"ENTERPRISE COMPANIES"

There remains a considerable amount of concern about the inability of small firms to raise finance in sums up to £100,000. Neither BES nor Venture capitalists have tackled this problem largely because of the relatively high appraisal costs of such propositions. Although BES does finance smaller investments, the bulk of the tax relief given goes to investments above £100,000 (90% of tax relief in 1984-85). Banks are not meeting such needs, even with the assistance of the LGS, because of a combination of natural caution about the risks compared to mortgage lending, bureaucracy in referring LGS cases to head offices, appraisal costs, and lack of compensation for risks through rewards of equity participation.

Problems in financing small firms are not limited to poor availability of finance. Often a company needs a mixture of loan and equity, but this is not available from one source.

These problems should be tackled through the creation of 'enterprise companies'. Such companies would be limited companies providing a mixture of equity and loan finance to small companies. Individuals and companies would be encouraged by tax incentives to invest in the shares of the enterprise company. Annex A sets out the details of this approach. We believe that the bias of these companies would be to a local area and they would create local venture capitalists. The aim is to make investment locally attractive to individuals and the limitations proposed on the size of the investments made by the enterprise company and the size of investment which individuals and companies could make in the enterprise company itself should achieve this.

One issue is how far such enterprise companies could exist alongside BES and LGS. They are not incompatible in the short term. The emphasis in enterprise companies is different to BES - allowing for corporate investments, offering a loan and equity mix and concentrating on the small and local end of the market. Enterprise companies could be given an LGS franchise and so compete with the banks. In the long run the enterprise company might replace BES but this would depend on their relative success in achieving their objectives.

The costs of appraisal and level of after care needed for venture capitalists to invest successfully in smaller expanding companies could remain a barrier to enterprise companies. "Support for appraisal costs on the lines of the Business improvement Scheme could be given to enterprise companies and to BES funds. Annex B outlines how this might be done."

ENTERPRISE

"Chance in a lifetime"

The creation of an enterprise culture requires a considerable change in attitude to the risks inherent in starting a business which is particularly hard in a society which has become risk-averse and anti-enterprise. A significant barrier to this development is the fact that few people have direct experience either themselves or through their family of running a business. Encouraging more people now to run their own business will have a powerful effect in developing a willingness and awareness of enterprise in the future.

One way to tackle this would be to provide incentives to people starting a business for the first time: incentives which could be used only once in a lifetime. The idea of a 'chance in a life time' scheme is outlined in Annex C. This would give a package of incentives including a tax free holiday for the first two years, enterprise training and financial advice to people setting up their business for the first time in their life. The cost of this approach may have to be restricted initially by piloting on a regional basis, for example in the North or North East. This might cost about £50 million in a full year.

"Spin-outs"

Just as important in creating a successful enterprise economy is the need to encourage people to leave established jobs to set up new businesses. Spin-outs of executives particularly to set up new businesses built on ideas which do not fit into the existing portfolio of the business for which they work would undoubtedly offer a higher rate of success in starting up businesses. But current tax rules are extremely complicated and act to prevent "spin-outs" for example:

- managers 'spun-out' and offered shares at a price below that paid by the backers of the new company may find themselves liable for income tax on the difference in price even though no gain can be realised

- managers buying shares part paid who then leave and wish to sell the shares to their successor have to pay tax on the difference between the market value of the fully paid shares and that of the partly paid shares

- IBM who wished to support managers setting up their own businesses through paying their salary for a period of 16 months and paying for enterprise and business training found that this was prevented because such expenses would not be deducted for corporation tax purposes and, more important, the managers themselves would be assessed for tax on the value of the enterprise and business training which they have received. This effectively prevented them running a programme of encouraging managers to start new businesses.

The legislation needs to be consolidated and simplified to remove such disincentives.

Decisions about self employment

Obstacles to people moving gradually from employment into self employment and to small businesses seeking to employ labour flexibly (part-time, temporary, contract) are also created by the existing tax and social security system. A particular difficulty is uncertainty about status and the understandable Revenue caution in accepting self-employed status. Annex D identifies some changes which could be made now and which are already the subject of Ministerial discussion to streamline the decision-taking, which essentially involves bringing together the tax and social security system into one decision point for self employment status. (Discussion of major structural change to abolish employment distinctions altogether will have to follow the response to Green Paper on Personal Taxation).

ANNEX A

ENTERPRISE COMPANIES

Enterprise companies (ECs) will be entirely private sector bodies. Government will provide incentive for private sector investment via BES style tax relief. The main additional features of EC investment compared with BES are:-

- investments from trading companies and institutions
- local bias
- bias towards investment in small firms

1. Objective

The objective of ECs is to supply the need of small businesses (both existing and start-ups) for capital in the most appropriate mix (between equity and loan), at a reasonable cost, on a long-term basis and with an appropriate level of pre-investment appraisal and post investment after-care.

2. The Concept

ECs will have the following features:-

a) The basic concept is that investors who are willing to invest risk capital in predominantly small local businesses will be able to subscribe for shares in the local enterprise company. The investors will receive tax relief on this investment. The local enterprise company will appoint directors from the local business community. The directors of the EC will invest its funds in local businesses, primarily in amounts of less than £100,000.

b) Unlike BES, investment in ECs will not be restricted to individuals. Companies, banks, financial institutions and other bodies prepared to invest risk capital in small businesses will all be eligible to invest.

c) They will be set up on a local basis - their constitutions could require that preference be given to local shareholding and local investment.

d) They will be limited companies and therefore separate continuing legal entitles.

e) They would be required to invest mainly in small companies in an appropraite mix of loan and equity capital. They will also be able to invest in partnerships/sole traders (which do not have share capital) by means of long term loans (possibly the interest charge being related to profits).

f) Investments would be predominantly in the range of £10,000 to £100,000. Requirements could stipulate that at each balance sheet date 50% of its invested funds (by value) and at least 70% of its investments (by number) would be represented by investments of less than £100,000. They could also be prohibited from making any investment which exceeded say £500,000 or say 15% of share capital plus reserves at the last balance sheet date. In addition these figures should be laid down by Statutory Instrument so that they can be varied in the light of experience.

f) Share capital could be called as required - at the end of the first year 50% of share capital received must have been invested and at each balance sheet date thereafter 75% must be invested.

h) They would be allowed to borrow funds from outside sources including their own shareholders.

i) They would be allowed to use a set percentage of their funds for management expenses (cost of raising capital, cost of appraisals, etc.).

3. Advantages

a) Simplicity - BES Funds cannot hold shares in their own name. When a BES Fund makes an investment in fact what happens is that each investor gets an apportionment of the shares acquired by the Fund. He therefore gets a very small direct holding in each target company. This is a particular problem where the BES Fund makes small investments as each investor therefore gets only a fraction of this small number of shares. The disadvantage for the company is that it gets a large number of shareholders, all of whom have to be kept on registers, sent copies of accounts, notices of meetings etc. This is an administrative burden particularly for small companies. Under the EC proposals, the investors buy shares in the EC which then makes a single investment in the target companies. Target companies therefore get only one new shareholder.

b) Risk spread marketability - investors spread risk by investing in EC because the EC has a spread of investment - EC shares should therefore be more marketable.

c) Involvement - under the BES Fund it is difficult for each individual shareholder to get involved in each of the companies whose shares are allocated to him by the BES Fund. Also the BES management have no ongoing responsibility to the investors and therefore little incentive to get involved or provide after care to target companies. The EC, on the other hand, is a continuing body whose management are continually answerable to its shareholders - they therefore have a strong incentive to manage the investments by keeping close to investee companies and providing extra help where required.

d) Industrial and institutional involvement - BES only allows individual investment. Investment by companies and institutions is a vast new source of investment money and backup expertise. EC would provide a strong and valuable link between successful local business and the local small firms. National/international companies and institutions could also purchase shares.

e) Continuity - the EC will be continuing legal entity and therefore a permanent land mark on the local scene and an important part of a local financial community.

4. Problems

a) Investment appraisal (the cost) - bad appraisal leads to bad investments. Appraisal of a small investment can be as costly as appraisal of a large one. Government assistance with appraisal costs for investment of less than £100k is a proposition which is often put forward as a measure of assistance which should be generally available. ECs would obviously take advantage of any general provision but an alternative, as a 'one off measure', would be to create special appraisal assistance for ECs in their first 3 years, in recognition of their obligations to invest in small businesses.

Limits for each appraisal might be set at the lower of 50% of the costs or 2% of the proposed investment plus an overall annual limit of 3% of LEC funds. EC would quickly become experts in apraising unquoted companies - initially assistance with training might be required. Government assistance with appraisals could be phased out after three years.

b) Marketability - always a problem with unquoted shares but EC would certainly be an improvement on present position. The expertise they will acquire, the profits made on successful companies moving up and their spread of risks would make their shares reasonably marketable.

5. Proposed Structure

a) Separate legal entity, ie. a limited company

b) Sources of Finance.

Equity - individuals, companies, institutions, others.

Loans - commercial sources and loans from equity investors.

Other - EC Regional/Social Funds, EIB, Local Authorities, NCB,

c) Incentives to Invest.

Individuals - tax relief as for present BES.

Companies - corporation tax relief on eligible investment restricted to the lower of a fixed sum - say £40,000 - or a percentage of profits - say 10%. Additional sums could be invested without relief.

Institutions and others - those within the UK tax net would receive the same tax relief as companies - other amounts would be raised on local social/economic/regional aid grouonds.

Loans from equity investors could be given a tax concession (interest only 50% taxable) to enable the EC to borrow on reasonable terms.

A reasonable period must be allowed to enable EC to invest sensibly - the present BES "mad scramble" before the tax year end does not always lead to good investment decisions. Suggested rules on investment by EC's are therefore that 50% of funds must be invested at the first balance sheet date and 75% at each succeeding balance sheet date.

d) Financing Businesses.

Investment (in an appropriate mix of equity and loan) to be made to small companies. EC should be allowed maximum freedom in packaging the finance they provide. They will need to be able to adapt to new circumstances and different situations. Freedom will encourage them to find new ways of providing finance.

Stand alone loans (without equity) should not be excluded. This might bring a new element of competition in leading to small companies which might in turn stimulate more innovation from the banks. EC would not be allowed to give overdrafts. Loans could also be made to unincorporated businesses (subject to constraints). These businesses do not of course have equity but similar risk/profit sharing could be achieved by allowing the interest charge to be linked to profit.

e) Local Involvement.

The limited company status will make the EC management accountable to its shareholders. As these will be largely local, a great deal of shareholder involvement could be expected. In particular local companies and institutions which have invested could be expected to provide advice, resources and staff on secondment.

6. Is there a need for EC?

Representations we receive (including reports from REU and SFS) highlight the following difficulties for small business in raising capital. The Peat Marwick Report on BES also highlighted similar problems which were not being successfully addressed by BES.

a) Companies have difficulty raising small amounts of capital (in particular equity capital) - say up to £150,000 (some say up to £250,000)

b) Companies/partnerships/sole traders all have difficulty raising suitable loan finance where repayments are geared to their future cashflow - eg deferment of capital repayment and flexibility in interest charges.

c) Outside London the bank is often the only source of funds.

d) Companies would like to be able to obtain a balanced package of loan and equity from the same supplier.

e) Businesses would like a continuing local contact with the provider of funds so they could refer back for further assistance if unforeseen problems/opportunities arise.

f) Successful local businesses/professions/institutions have a local pride and would like to assist business developments in their area. There is an element of self interest for them in developing local business prosperity. There is no mechanism through which to channel their efforts at present.

The enterprise company attempts to answer these questions.

7. Why will EC's invest in smaller local companies?

The question has to be asked as to what prevent EC moving 'up market' to larger (less risky) ventures outside the local area.

In paractice it would be extremely difficult to tie enterprise companies to a 'local' area by statute. This is neither necessary nor desirable. Local communities are already showing their desire for such a body in attempts to set up local BES Funds (which are not really) suitable for the job) and the success of such bodies as the West Yorkshire Enterprise Board.

ECs might develop in the same way as the bulding society movement where societies were set up locally with strong local roots but with the most successful (in the fullness of time) developing into strong national institutions. As long as they continue to meet the needs of small local business (as the law would demand) expansion by the more successful EC's should be welcomed.

a) The EC company constitution and the prospectus on which its shares are issued could lay down the criteria for investments in small local businesses (eg the company will follow the criteria laid down from time to time by the Chancellor of the Exchequer for defining an EC). Directors will be in breach of duty if this is not followed.

b) It is not necessary or desirable to attempt restriction by definition of local areas in the initial legislation. However the fact that an EC is incorporated in a local area, with local shareholders and (generally) local directors, will give it a local identity which will in practice bias it to local investments.

c) The difficulty and cost in appraising and controlling small investments from long distance will give commercial incentives to invest in businesses close to the EC management centres.

d) If ECs do not follow the rules on investing the appropriate amount in small companies they will lose the beneficial tax status. EC's would need to renew their approved status with Inland Revenue each year when their accounts are presented. The requirements for BES is that rules must be met for 5 years. A similar rule could apply for EC with a slight adjustment so that shareholders lost 20% of their tax relief in each of the following five years in which the criteria were not satisfied. Shareholder pressure would keep the directors in line.

Annex B

Appraisal Costs

The supply of small loans is inhibited by the costs of investment appraisal, which can be proportionately much greater for small than for large investments. Funding bodies are therefore encouraged to make fewer, larger loans. Many small firms have suggested that assistance with appraisal costs would help them in obtaining funds. BIS and BTAS provide precedents for providing similar assistane. A grant scheme could have the following features:

(i) it would be limited to Enterprise Companies and BES investments. This would limit the costs, encourage people to channel investment through these schemes and prevent abuse of the cost limits;

(ii) it would be limited to appraisals on investments under £100,000, so that help goes where it is most needed;

(iii) it would be limited to 55% of the cost of each appraisal up to a maximum of £2,500 or 4% of the proposed investment whichever is smaller - this ties in with current BIS limits;

(iv) to prevent an open-ended commitment of funding, the grant 'pool' could be subject to an overall annual amount [or BES grants could be, with individual ECs subject to an annual limit of 3% of their funds].

ANNEX C

'CHANCE IN A LIFE TIME'

Policies on enterprise concentrate on types of firm rather than individuals. Yet an essential part of spreading the enterprise culture is to increase individuals' knowledge and experience of running a business. The evidence is that the sons of self employed men are much more likely ($2\frac{1}{2}$ times more likely) than other people to enter self employment themselves. Encouraging more people now to try to run their own business will be a powerful effect in the future in encouraging a willingness and an awareness of enterprise.

One approach is to offer a package of assistance to anyone who wanted to set up a business but that package would only be available to them once in their life time.

The package might include enterprise training (eg. a one week self employment course), a voucher towards advice on finance or marketing, a tax holiday for the first two years and possibly free rates for the first year or two. This package would not be linked with any other scheme. People's 'rights' to the package would probably have to be through a separate administrative check based on the national insurance system. People who were already self employed would not be eligible.

The cost of such proposals depends on the number and value of such incentives and the coverage of the scheme. Based on the assumption of £200 training voucher, 2 years' exemption from income taxes, NIC and rates and assuming a 25% induced increase in self-employment, we have very provisionally estimated a cost of just over £1 billion. (The MSC Adult Training budget could be used to finance the training voucher.)

It would be possible to run this limited by region. This would reduce the costs very significantly; a scheme limited to the North might cost £50 million. This would also limit the aim of the scheme which is to fundamentally shift a cultural attitude.

[One extension to this approach could be a form of tax amnesty. This might include some level of forgiveness for the debts, arrangements for scheduling tax debt repayments, freedom from penalties, and help with understanding tax requirements and putting in new accounting systems. This could be a permanent scheme as part of the "chance in a lifetime" package.]

PPS Mr

Alex - I think these are with you.

FROM: M W Norgrove

DATE: 5 September 1986

MR B H KNOX - C&E

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Monger
Mr Scholar
Miss Sinclair
Mr Cropper
PS/Customs & Excise

PRE-BUDGET RESTRICTIONS

The Minister of State was grateful for your submission of 18 August. Subject to the Chancellor's views (given that this is a Budget related event) he is content with the six recommendations summarised at paragraph 3. The Minister has commented that the effect on importers helps us on tobacco.

MWN

M W NORGROVE
Private Secretary

SM2/39

1. ~~Mr Noss~~
2. PUP

FROM: CATHY RYDING
DATE: 8 SEPTEMBER 1986

PS/MINISTER OF STATE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Monger
Mr Scholar
Miss Sinclair
Mr Cropper

Mr Knox - C&E
PS/C&E

PRE-BUDGET RESTRICTIONS

The Chancellor has seen Mr Knox's minute to the Minister of State of 18 August.

2. The Chancellor had no objections to the 6 recommendations summarised in paragraph 3.

C.R

CATHY RYDING

1860/12

CONFIDENTIAL

PM 12/9

FROM: R PRATT
DATE: 10 September 1986

1. SIR PETER MIDDLETON
2. CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Cassell
Mr H Evans
Mrs Lomax
Mr D Moore
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Turnbull
Miss Sinclair
Mr Culpin
Mr Mowl
Miss O'Mara
Mr Dyer
Mr Cropper
Mr Ross Goobey
Mr Tyrie

PS/IR
PS/C&E
Mr Beighton (IR)
Mr Wilmott (C&E)
Mr Graham
(Parliamentary Counsel)

PRATT → CH/EX 10/9

Ch

OK for March 17 as first choice? (with March 10 & 24 as alternatives)?

AA

Agreed. I will take a final decision after the AS is out of the way. NL

DATE FOR THE 1987 BUDGET

I attach a note which, as is usual for this time of the year, sets out the considerations affecting next years Budget date.

2. Because Easter is very late next year, the choice is slightly different from that in the last two or three years. A post Easter Budget would be the latest for at least the last 15 years; would cause formidable Finance Bill problems and, therefore, virtually rules itself out. On the other hand, there are five serious possibilities for a pre-Easter Budget, ranging from 10 March to 7 April.

62

3. The disadvantages of having Budget day after the beginning of the financial year (as April 7 would be) or on the same day as a State visit (March 31) make the later two dates rather less attractive than 10 March, 17 March and 24 March. There is little to choose between these last three, but the earlier dates allow more flexibility for managing a truncated Finance Bill timetable in the event of a summer election and the later date gives time to assimilate information about the February PSBR figures into the drafting of the FSBR.

4. On balance March 17 - the equivalent date to Budget day in 1985 and 1986 - perhaps has the edge. While no final decision is necessary at this stage, it would be helpful for planning purposes if you were to let us know if you agree that,

(1) A post Easter budget can be ruled out;

(2) March 17 is the most attractive option in 1987, with March 10 and March 24 as alternatives.

Richard Pratt

RICHARD PRATT

1860/011

CONFIDENTIAL

THE DATE OF THE 1987 BUDGET

This note examines the options for the 1987 Budget date.

A Budget after Easter

Since Easter is very late next year (Sunday 19 April), the earliest day for a post Easter Budget would be Tuesday April 28. Apart from the post election Budget in 1979, we have not had a Budget as late as this for at least 15 years, (see Annex A) and the difficulties it would present for the Finance Bill management would be formidable. Annex B shows illustrative Finance Bill timetables. An April 28 Budget day would require advance security printing of the Finance Bill, and a later end to Standing Committee than in any year since at least 1971. These and the other disadvantages of a post Easter Budget (paragraph 3 below), appear to outweigh the advantage that would be gained by greater knowledge of the PSBR outturn for 1986-87. This option therefore looks a very doubtful starter for 1987.

Budget day before Easter

2. The late Easter expands the range of possible pre Easter dates, with any of the 5 weeks between March 10 and April 7 serious possibilities (April 14 would not leave time for Budget debates before the recess). As Annex B shows there are no real Finance Bill management problems with any of these dates.

3. The general arguments for the earlier or later of these dates are well rehearsed. An early Budget gives more time for preparing the Finance Bill and for managing its passage through Parliament. It brings forward the impact of tax changes - whether income tax cuts on pay packets, or excise duties on Government receipts. (It is helpful for income tax changes to be made before the beginning of the tax year as otherwise deductions at source from interest and ACT on dividends are collected at the wrong rate for the first few weeks of the year). An early Budget also ensures that the Budget

(and post Budget work) is out of the way by Easter, or soon after. More specifically in 1987, the possibility of an election may add more weight to the arguments for an early Budget day in order to give more flexibility in managing a truncated Finance Bill procedure (in 1983, Budget day was on 15 March).

4. On the other hand, a later Budget allows more time for pre Budget planning and (depending on the precise timing) means that more information may be available about the February outturns for public finances , as well as about RPI and money supply. Annex C shows how the dates on which we have this information compare with the deadlines for Budget decisions. And one further factor for 1987 is that a later Budget Day allows more flexibility in setting the date for a January (or even early February) privatisation, without running in to disclosure problems.

5. We also need to bear in mind a State visit from 31 March to 3 April, and the possibility of international engagements, particularly IMF, in April.

The Options Considered

6. Although an April 7 Budget day would come after our first internal estimate of the 1986-87 CGBR, there would be no time to make more than minor changes to the FSBR, and no opportunity to alter any tax measures. There is thus little practical advantage to set against the disadvantages of such a late Budget which would fall after the beginning of the financial year, and could result in the usual TCSC enquiry etc interfering with international commitments.

7. March 31 offers little advantage over March 24. The 31st would allow more time to assimilate the figures for the February PSBR, money numbers GDP growth and RPI. However in practice, it is highly unlikely that any of these figures would prompt changes in Budget decisions, while for both a 24th and a 31st Budget Day, there would be time to take account of them in the Budget documentation (see

Annex C). Since March 31 suffers from the general disadvantage of later Budgets and happens to fall on the first day of a State visit (requiring the Prime Minister and other Ministers' attendance) it is perhaps less attractive an option.

8. There is little to choose between the remaining three dates - 10, 17 and 24 March. March 10 would be early by historical standards; would shave a week off this year's pre Budget planning period, and would allow no real knowledge of the February PSBR before Budget day. But it would give the maximum flexibility in managing a truncated Finance Bill timetable in the event of a election. The converse applies to March 24.

9. With a March 17 Budget, the February PSBR figures would be published on Budget Day (as was the case this year), whereas the end February money figures would not be published until a few days later (in previous years, the mid-February Banking month figures would have been available). The GDP growth figures would also be published later that week. This combination would mean that the Budget documents would be finalised in the light of knowledge of the February PSBR figures but not the February money figures or GDP growth. The latter might, when published differ from the figure in the FSBR. Moreover the money supply targets table in the FSBR would have to show figures for end-January rather than end-February. None of these points are of any great weight but they need to be borne in mind.

10. On balance, March 17 - the equivalent date to the Budget Days in 1985 and 1986 - seems the safest bet.

FISCAL POLICY GROUP

ANNEX A

YEAR	EASTER SUNDAY	BUDGET DAY	BILL PUBLISHED	2ND READING	COMMITTEE: WHOLE HOUSE		COMMITTEE: STANDING		REPORT		3RD READING	LORDS	PAGES		DAYS BUDGET TO 3RD READING	COMMENTS
					BEGAN	DAYS	DAYS	ENDED	BEGAN	DAYS			BILL	ACT		
1971	11 APR	30 MAR	20 APR	28 APR	11 MAY	4	7	21 JUN	5 JUL	3	7 JUL	21 JUL	119	130	99	
1972	1 APR	21 MAR	11 APR	20 APR	9 MAY	6	15	28 JUN	10 JUL	3	19 JUL	26 JUL	204	223	120	
1973	22 APR	6 MAR	23 MAR	2 APR	10 APR	2	7	23 MAY	10 JUL	1	11 JUL	24 JUL	92	116	127	
1974	14 APR	26 MAR	26 APR	9 MAY	16 MAY	5	8	2 JUL	16 JUL	3	22 JUL	30 JUL	93	122	118	POST-ELECTION
1974	—	12 NOV	10 DEC	17 DEC	15 JAN (1975)	3	12	18 FEB (1975)	4 MAR (1975)	4	10 MAR (1975)	13 MAR (1975)	130	157	108	WINTER BUDGET
1975	30 MAR	15 APR	29 APR	8 MAY	15 MAY	3	8	3 JUL	16 JUL	2	17 JUL	31 JUL	110	122	93	
1976	18 APR	6 APR	15 APR	3 MAY	11 MAY	3	13	1 JUL	13 JUL	3	19 JUL	27 JUL	144	179	105	
1977	10 APR	29 MAR	19 APR	28 APR	9 MAY	3	8	23 JUN	14 JUL	3	25 JUL	28 JUL	78	88	128	
1978	26 MAR	11 APR	20 APR	27 APR	8 MAY	3	10	27 JUN	5 JUL	4	13 JUL	31 JUL	91	108	93	
1979	—	12 JUN	21 JUN	27 JUN	3 JUL	5	—	—	18 JUL	1	18 JUL	24 JUL	22	22	36	POST-ELECTION
1980	6 APR	26 MAR	17 APR	8 MAY	2 JUN	3	10	3 JUL	16 JUL	2	17 JUL	31 JUL	142	176	113	
1981	19 APR	10 MAR	3 APR	13 APR	30 APR	5	11	30 JUN	14 JUL	3	20 JUL	24 JUL	195	218	132	
1982	11 APR	9 MAR	26/30 MAR	6 APR	22 APR	4	11	24 JUN	12 JUL	2	13 JUL	20 JUL	189	256	126	
1983	4 APR	15 MAR	31 MAR	14 APR	25 APR	4	—	—	—	—	11 MAY	12 MAY	164	79	56	PRE-ELECTION
1984	22 APR	13 MAR	29 MAR	10 APR	30 APR	3	13	26 JUN	10 JUL	2	11 JUL	25 JUL	223	262	120	
1985	7 APR	19 MAR	16 APR	29 APR	7 MAY	2	9	18 JUN	9 JUL	2	10 JUL	23 JUL	199	242	113	
1986	30 MAR	18 MAR	16 APR	29 APR	6 MAY	2	10	19 JUN	8 JUL	2	17 JUL	25 JUL	200	265	121	

BUDGET OPTIONS 1987

ANNEX . B.

	(1) 10/3/87	(2) 17/3/87	(3) 24/3/87	(4) 31/3/87	(5) 7/4/87	(6) 28/4/87
BUDGET DAY.	10	17	24	31	7	28
BILL TO HOUSE.	27	3	9	24.	24.	8
BILL PUBLISHED.	3	10	16	1	1	15
2nd READING.	13	28	5	11	11	1
COMMITTEE OF WHOLE HOUSE.	27 – 29	11 – 13	11 – 13	18 – 20	18 – 20	8 – 10
STANDING COMMITTEE.	5 – 25, 29 – 9	19. – 23.	19. – 23.	2. – 30.	2 – 30	16 – 9
REPORT STAGE + 3rd READING.	23. – 24.	7 – 8	7 – 8	14 – 15	14 – 15	23. – 24.
HOUSE OF LORDS.	21	21	23	23	23	27

MARCH: 2, 9, 16, 23, 30

APRIL: 6, 13, 20, 27

MAY: 4, 11, 18, 25

JUNE: 1, 8, 15, 22, 29

JULY: 6, 13, 20, 27

AUGUST: 3, 10

EASTER RECESS (17 – 24)

BANK HOLIDAY.

WHITSUN RECESS (25 – 29)

ANNEX C.

DEADLINES FOR BUDGET DECISIONS ON TAX RATES.

	DATES FOR KEY STATISTICS.	BUDGET DAY 10 MARCH 1987	BUDGET DAY 17 MARCH 1987	BUDGET DAY 24 MARCH 1987	BUDGET DAY 31 MARCH 1987	BUDGET DAY. 7 APRIL 1987.
FEBRUARY						
17		VAT + MOST EXCISE.				
18						
19						
20						
21						
22						
23						
24		INCOME TAX BASIC RATE.	VAT + MOST EXCISE.			
25						
26						
27						
28						
MARCH 1						
2		INCOME TAX ALLOWANCE	INCOME TAX BASIC RATE.			
3	CGBR - 1st ESTIMATE (FEBRUARY)			VAT + MOST EXCISE.		
4						
5						
6		FSBR FINAL DRAFT.				
7						
8						
9			INCOME TAX ALLOWANCE	INCOME TAX BASIC RATE.		
10	PSBR - PROV. ESTIMATE (FEBRUARY).	BUDGET DAY.			VAT + MOST EXCISE.	
11	RPI - KNOWN IN HMT					
12	PSBR - FIRM ESTIMATE (FEBRUARY)					
13	RPI - PUBLISHED.		FSBR FINAL DRAFT.			
14						
15						
16				INCOME TAX ALLOWANCE	INCOME TAX BASIC RATE	VAT + MOST EXCISE
17	PSBR - PUBLISHED (FEBRUARY)		BUDGET DAY.			
18						
19	PROV. MONEY					
20				FSBR FINAL DRAFT.		
21						
22						
23					INCOME TAX ALLOWANCE	INCOME TAX BASIC RATE
24				BUDGET DAY.		
25						
26						
27					FSBR FINAL DRAFT.	
28						
29						
30	FULL MONEY.					INCOME TAX ALLOWANCE
31					BUDGET DAY.	
APRIL. 1						
2	CGBR - 1st ESTIMATE (MARCH).					FSBR FINAL DRAFT.
3						
4						
5						
6						BUDGET DAY
7						

LD/121

CONFIDENTIAL

PWP

FROM: A C S ALLAN
DATE: 16 SEPTEMBER 1986

ALLAN → PRATT 16/9

MR PRATT

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Sir G Littler
Mr F E R Butler
Mr Cassell
Mr Evans
Mrs Lomax
Mr Moore
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Turnbull
Miss Sinclair
Mr Culpin
Mr Mowl
Miss O'Mara
Mr Dyer
Mr Cropper
Mr Ross Goobey
Mr Tyrie

PS/IR
PS/C&E
Mr Beighton - IR
Mr Wilmott (C&E)
Mr Graham
(Parliamentary Counsel)

DATE FOR THE 1987 BUDGET

The Chancellor has seen your minute of 10 September and agrees that a post-Easter Budget can be ruled out; and that 17 March is the most attractive option, with 10 March and 24 March as alternatives.

ACSA

A C S ALLAN

Papers please

FROM: R PRATT
DATE: 18 SEPTEMBER 1986

PRATT → ALLAN 18/9

MR A C S ALLAN

cc Mr Scholar

DATE FOR THE 1987 BUDGET

Now that the Chancellor has agreed that we should aim for 17 March 1987 for next year's Budget, the next step is for you to write to No 10.

... 2. I attach a draft letter.

Richard Pratt
RICHARD PRATT

Ch
OK to write

Ch
OK?
AA

best hold for time being then spoken

1-47

Plea type for Alex's sig

DRAFT LETTER FROM MR ALLAN TO:

David Norgrove Esq
Private Secretary
No 10 Downing Street
LONDON SW1

DATE OF THE 1987 BUDGET

The Prime Minister may wish to be aware that the Chancellor is aiming to present his Budget on 17 March next year. However, ~~It~~ it is not yet possible to make a final decision~~, of course,~~ and ~~for the moment,~~ the 10th and 24th March are still possible alternative dates. As you know, we normally announce the date of the Budget during the first business questions in the New Year.

A C S ALLAN
~~[ACSA]~~
Principal Private Secretary

FROM: M C SCHOLAR
DATE: 19 SEPTEMBER 1986

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir Peter Middleton
Mr Byatt
Mr Cassell
Mr Monck
Miss Sinclair
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Battishill - IR
Sir A Fraser - C&E

TAX: FORWARD PLANNING: MEETING ON 22 SEPTEMBER

... I attach, as you requested, an annotated agenda for Monday's meeting, which has been prepared with help from the Revenue Departments.

2. I suggest that the purpose of the meeting should be to take stock of progress since your meeting on 29 July, and, avoiding where possible detailed consideration of any individual issues, to identify areas in which you would like more work done, and areas in which no more work is required at present. I have included on the agenda all the items - with one exception (see below) - on which your July meeting sought further work, even where in the time available since then further papers then promised are not yet ready.

3. I think that it will be helpful on Monday, in order to maintain the momentum of the work, if a rough date can be identified, in the case of each item, by which the next stage in the process is to be ready. Where possible I have built this into the annotated agenda. It will also be helpful to be clear in each case which of your Ministerial colleagues has responsibility for pursuing the matter; again I have included an indication in the agenda.

4. The agenda does not include anything on APRT, since any action here would be taken in the autumn rather than in the Budget. The interdepartmental working party is still expected to report by the end of the month.

MCS

M C SCHOLAR

SECRET

Tax: Forward Planning

Annotated agenda

1. **Abolition of taxes**

(Mr Monger of 4 September: paragraph references shown seriatim below)

(a) decide now not to abolish (this year):

paragraphs 5-7	VED (but think further about a switch from VED to derv, see item 15 below)
8-10	Car tax (to recoup £1.1 bn loss revenue through petrol taxation increase of 20p per gallon needed; or £50 increase in VED)
12	Heavy Fuel Oil (because of the Frigg effect)
13	Gas oil (increased last year)
14	LPG and aviation gasoline (to protect petrol duty yield by discouraging substitution)
24	Stamp duty (see also item 10 below) - cost £1520m (or £650m if shares only)
26	Life assurance policy duty (yield £65m) (see also items 6(ii) and 14 below on insurance taxation issues)
28	Income tax additional rate (protecting higher rate income tax yield by eliminating the incentive to shelter income in trusts)
29	Income tax Schedule B on woodlands
33-34	Any elements in corporation tax or inheritance tax
3,23	The rest - ie major oil duties, all main direct taxes etc

(b) Do we wish to pursue abolition of:

15	Bingo duty (yield £60m)
16-20	On-course betting duty (yield £20m)
21	Matches and Mechanical lighters (yield £10m each)
25	Capital duty (yield £150m) and unit trust duty (yield £30m)
30-32	Capital gains tax (see also item 3(i) below) - assimilation with income tax

2. **<u>US/G5 tax reform - general issues</u>**

(Paper from Washington - Mr R I G Allen's letter of 17 September, Mr Johns of 19 September, and Mr Scholar of 19 September)

Do these papers suggest any themes worth pursuing which are not raised specifically elsewhere in this annotated agenda?

3. **<u>Capital Gains Tax</u>**

(i) **<u>Reform of CGT</u>**

(Mr Cayley of 17 September under cover of Mr Isaac of 17 September)

Examines options for integration of CGT with income tax and removal of indexation. Do Ministers wish to pursue any of these possibilities? (FST)

(ii) **<u>Capital losses for groups</u>**

IR will submit paper in early October - on question whether there should be legislation to provide group relief for capital losses and counter capital loss buying. (FST)

(iii) **<u>Disincorporation</u>**

Should there be legislation to ease tax rules for disincorporation? IR will submit paper in early October. (FST)

(iv) **<u>Venture Capital</u>**

IR are exploring with BVCA the tax consequences of setting up onshore venture capital funds. A further meeting will be held at the start of October after which IR will report to Ministers. (FST)

4. **<u>Income Tax Issues</u>**

(i) **<u>Minimum Tax</u>**

(Mr Isaac 30 January 1986)

This is a starter for 1987, with a more selective list of tax shelters than in 1986. IR conducting a survey of higher paid taxpayers to determine what use is made of tax shelters. Consultation will probably be necessary; paper coming forward in October. (FST)

(ii) **Tax relief for personal employees**

(Mr Isaac of 20 August, Chancellor of 29 August, Chief Secretary of 5 September, Minister of State of 8 September, Mr Cropper of 5 September)

- Do the disadvantages in terms of tax principle, practical anomalies and revenue and administrative cost outweigh the gains to employment?
- Would this be a cost-effective measure against the black economy? (FST)

(iii) **Child Care Allowance**

(Chancellor of 29 August; Mr Mace of 19 September; ~~IR paper [by weekend]~~)

- What would be the aims of the relief?
- Would the likelihood of achieving them outweigh the substantial revenue and administrative costs and the danger of increasing pressure for further reliefs for work-related personal expenditure? (FST)

(iv) **Mortgage Interest Relief**

IR, on a contingent basis, are preparing a paper on timing, implementation etc constraints on:

- restriction of relief to the basic rate;
- restriction of the relief to the residence, not the individual

as a possible quid pro quo for an increase in mortgage interest relief ceiling.

Paper expected last week in September. (FST)

(v) **Benefits-in-kind - £8,500 threshold**

IR paper in preparation

Abolition of threshold means extra revenue, but higher staff and compliance costs. Raising threshold could bring worthwhile staff and compliance savings, but at a revenue cost. Decided last year to continue existing policy of allowing threshold to "wither on the vine". Has the balance of the advantages and disadvantages changed, and can the threshold be abolished for car and fuel benefits only? (FST)

(vi) **Maintenance Payments**

Suggestion that maintenance payments might be made tax-neutral would produce staff savings. But could have significant distribution effects. Revenue paper now being prepared. (FST)

(vii) **Composite Rate Tax**

(Mr O'Connor 16 July)

Personal Pensions free standing AVCs

Existing preceding year basis introduced at the request of the banks to ensure that rates were known in advance. Building Societies now concerned that a substantial basic rate cut could leave too narrow a margin between composite rate and basic rate. IR paper shortly, via EST.

5. **Pensions**

Tax regime for new personal pensions being designed - inter-departmental working group (Revenue, Treasury, DHSS, Government Actuary). (Messrs Corlett and Munro of 30 July)

- timing acceptable: submission round end of October with view to consultation document in November?
- need to have clear position on free standing Additional Voluntary Contributions (AVCs) before consultative document issued (via FST).

6. **Business Tax issues**

Habitat

(i) **Payment dates**

(Mr Reed of 2 September, Chancellor of 8 September, FST of 15 September)

Avoidance by delaying date when CT becomes payable (eg Habitat case). Further submission shortly. (FST)

(ii) **Life Assurance Companies**

Agreed 29 July meeting major reforms probably for next Parliament. Only limited measures possible for 1987 Bill. Submission in October will cover both long-term reform and possible candidates for 1987. (FST)

(iii) **Pre trading R & D**

Discussions between IR and DTI in progress. Report to Ministers due end October/early November. (FST)

7. **International**

(i) **International (General)**

Potential revenue-raising measures on international side in CT sector. Review underway - IR paper in early October. (FST)

(ii) **Dual Resident Companies**

A device enabling a company to get a deduction for one loss in two countries - usually US/UK. Possibility of legislation in 1987. Last submission to the FST 7 August 1986. Further submission shortly. (FST)

8. **Lloyds**

(Mr Spence of 30 January 1986, 6 and 14 August, EST of 13 August, Mr Cropper of 9 September, Mr Allan of 11 September)

Revenue (Mr Spence of 6 August) reported on discussions with Lloyds for new tax arrangements, treating syndicates rather than names as the tax unit. Mr Cropper has suggested delaying changes, on political grounds, until after the General Election. Decision required soon if to be included in 1987 Finance Bill. Revenue submission by end October will set out options and assess consequences of deferring legislation beyond 1987. (EST)

9. **Keith**

(Mr Corlett of 3 July)

- Is it accepted that Inland Revenue Keith cannot be implemented in full in 1987?
- If so, does the division into more manageable packages - A, B and C make sense?
- Should full consultative document (including draft clauses) still be published in November?
- Should it give an indication of what might be in 1987 Finance Bill?
- Should this be package A (including pay and file)? Or should it be cut down to pay and file plus directors' fees? (EST)

10. **Stamp Duty Issues**

- Is it agreed that no further structural changes be introduced this year, to allow Reserve Tax to settle down?
- Leave open possibility of rate or threshold changes?
- If life assurance duty to be retained (see 1) do we want to consider exempting re-insurance?

- 31 day rule covered in Mr Draper's minute of 12 September

Removal of stamp duty on PEPs

- Would mean that investment in PEPs could be completely tax free
- feasible, but could be expensive in terms of revenue foregone. Some administrative cost for Revenue
- Implications for plan managers' systems would need to be considered. (EST)

11. **Charities**

(Mr Corlett of 27 June, 19 September)

No concessions on VAT and charities, although there could be an increase in the ceiling for payroll giving.

How are arrangements going for further consultations with charity movement? (FST)

12. **Profit related pay**

- Consultation ends 17 October - many responses still to come.
- Is it too early for a preliminary view on
  - whether tax relief should go ahead
  - if so, whether any major change is necessary to scheme outlined in Green Paper
  - if not, what policy stance on PRP should there be? (MST)

13. **Credit Card Tax**

(Mr Norgrove of 15 September, Mr Allan of 17 September and Mr Wilmott of 19 September)

- Tax on credit cards (including charge cards) considered in run-up to 1986 Budget but not pursued. Yield figures being revised, but unlikely to exceed £100 million (1% on turnover), £45 million (10p on each transaction) or £20 million (10p on each monthly account).
- Case for looking again at wider tax on consumer credit considered in 1984 but postponed till next Parliament, largely because of time-lag in revenue yield. (A ½% duty would yield about £100m in a full year, ie perhaps in 1988-89, if mortgages were excluded, and £350m if they were included). (MST)

14. **Insurance Premium Tax**

(Mr Knox of 27 August, Mr Norgrove of 1 September, Mr Wilmott of 15 September, Mr Allan of 17 September)

Are the attractions of this tax - eventual yield (NB low initial yield), low rpi effect, insurance a relatively lightly taxed sector - outweighed by the problems - effect on business, need to apply to existing contracts, avoidance?

Is further work required? May the DTI be consulted? If so should Customs report further, say, by end October (via MST)?

15. **Switch from VED to derv for lorries**

(Mr Romanski and S of S Transport of 31 July, Chancellor of the Exchequer of 4 August, S of S Transport of 8 August, Mr Romanski of 20 August, MST of 28 August, Chancellor of the Exchequer of 28 August)

For 1987, it is proposed to switch the balance of lorry taxation from VED to derv. While there may be a small shift from car VED to petrol, the outcome will be to diminish the differential between derv and petrol duties.

S of S Transport proposes £100m shift (approximately 22 per cent of total lorry VED revenue and equivalent to a derv pump price rise of 6.5p per gallon) and is concerned that too great a shift will reduce flexibility to align total lorry taxation with road track cost.

Officials are working on the maximum size of the shift. Further submission in October/November. (MST)

SECRET

FROM: M C SCHOLAR
DATE: 19 SEPTEMBER 1986

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir Peter Middleton
Mr Byatt
Mr Cassell
Mr Monck
Miss Sinclair
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Battishill - IR
Sir A Fraser - C&E

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SECRET

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33-34	Any elements in corporation tax or inheritance tax
3,23	The rest - ie major oil duties, all main direct taxes etc

(b) Do we wish to pursue abolition of: worth looking @.

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16-20	On-course betting duty (yield £20m)
21	Matches and Mechanical lighters (yield £10m each) X look @ again.
25	Capital duty (yield £150m) and unit trust duty (yield £30m)
30-32	Capital gains tax (see also item 3(i) below) - assimilation with income tax

Class IV NI
self employed

2. **US/G5 tax reform - general issues**

(Paper from Washington - Mr R I G Allen's letter of 17 September, Mr Johns of 19 September, and Mr Scholar of 19 September)

Do these papers suggest any themes worth pursuing which are not raised specifically elsewhere in this annotated agenda?

3. **Capital Gains Tax**

(i) **Reform of CGT**

(Mr Cayley of 17 September under cover of Mr Isaac of 17 September)

Examines options for integration of CGT with income tax and removal of indexation. Do Ministers wish to pursue any of these possibilities? (FST)

(ii) **Capital losses for groups**

IR will submit paper in early October - on question whether there should be legislation to provide group relief for capital losses and counter capital loss buying. (FST) Ch NA s boss mover.

(iii) **Disincorporation**

Should there be legislation to ease tax rules for disincorporation? IR will submit paper in early October. (FST) ? consultative note la 87 legislation.

(iv) **Venture Capital**

IR are exploring with BVCA the tax consequences of setting up onshore venture capital funds. A further meeting will be held at the start of October after which IR will report to Ministers. (FST)

4. **Income Tax Issues**

(i) **Minimum Tax**

(Mr Isaac 30 January 1986)

This is a starter for 1987, with a more selective list of tax shelters than in 1986. IR conducting a survey of higher paid taxpayers to determine what use is made of tax shelters. Consultation will probably be necessary; paper coming forward in October. (FST)

(ii) **Tax relief for personal employees**

(Mr Isaac of 20 August, Chancellor of 29 August, Chief Secretary of 5 September, Minister of State of 8 September, Mr Cropper of 5 September)

- Do the disadvantages in terms of tax principle, practical anomalies and revenue and administrative cost outweigh the gains to employment?
- Would this be a cost-effective measure against the black economy? (FST)

(iii) **Child Care Allowance**

(Chancellor of 29 August; Mr Mace of 19 September; IR paper [by weekend])

- What would be the aims of the relief?
- Would the likelihood of achieving them outweigh the substantial revenue and administrative costs and the danger of increasing pressure for further reliefs for work-related personal expenditure? (FST)

(iv) **Mortgage Interest Relief**

IR, on a contingent basis, are preparing a paper on timing, implementation etc constraints on:

- restriction of relief to the basic rate;
- restriction of the relief to the residence, not the individual

as a possible quid pro quo for an increase in mortgage interest relief ceiling.

Paper expected last week in September. (FST)

(v) **Benefits-in-kind - £8,500 threshold**

IR paper in preparation Wither.

Abolition of threshold means extra revenue, but higher staff and compliance costs. Raising threshold could bring worthwhile staff and compliance savings, but at a revenue cost. Decided last year to continue existing policy of allowing threshold to "wither on the vine". Has the balance of the advantages and disadvantages changed, and can the threshold be abolished for car and fuel benefits only? (FST)

(vi) **Maintenance Payments**

Suggestion that maintenance payments might be made tax-neutral would produce staff savings. But could have significant distribution effects. Revenue paper now being prepared. (FST)

(vii) **Composite Rate Tax**

(Mr O'Connor 16 July)

Existing preceding year basis introduced at the request of the banks to ensure that rates were known in advance. Building Societies now concerned that a substantial basic rate cut could leave too narrow a margin between composite rate and basic rate. IR paper shortly, via EST.

5. **Pensions**

Tax regime for new personal pensions being designed - inter-departmental working group (Revenue, Treasury, DHSS, Government Actuary). (Messrs Corlett and Munro of 30 July)

- timing acceptable: submission round end of October with view to consultation document in November?
- need to have clear position on free standing Additional Voluntary Contributions (AVCs) before consultative document issued (via FST).

6. **Business Tax issues**

(i) **Payment dates**

(Mr Reed of 2 September, Chancellor of 8 September, FST of 15 September)

Avoidance by delaying date when CT becomes payable (eg Habitat case). Further submission shortly. (FST)

(ii) **Life Assurance Companies**

Agreed 29 July meeting major reforms probably for next Parliament. Only limited measures possible for 1987 Bill. Submission in October will cover both long-term reform and possible candidates for 1987. (FST)

(iii) **Pre trading R & D**

Discussions between IR and DTI in progress. Report to Ministers due end October/early November. (FST)

7. **International**

(i) **International (General)**

Potential revenue-raising measures on international side in CT sector. Review underway - IR paper in early October. (FST)

(ii) **Dual Resident Companies**

A device enabling a company to get a deduction for one loss in two countries - usually US/UK. Possibility of legislation in 1987. Last submission to the FST 7 August 1986. Further submission shortly. (FST)

8. **Lloyds**

(Mr Spence of 30 January 1986, 6 and 14 August, EST of 13 August, Mr Cropper of 9 September, Mr Allan of 11 September)

Revenue (Mr Spence of 6 August) reported on discussions with Lloyds for new tax arrangements, treating syndicates rather than names as the tax unit. Mr Cropper has suggested delaying changes, on political grounds, until after the General Election. Decision required soon if to be included in 1987 Finance Bill. Revenue submission by end October will set out options and assess consequences of deferring legislation beyond 1987. (EST)

9. **Keith**

(Mr Corlett of 3 July)

- Is it accepted that Inland Revenue Keith cannot be implemented in full in 1987?
- If so, does the division into more manageable packages - A, B and C make sense?
- Should full consultative document (including draft clauses) still be published in November?
- Should it give an indication of what might be in 1987 Finance Bill?
- Should this be package A (including pay and file)? Or should it be cut down to pay and file plus directors' fees? (EST)

10. **Stamp Duty Issues**

- Is it agreed that no further structural changes be introduced this year, to allow Reserve Tax to settle down?
- Leave open possibility of rate or threshold changes?
- If life assurance duty to be retained (see 1) do we want to consider exempting re-insurance?

- 31 day rule covered in Mr Draper's minute of 12 September

Removal of stamp duty on PEPs

- Would mean that investment in PEPs could be completely tax free
- feasible, but could be expensive in terms of revenue foregone. Some administrative cost for Revenue
- Implications for plan managers' systems would need to be considered. (EST)

11. **Charities**

(Mr Corlett of 27 June, 19 September)

No concessions on VAT and charities, although there could be an increase in the ceiling for payroll giving.

How are arrangements going for further consultations with charity movement? (FST)

12. **Profit related pay**

- Consultation ends 17 October - many responses still to come.
- Is it too early for a preliminary view on
  - whether tax relief should go ahead
  - if so, whether any major change is necessary to scheme outlined in Green Paper
  - if not, what policy stance on PRP should there be? (MST)

13. **Credit Card Tax**

(Mr Norgrove of 15 September, Mr Allan of 17 September and Mr Wilmott of 19 September)

- Tax on credit cards (including charge cards) considered in run-up to 1986 Budget but not pursued. Yield figures being revised, but unlikely to exceed £100 million (1% on turnover), £45 million (10p on each transaction) or £20 million (10p on each monthly account).
- Case for looking again at wider tax on consumer credit considered in 1984 but postponed till next Parliament, largely because of time-lag in revenue yield. (A ½% duty would yield about £100m in a full year, ie perhaps in 1988-89, if mortgages were excluded, and £350m if they were included). (MST)

14. **Insurance Premium Tax**

(Mr Knox of 27 August, Mr Norgrove of 1 September, Mr Wilmott of 15 September, Mr Allan of 17 September)

Are the attractions of this tax - eventual yield (NB low initial yield), low rpi effect, insurance a relatively lightly taxed sector - outweighed by the problems - effect on business, need to apply to existing contracts, avoidance?

Is further work required? May the DTI be consulted? If so should Customs report further, say, by end October (via MST)?

15. **Switch from VED to derv for lorries**

(Mr Romanski and S of S Transport of 31 July, Chancellor of the Exchequer of 4 August, S of S Transport of 8 August, Mr Romanski of 20 August, MST of 28 August, Chancellor of the Exchequer of 28 August)

For 1987, it is proposed to switch the balance of lorry taxation from VED to derv. While there may be a small shift from car VED to petrol, the outcome will be to diminish the differential between derv and petrol duties.

S of S Transport proposes £100m shift (approximately 22 per cent of total lorry VED revenue and equivalent to a derv pump price rise of 6.5p per gallon) and is concerned that too great a shift will reduce flexibility to align total lorry taxation with road track cost.

Officials are working on the maximum size of the shift. Further submission in October/November. (MST)

DATE FOR THE 1987 BUDGET

MR 1/2

CONFIDENTIAL

ALLAN → CULPIN 23/9

[Minrs & advisers relaxed, but left that here RC's [illegible]]

DATE: A C S ALLAN

FROM: 23 SEPTEMBER 1986

MR CULPIN

cc: Mr Scholar
Mr Pratt

DATE FOR THE 1987 BUDGET

The Chancellor has realised that the provisional date for the 1987 Budget, March 17, is St Patrick's day! He is slightly concerned about whether this would lead to all sorts of unnecessary and unwanted stories. He will be raising it with Ministers and advisors at prayers tomorrow, but would be grateful for any comments you may have.

ACSA

A C S ALLAN

Alex

1987 BUDGET

You may wish to know that Buckingham Palace now say that there will be a State Visit on 24-27 March next year. This is a change to their original view and may affect the Chancellor's thinking on the date of the Budget.

not [illegible]

D

24/9

674/40

CONFIDENTIAL

FROM: ROBERT CULPIN
DATE: 24 SEPTEMBER 1986

CHANCELLOR

cc Mr Scholar-or
Mr Pratt

DATE FOR THE 1987 BUDGET

I can think of worse subjects for jokes than St Patrick's Day. So I would not change your provisional decision on that account. Indeed, there is some small advantage in being able to predict what the silly stories will be.

2. I wondered if there might be a security worry. But, touch wood, I don't think St Patrick's has been a day for IRA "troubles".

R

ROBERT CULPIN

Ch

OK to write to No 10 now?

AA

yes

CONFIDENTIAL

MR 4/35

COVERING SECRET

PWP

FROM: A P HUDSON

DATE: 25 SEPTEMBER 1986

MR SCHOLAR

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Monck
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Ross Goobey
Mr Battishill - IR
Mr Isaac - IR
Sir A Fraser - C&E

TAX : FORWARD PLANNING

I attach the note of the meeting on 22 September.

2. Your minute of 19 September suggested that it would be helpful to set a date for the next stage in the preparation of each item, and also to decide which Minister should be in the lead. The Chancellor did ask for papers to come up as early as possible, but very few specific dates were set.

3. Could I ask you, in conjunction with the Revenue departments, to draw up a timetable setting out when the different issues are expected to come to Ministers, when decisions will be needed on, for example, matters requiring consultation, and suggesting which Minister should be in the lead? This should help Ministers and officials to plan their work over the next few months.

C.R.

PP A P HUDSON

NOTE OF A MEETING HELD IN HM TREASURY
ON 22 SEPTEMBER 1986

Present: Chancellor
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Mr Battishill - IR
Mr Isaac - IR

Sir A Fraser - C&E

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1. The meeting followed the annotated agenda attached to Mr Scholar's 19 September minute.

2. The Chancellor said that he was grateful for the work done so far. He asked that further papers should come up as early as possible. This should save work, as items were ruled out.

ABOLITION OF TAXES

General

3. The Chancellor said that he did not want to abolish any of the taxes listed in paragraph 1(a), except that he would like further work to be done on the tax treatment of woodlands.

Woodlands

4. The Chancellor said that he had always seen a strong case for abolishing Schedule B, but had encountered opposition from the Scottish Office. However, during his Scottish tour on 4-5 September, a number of people had argued that, while there needed to be tax relief for forestry, the present structure gave relief to the wrong people for the wrong type of trees on the land. There were also environmental arguments for changing the relief. In addition, one of the ways of cutting agricultural production might be to divert activity into woodlands, so there might be some small benefit on the CAP. The Chancellor saw no possibility of abolishing the relief, because long term investments had been made on the assumption that it would continue. The question was, could it be reformed to produce more sensible results, and so that the cost was certainly no greater and possibly less. He did not favour making tax relief dependent on approval of the planting. He asked the Revenue to take another look at the question.

Duties

5. Mr Tyrie suggested that it would be politically attractive to abolish VED, particularly on lorries. The Chancellor did not think this was feasible: abolition was too expensive, and VED was useful for policing purposes. Policy was already to switch the balance of lorry taxation from VED to derv, and the size of the switch this year would be decided nearer the Budget.

6. The Chancellor was against abolition of bingo duty.

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8. The Chancellor asked whether the duties on matches and mechanical lighters could be split, and, for example, the duty on matches retained but that on mechanical lighters abolished. Sir A Fraser said that this would be possible administratively, but might arouse the European Commission's interest in the matches duty. It might also lead to the closure of a match factory in Liverpool. Customs were consulting the DTI.

9. Sir P Middleton and Mr Cassell did not want to rule out the possibility of abolishing capital duty. The Chancellor agreed, but thought that there were likely to be better uses for the £150 million cost.

Class IV NIC

10. Mr Battishill raised the possibility of abolishing class IV NIC. This would be a simplification, and would save some 100 staff, though the cost would be £300 million. The Chancellor noted that this could not be done in a Finance Bill, though there was normally a Social Security Bill available. He agreed that this possibility should be explored, and said that the charge was absurd in principle.

US/G5 TAX REFORM - GENERAL ISSUES

11. There was no specific discussion of this item.

CAPITAL GAINS TAX

12. The Chancellor suggested leaving reform of CGT to the end of the meeting (see paragraphs 49-53).

13. On capital losses for groups, the Revenue would submit a paper in early October. There were two strands to the question:

(a) Until 2-3 years ago, companies engaged in a good deal of capital loss buying. This had been limited by the Ramsey and Dawson decisions. But more cases would soon be coming to the courts, which could change the position.

(b) At present, there was no statutory provision to give companies group relief on losses. In practice, most companies found ways of getting the relief. But industry was pressing for a statutory provision, and this was justified in principle.

Dealing with the issue could require 15 pages of legislation. The Chancellor commented that this did not look a strong runner.

14. On disincorporation, Mr Isaac explained that there had been some preliminary consultation, going beyond CGT issues. There was a lot of pressure for action, but no agreement on precisely what should be done. There might be a need for a consultative document. The Revenue would put up a note within a fortnight. Mr Battishill noted that the Deregulation White Paper had held out the prospect of action on this issue. The Chancellor asked for two options to be presented:

(a) the complete package requiring consultation;

(b) a more modest package which would not need consultation, and could therefore be ready for 1987.

15. The Chancellor said he hoped it would be possible to make progress on venture capital. The Financial Secretary reported that agreement had almost been reached with the industry.

INCOME TAX ISSUES

Minimum Tax

16. The Chancellor asked for the Revenue's submission to come forward as soon as possible. Mr Isaac reported that the results of the survey of higher paid taxpayers were just becoming available.

17. The Chancellor asked if a Minimum Tax rule should be introduced for companies as well. It would be useful to look at both possibilities together, on grounds of fairness, but he did not think that we had the same problems as the USA on the company side. Mr Battishill confirmed that the main tax shelters which the Americans were abolishing had never existed in this country. What problems there were had largely been removed by the 1984 reforms. The reason some profitable companies still paid very little tax was generally because of accumulated losses.

Tax relief for personal employees and Child Care allowance

18. The Chancellor said that these subjects raised a variety of different considerations. But the only option worth pursuing was the possibility of introducing a child care allowance as part of the Green Paper reforms. In retrospect, presenting this along with transferable allowances could have made it easier to sell the Green Paper proposals. The question now was how it could best be grafted on, either as a measure to pave the way for transferable allowances, or as a measure introduced in response to the consultation. The Chancellor noted that there would certainly have to be some statement about the outcome of the consultation. He might raise the possibility of a child care allowance with the

Prime Minister in a bilateral, since it might answer some of her doubts about transferable allowances. But this was not a starter for the next Budget.

19. Mr Isaac pointed out that a child care allowance could have a substantial staff cost. There would be difficult questions about which parent should claim the allowance, and whether it should be transferable. Mr Battishill said that it could resurrect arguments for full child tax allowances.

Mortgage interest relief

20. The Chancellor thought that both the possible measures - restricting the relief to the basic rate, and applying it to the residence - would have to apply to future mortgages only. He asked if this would clog the market. Mr Ross Goobey suggested that there could be a transitional period, and the Economic Secretary thought that a five year period would be sufficient to deal with most existing cases. The Chancellor asked that these points should be taken into account in the Revenue submission.

Benefits-in-kind

21. The Chancellor said that he had asked about the possibility of abolishing the £8,500 threshold for car and fuel benefits only because he thought it would be easier administratively. Mr Isaac confirmed that these benefits produced more tax for less work than the others, and were also easier for companies to handle. But abolishing the threshold would still mean extra costs for the Revenue and business.

22. The Chancellor said that the sensible thing was to continue to allow the threshold to "wither on the vine". He did not want to raise it, in spite of pressure from the Deregulation Unit in this area. Employers could easily get round the compliance costs by replacing benefits with higher salary payments.

Maintenance payments

23. The Chancellor said that the key question here was the distributional effects. If these were acceptable, he would want to take action. He asked if it would be possible to make the decision at a late stage, since the impact of the distributional effects would depend in part on other measures in the Budget.

Composite rate tax

24. The Economic Secretary said that if there was a substantial reduction in the basic rate, there would be a case for a shorter time lag before it fed through into the composite rate. The Chancellor thought this could lead to a big complication to deal with what was simply a transitional problem, and was not sympathetic to making a change.

PENSIONS

25. The Chancellor asked that all pension issues should be brought together in the report of the group chaired by Mr Corlett. If the proposal for free-standing AVCs was to be resisted, all the arguments would have to be exposed. It was very important that Treasury and Revenue officials took the lead in specifying how the quantum of tax relief could be established.

BUSINESS TAX ISSUES

Payment Dates

26. The Financial Secretary said that he had made clear publicly that this question was under review. The Chancellor said that the present position did not seem to make sense.

Life Assurance Companies

27. The Chancellor said that this was a very complicated subject, and that he was not attracted to making changes in 1987.

Pre trading R&D

28. The Chancellor said that there was a lot of pressure for change here, and that some action might be necessary.

Companies' capital gains

29. The Chancellor asked if it would be possible to charge companies' capital gains to corporation tax, whether or not the rest of CGT was reformed. Mr Isaac said that this would be possible, but suggested that the two questions be considered together. The Chancellor asked if the change on companies would raise extra revenue. Mr Battishill said that, by itself, it would, but that there would also be pressure to allow ACT to be set off against capital gains, which could entail an overall cost.

INTERNATIONAL

International (General)

30. It was noted that there would be a submission in early October on revenue-raising measures.

Dual resident companies

31. The Chancellor said that this should be a definite starter. The US Government had taken action which made it easier for us to follow suit.

LLOYDS

32. The Economic Secretary said that he was reluctant to take action in 1987 on political and general grounds. The issues were very complicated. Lloyds would be able to whip up support from underwriters. And legislation would raise the whole question of Lloyds, just as it was becoming quieter.

33. Mr Battishill said that the legislation would certainly be difficult, but that it could be equally difficult to do nothing. It was now necessary to examine syndicate accounts properly, and the present arrangements did not allow time for that, with the result of that loss relief could not be given promptly. So there could be pressure from Lloyds for a continuation of the old system of not examining accounts in detail. He recommended completing the discussions with Lloyds, and then considering the best way forward.

34. The Chancellor agreed to this, and asked the Economic Secretry to continue to supervise. Sir Peter Middleton commented that it would be difficult to do nothing on Lloyds, and that legislation would not be unexpected.

KEITH

35. The Economic Secretary said that he would like to take some action on Keith, to maintain the momentum. There was too much for one Finance Bill, so the question was whether a reasonable package could be put together for 1987. He would like to concentrate on Pay and File, which would provide a more orderly system of company tax payments, but would not actually come in for three years. Action might also be taken on PAYE abuse, and - with more difficulty - income tax returns and assessments.

36. Mr Isaac suggested that the way forward might be to publish the package as a whole, but to make clear that the Government was considering only part of it for early legislation.

37. The Chancellor noted that Pay and File was not actually a Keith recommendation, though it was linked to Keith. Mr Battishill said that Keith had said clearly that present procedures were out of date. Keith's own solution was unworkable, and a different approach was being put forward. There would have to be prompt action to keep open the possibility of legislating in 1987.

38. The Minister of State asked whether any Customs issues should be reopened, if there was to be action on Keith. Sir A Fraser said that there might be one or two Budget starters. The Chancellor said that he was particularly keen to implement Customs' small business review.

STAMP DUTY ISSUES

39. It was agreed that no action should be taken on stamp duty, though the treatment of PEPs would have to be considered.

CHARITIES

40. The Chancellor said that no action should be taken in 1987, apart from a possible increase in the ceiling for payroll giving, as a lollipop.

PROFIT RELATED PAY

41. The Chancellor said that the next step was to assess the comments on the Green Paper. He thought it more likely than not that he would want to go ahead with tax relief.

CREDIT CARD TAX

42. The Chancellor saw immense problems in a wider tax on consumer credit. But he did not think that this should rule out a credit card tax, which could be a significant revenue-raiser. He did not

think that taxing credit cards (and charge cards) would lead to a significant diversion to other forms of payment, because of the convenience of plastic cards. The political acceptability of the tax would be helped because it would bring home to people how much they paid for credit anyway. He asked for further work to be done.

43. Mr Cassell said that the ideas had not been ruled out because a wider tax did not look feasible; indeed, the administrative difficulties of a wider tax appeared to have eased. But he was concerned that singling out one means of credit for tax would lead to distortions, and could have an impact on M0. Sir T Burns thought the tax would be a backward step, and Mr Byatt thought it would look odd, given the emphasis on non-distortionary financing. The Chancellor did not accept this: he started with the view that financial services generally were undertaxed, and was looking at how to redress this.

44. The Minister of State said that there would be a massive campaign against such a tax, though the Financial Secretary pointed out that the opponents of credit would support it. The Chancellor noted that taxation on credit card companies had been increased two years ago, with no protest at all.

Insurance Premium Tax

45. The Chancellor said that this was another potential revenue-raiser, which other countries had and we did not.

46. The Economic Secretary said that he would not object to the tax if it were already in place, but was not keen to introduce it. The Financial Secretary also had reservations about "taxing prudence". But the Minister of State was keener on this than on a credit card tax. Mr Byatt was nervous about approaching the taxation of financial services in a piecemeal fashion.

47. Sir A Fraser said that Customs would need to consult the DTI to take the work much further, and that they would probably be hostile. The Chancellor asked for that work to be done, and asked Customs to find out about other countries' experience, particularly with off-shore leakage, either from DTI or from Embassies.

Switch from VED to derv for lorries

48. The Chancellor looked forward to a further submission.

Reform of Capital Gains Tax

49. There was a short discussion of reform of Capital Gains Tax, prior to the separate meeting.

50. The Chancellor said that abolition of indexation relief should clearly be part of a CGT package. This could be seen in conjunction with changes to the higher rates of income tax. He did not see a case for compensating people with pre-1982 gains as such: the problem was inflationary gains generally. He saw no difficulty with putting a ring-fence round capital losses: the Americans already did this. Similarly, there was no reason not to have a different threshold for capital gains and income tax.

51. Mr Cassell was concerned that one substantial gain could push a taxpayer to the top rate of income tax. He asked about spreading provisions. The Chancellor wondered if there could be a provision similar to that in Inheritance Tax, so that liability would be calculated in the normal way, but payment could be spread. Mr Isaac said that there were two alternatives: either to tax gains at the basic rate only; or to work out the taxpayer's marginal rate on the basis of his income alone, and then to tax the whole of his capital gains at that rate.

52. The Economic Secretary said that his starting position was that charging capital gains to income tax would be a very bad move in enterprise terms. It was against the policy of encouraging risk-taking. The effect would depend on the rate structure, but he thought it was in principle a step in the wrong direction.

53. The Chancellor said that this was an important consideration but he was not sure that this would be the effect. He asked the Revenue to expand the existing paper (Mr Isaac of 17 September) and to provide an annotated agenda for a separate meeting.

APH

A P HUDSON
25 September 1986

MR 4/35

COVERING SECRET

FROM: A P HUDSON

DATE: 25 SEPTEMBER 1986

MR SCHOLAR

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Monck
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Ross Goobey
Mr Battishill - IR
Mr Isaac - IR
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Financial Secretary
Economic Secretary
Minister of State
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8. The Chancellor asked whether the duties on matches and mechanical lighters could be split, and, for example, the duty on matches retained but that on mechanical lighters abolished. Sir A Fraser said that this would be possible administratively, but might arouse the European Commission's interest in the matches duty. It might also lead to the closure of a match factory in Liverpool. Customs were consulting the DTI.

9. Sir P Middleton and Mr Cassell did not want to rule out the possibility of abolishing capital duty. The Chancellor agreed, but thought that there were likely to be better uses for the £150 million cost.

Class IV NIC

10. Mr Battishill raised the possibility of abolishing class IV NIC. This would be a simplification, and would save some 100 staff, though the cost would be £300 million. The Chancellor noted that this could not be done in a Finance Bill, though there was normally a Social Security Bill available. He agreed that this possibility should be explored, and said that the charge was absurd in principle.

US/G5 TAX REFORM - GENERAL ISSUES

11. There was no specific discussion of this item.

CAPITAL GAINS TAX

12. The Chancellor suggested leaving reform of CGT to the end of the meeting (see paragraphs 49-53).

13. On capital losses for groups, the Revenue would submit a paper in early October. There were two strands to the question:

(a) Until 2-3 years ago, companies engaged in a good deal of capital loss buying. This had been limited by the Ramsey and Dawson decisions. But more cases would soon be coming to the courts, which could change the position.

(b) At present, there was no statutory provision to give companies group relief on losses. In practice, most companies found ways of getting the relief. But industry was pressing for a statutory provision, and this was justified in principle.

Dealing with the issue could require 15 pages of legislation. The Chancellor commented that this did not look a strong runner.

14. On disincorporation, Mr Isaac explained that there had been some preliminary consultation, going beyond CGT issues. There was a lot of pressure for action, but no agreement on precisely what should be done. There might be a need for a consultative document. The Revenue would put up a note within a fortnight. Mr Battishill noted that the Deregulation White Paper had held out the prospect of action on this issue. The Chancellor asked for two options to be presented:

(a) the complete package requiring consultation;

(b) a more modest package which would not need consultation, and could therefore be ready for 1987.

15. The Chancellor said he hoped it would be possible to make progress on venture capital. The Financial Secretary reported that agreement had almost been reached with the industry.

INCOME TAX ISSUES

Minimum Tax

16. The Chancellor asked for the Revenue's submission to come forward as soon as possible. Mr Isaac reported that the results of the survey of higher paid taxpayers were just becoming available.

17. The Chancellor asked if a Minimum Tax rule should be introduced for companies as well. It would be useful to look at both possibilities together, on grounds of fairness, but he did not think that we had the same problems as the USA on the company side. Mr Battishill confirmed that the main tax shelters which the Americans were abolishing had never existed in this country. What problems there were had largely been removed by the 1984 reforms. The reason some profitable companies still paid very little tax was generally because of accumulated losses.

Tax relief for personal employees and Child Care allowance

18. The Chancellor said that these subjects raised a variety of different considerations. But the only option worth pursuing was the possibility of introducing a child care allowance as part of the Green Paper reforms. In retrospect, presenting this along with transferable allowances could have made it easier to sell the Green Paper proposals. The question now was how it could best be grafted on, either as a measure to pave the way for transferable allowances, or as a measure introduced in response to the consultation. The Chancellor noted that there would certainly have to be some statement about the outcome of the consultation. He might raise the possibility of a child care allowance with the

Prime Minister in a bilateral, since it might answer some of her doubts about transferable allowances. But this was not a starter for the next Budget.

19. Mr Isaac pointed out that a child care allowance could have a substantial staff cost. There would be difficult questions about which parent should claim the allowance, and whether it should be transferable. Mr Battishill said that it could resurrect arguments for full child tax allowances.

Mortgage interest relief

20. The Chancellor thought that both the possible measures - restricting the relief to the basic rate, and applying it to the residence - would have to apply to future mortgages only. He asked if this would clog the market. Mr Ross Goobey suggested that there could be a transitional period, and the Economic Secretary thought that a five year period would be sufficient to deal with most existing cases. The Chancellor asked that these points should be taken into account in the Revenue submission.

Benefits-in-kind

21. The Chancellor said that he had asked about the possibility of abolishing the £8,500 threshold for car and fuel benefits only because he thought it would be easier administratively. Mr Isaac confirmed that these benefits produced more tax for less work than the others, and were also easier for companies to handle. But abolishing the threshold would still mean extra costs for the Revenue and business.

22. The Chancellor said that the sensible thing was to continue to allow the threshold to "wither on the vine". He did not want to raise it, in spite of pressure from the Deregulation Unit in this area. Employers could easily get round the compliance costs by replacing benefits with higher salary payments.

Maintenance payments

23. The Chancellor said that the key question here was the distributional effects. If these were acceptable, he would want to take action. He asked if it would be possible to make the decision at a late stage, since the impact of the distributional effects would depend in part on other measures in the Budget.

Composite rate tax

24. The Economic Secretary said that if there was a substantial reduction in the basic rate, there would be a case for a shorter time lag before it fed through into the composite rate. The Chancellor thought this could lead to a big complication to deal with what was simply a transitional problem, and was not sympathetic to making a change.

PENSIONS

25. The Chancellor asked that all pension issues should be brought together in the report of the group chaired by Mr Corlett. If the proposal for free-standing AVCs was to be resisted, all the arguments would have to be exposed. It was very important that Treasury and Revenue officials took the lead in specifying how the quantum of tax relief could be established.

BUSINESS TAX ISSUES

Payment Dates

26. The Financial Secretary said that he had made clear publicly that this question was under review. The Chancellor said that the present position did not seem to make sense.

Life Assurance Companies

27. The Chancellor said that this was a very complicated subject, and that he was not attracted to making changes in 1987.

Pre trading R&D

28. The Chancellor said that there was a lot of pressure for change here, and that some action might be necessary.

Companies' capital gains

29. The Chancellor asked if it would be possible to charge companies' capital gains to corporation tax, whether or not the rest of CGT was reformed. Mr Isaac said that this would be possible, but suggested that the two questions be considered together. The Chancellor asked if the change on companies would raise extra revenue. Mr Battishill said that, by itself, it would, but that there would also be pressure to allow ACT to be set off against capital gains, which could entail an overall cost.

INTERNATIONAL

International (General)

30. It was noted that there would be a submission in early October on revenue-raising measures.

Dual resident companies

31. The Chancellor said that this should be a definite starter. The US Government had taken action which made it easier for us to follow suit.

LLOYDS

32. The Economic Secretary said that he was reluctant to take action in 1987 on political and general grounds. The issues were very complicated. Lloyds would be able to whip up support from underwriters. And legislation would raise the whole question of Lloyds, just as it was becoming quieter.

33. Mr Battishill said that the legislation would certainly be difficult, but that it could be equally difficult to do nothing. It was now necessary to examine syndicate accounts properly, and the present arrangements did not allow time for that, with the result of that loss relief could not be given promptly. So there could be pressure from Lloyds for a continuation of the old system of not examining accounts in detail. He recommended completing the discussions with Lloyds, and then considering the best way forward.

34. The Chancellor agreed to this, and asked the Economic Secretry to continue to supervise. Sir Peter Middleton commented that it would be difficult to do nothing on Lloyds, and that legislation would not be unexpected.

KEITH

35. The Economic Secretary said that he would like to take some action on Keith, to maintain the momentum. There was too much for one Finance Bill, so the question was whether a reasonable package could be put together for 1987. He would like to concentrate on Pay and File, which would provide a more orderly system of company tax payments, but would not actually come in for three years. Action might also be taken on PAYE abuse, and - with more difficulty - income tax returns and assessments.

36. Mr Isaac suggested that the way forward might be to publish the package as a whole, but to make clear that the Government was considering only part of it for early legislation.

37. The Chancellor noted that Pay and File was not actually a Keith recommendation, though it was linked to Keith. Mr Battishill said that Keith had said clearly that present procedures were out of date. Keith's own solution was unworkable, and a different approach was being put forward. There would have to be prompt action to keep open the possibility of legislating in 1987.

38. The Minister of State asked whether any Customs issues should be reopened, if there was to be action on Keith. Sir A Fraser said that there might be one or two Budget starters. The Chancellor said that he was particularly keen to implement Customs' small business review.

STAMP DUTY ISSUES

39. It was agreed that no action should be taken on stamp duty, though the treatment of PEPs would have to be considered.

CHARITIES

40. The Chancellor said that no action should be taken in 1987, apart from a possible increase in the ceiling for payroll giving, as a lollipop.

PROFIT RELATED PAY

41. The Chancellor said that the next step was to assess the comments on the Green Paper. He thought it more likely than not that he would want to go ahead with tax relief.

CREDIT CARD TAX

42. The Chancellor saw immense problems in a wider tax on consumer credit. But he did not think that this should rule out a credit card tax, which could be a significant revenue-raiser. He did not

think that taxing credit cards (and charge cards) would lead to a significant diversion to other forms of payment, because of the convenience of plastic cards. The political acceptability of the tax would be helped because it would bring home to people how much they paid for credit anyway. He asked for further work to be done.

43. Mr Cassell said that the ideas had not been ruled out because a wider tax did not look feasible; indeed, the administrative difficulties of a wider tax appeared to have eased. But he was concerned that singling out one means of credit for tax would lead to distortions, and could have an impact on M0. Sir T Burns thought the tax would be a backward step, and Mr Byatt thought it would look odd, given the emphasis on non-distortionary financing. The Chancellor did not accept this: he started with the view that financial services generally were undertaxed, and was looking at how to redress this.

44. The Minister of State said that there would be a massive campaign against such a tax, though the Financial Secretary pointed out that the opponents of credit would support it. The Chancellor noted that taxation on credit card companies had been increased two years ago, with no protest at all.

Insurance Premium Tax

45. The Chancellor said that this was another potential revenue-raiser, which other countries had and we did not.

46. The Economic Secretary said that he would not object to the tax if it were already in place, but was not keen to introduce it. The Financial Secretary also had reservations about "taxing prudence". But the Minister of State was keener on this than on a credit card tax. Mr Byatt was nervous about approaching the taxation of financial services in a piecemeal fashion.

47. Sir A Fraser said that Customs would need to consult the DTI to take the work much further, and that they would probably be hostile. The Chancellor asked for that work to be done, and asked Customs to find out about other countries' experience, particularly with off-shore leakage, either from DTI or from Embassies.

Switch from VED to derv for lorries

48. The Chancellor looked forward to a further submission.

Reform of Capital Gains Tax

49. There was a short discussion of reform of Capital Gains Tax, prior to the separate meeting.

50. The Chancellor said that abolition of indexation relief should clearly be part of a CGT package. This could be seen in conjunction with changes to the higher rates of income tax. He did not see a case for compensating people with pre-1982 gains as such: the problem was inflationary gains generally. He saw no difficulty with putting a ring-fence round capital losses: the Americans already did this. Similarly, there was no reason not to have a different threshold for capital gains and income tax.

51. Mr Cassell was concerned that one substantial gain could push a taxpayer to the top rate of income tax. He asked about spreading provisions. The Chancellor wondered if there could be a provision similar to that in Inheritance Tax, so that liability would be calculated in the normal way, but payment could be spread. Mr Isaac said that there were two alternatives: either to tax gains at the basic rate only; or to work out the taxpayer's marginal rate on the basis of his income alone, and then to tax the whole of his capital gains at that rate.

52. The Economic Secretary said that his starting position was that charging capital gains to income tax would be a very bad move in enterprise terms. It was against the policy of encouraging risk-taking. The effect would depend on the rate structure, but he thought it was in principle a step in the wrong direction.

53. The Chancellor said that this was an important consideration but he was not sure that this would be the effect. He asked the Revenue to expand the existing paper (Mr Isaac of 17 September) and to provide an annotated agenda for a separate meeting.

APH

A P HUDSON
25 September 1986

* Altho' you will not want to make a spch on this, you will need a line of defence. R. Culpin & I have sketched this out overleaf. Yrs.

FROM: A G TYRIE

DATE: 25 SEPTEMBER 1986

CHIEF SECRETARY

cc Chancellor
Mr Cropper
Mr Ross Goobey
Mr Culpin

POSSIBLE PRESS RELEASE ON FRIDAY

The IFS intend to put out a release on our costing of Labour's policies on Friday afternoon.

2. They are sending me an advance copy, hopefully by close of play tonight. I understand they also giving one to Mr Hattersley.

3. I recommend that you do not put out a release on £28 billion until we have seen this draft. Once we have seen it we may conclude that it would be better to await the press reaction over the weekend.

4. I have discussed the possibility of a release on local authority pay with Mr Culpin. He advises against it on the grounds that we have had a lot of statements about pay recently and do have any measures to deal with it. Although sensible to make the point from time to time we can over-do it.

5. An alternative would be a short release on Labour's apparent commitment to abolish the BES. Do you like this idea?

6. Do you have a moment to discuss this tonight, perhaps after the Home Office bilateral?

AGT

A G TYRIE

1. Welcome costing of parties' programmes, following CST's lead.

2. Seems little dispute over

(a) content of Labour programme

(b) costing of items

3. Expenditure certain. Revenue forecasts uncertain — especially as Labour's overall programme more likely to raise than lower unemployment. Last time(?) Lab Govt went in as public spend ✓ spree, unemployment doubled.

4. Not only first year that matters. Do other pledges lapse?

4A. Clear that forecasts & borrowing will soar very substantially.

5. IFS says "anti-unemployt. programme" vague & not costed.

6. Says nothing about inflation or pay (despite ↓ XR)

MR 3/29

PUP

FROM: CATHY RYDING

DATE: 26 SEPTEMBER 1986

PS/CHIEF SECRETARY

cc: Mr Culpin
Mr Cropper
Mr Ross Goobey
Mr Tyrie

POSSIBLE PRESS RELEASE ON FRIDAY

The Chancellor has seen Mr Tyrie's minute to the Chief Secretary of 25 September.

2. The Chancellor has commented that although the Chief Secretary will not wish to make a speech on this, he will need a line to take. The Chancellor and Mr Culpin have sketched out the following:

i) Welcome costing of parties' programmes, following CST's lead.

ii) Seems little dispute over
(a) content of Labour's programme
(b) costing of items

iii) Expenditure certain. Revenue flowbacks uncertain - especially as Labour's overall programme more likely to raise than lower unemployment. Last time a Labour Government went on a public spending spree, unemployment doubled.

iv) Not only first year that matters. Do other pledges lapse?

v) Clear that taxation and borrowing would both rise substantially.

vi) IFS says "anti - unemployment programme" vague and not costed.

vii) Says nothing about inflation or pay (despite falling exchange rates).

C.R

CATHY RYDING

LD/039

AWP

FROM: A P HUDSON
DATE: 30 SEPTEMBER 1986

MR SCHOLAR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Monck
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Ross Goobey
Mr Battishill - IR
Mr Isaac - IR
Sir A Fraser - C&E

TAX: FORWARD PLANNING

I am afraid that one of the figures quoted in the note of the 22 September meeting (attached to my 25 September minute) was wrong.

2. Paragraph 10 referred to a saving of 100 staff; it should be a saving of 200 staff.

APH

A P HUDSON

Chancellor.

CHANCELLOR OF THE EXCHEQUER

1. I have just obtained this from the IFS.

2. It is not good news. They have their facts broadly right but have presented them in an unfavourable light. They have done a lot of Labour's work for them.

3. We don't know when the press will run this as a story (if I have a copy so will several journalists). I favour not reacting immediately to press reports / invitations to respond

over

until we have:

- analysed in detail the attachment

- seen whether the press swallow the IFS line whole.

Do you agree?

Andrew.

SECRETARY OF STATE FOR EMPLOYMENT

Fourth, encouraging share ownership has been a consistent part of your fiscal approach which we strongly support. We believe that a further significant step is needed to establish employee share ownership more firmly. A number of improvements in share ownership legislation and tax relief could be made; ESOP's offer a way of encouraging more use of 1978 Act schemes in particular circumstances and tax relief on share purchases by employees through saving contracts should be given. A further impetus to employee involvement is even more important if you decide to end NIC exemption for discretionary payments through a trust which will hit cash based profit sharing schemes.

Fifth, we both wish to encourage labour mobility through freeing up the housing market. Tax relief to private landlords on their rental income would be a major encouragement to the private rental sector. Tax relief on "digs" would be a step on the way.

There are other issues in our submission, particularly on spin outs and small workshops, which I hope you will consider favourably.

I would be delighted to discuss these suggestions with you in more detail. I am sure that you will share my concern to make progress on the five major issues which I have highlighted.

Yours

David

ENTERPRISE CO'S

"ENTERPRISE COMPANIES"

There remains a considerable amount of concern about the inability of small firms to raise finance in sums up to £100,000. Neither BES nor Venture capitalists have tackled this problem largely because of the relatively high appraisal costs of such propositions. Although BES does finance smaller investments, the bulk of the tax relief given goes to investments above £100,000 (90% of tax relief in 1984-85). Banks are not meeting such needs, even with the assistance of the LGS, because of a combination of natural caution about the risks compared to mortgage lending, bureaucracy in referring LGS cases to head offices, appraisal costs, and lack of compensation for risks through rewards of equity participation.

Problems in financing small firms are not limited to poor availability of finance. Often a company needs a mixture of loan and equity, but this is not available from one source.

These problems should be tackled through the creation of 'enterprise companies'. Such companies would be limited companies providing a mixture of equity and loan finance to small companies. Individuals and companies would be encouraged by tax incentives to invest in the shares of the enterprise company. Annex A sets out the details of this approach. We believe that the bias of these companies would be to a local area and they would create local venture capitalists. The aim is to make investment locally attractive to individuals and the limitations proposed on the size of the investments made by the enterprise company and the size of investment which individuals and companies could make in the enterprise company itself should achieve this.

One issue is how far such enterprise companies could exist alongside BES and LGS. They are not incompatible in the short term. The emphasis in enterprise companies is different to BES - allowing for corporate investments, offering a loan and equity mix and concentrating on the small and local end of the market. Enterprise companies could be given an LGS franchise and so compete with the banks. In the long run the enterprise company might replace BES but this would depend on their relative success in achieving their objectives.

The costs of appraisal and level of after care needed for venture capitalists to invest successfully in smaller expanding companies could remain a barrier to enterprise companies. Support for appraisal costs on the lines of the Business improvement Scheme could be given to enterprise companies and to BES funds. Annex B outlines how this might be done.

CHANCE IN A LIFETIME

ENTERPRISE

"Chance in a lifetime"

The creation of an enterprise culture requires a considerable change in attitude to the risks inherent in starting a business which is particularly hard in a society which has become risk-averse and anti-enterprise. A significant barrier to this development is the fact that few people have direct experience either themselves or through their family of running a business. Encouraging more people now to run their own business will have a powerful effect in developing a willingness and awareness of enterprise in the future.

One way to tackle this would be to provide incentives to people starting a business for the first time: incentives which could be used only once in a lifetime. The idea of a 'chance in a life time' scheme is outlined in Annex C. This would give a package of incentives including a tax free holiday for the first two years, enterprise training and financial advice to people setting up their business for the first time in their life. The cost of this approach may have to be restricted initially by piloting on a regional basis, for example in the North East. This might cost less than £50 million in a full year.

"Spin-outs"

Just as important in creating a successful enterprise economy is the need to encourage people to leave established jobs to set up new businesses. Spin-outs of executives particularly to set up new businesses built on ideas which do not fit into the existing portfolio of the business for which they work would undoubtedly offer a higher rate of success in starting up businesses. But current tax rules are extremely complicated and act to prevent "spin-outs" for example:

- managers 'spun-out' and offered shares at a price below that paid by the backers of the new company may find themselves liable for income tax on the difference in price even though no gain can be realised

- managers buying shares part paid who then leave and wish to sell the shares to their successor have to pay tax on the difference between the market value of the fully paid shares and that of the partly paid shares

- IBM who wished to support managers setting up their own businesses through paying their salary for a period of 16 months and paying for enterprise and business training found that this was prevented because such expenses would not be deducted for corporation tax purposes and, more important, the managers themselves would be assessed for tax on the value of the enterprise and business training which they have received. This effectively prevented them running a programme of encouraging managers to start new businesses.

The legislation needs to be consolidated and simplified to remove such disincentives.

Decisions about self employment

Obstacles to people moving gradually from employment into self employment and to small businesses seeking to employ labour flexibly (part-time, temporary, contract) are also created by the existing tax and social security system. A particular difficulty is uncertainty about status and the understandable Revenue caution in accepting self-employed status. Annex D identifies some changes which could be made now and are already the subject of Ministerial discussion to streamline the decision-taking, which essentially involves bringing together the tax and social security system into one decision point for self employment status. (Discussion of major structural change to abolish employment distinctions altogether will have to follow the response to Green Paper on Personal Taxation).

'LEARN AS YOU EARN'

We do little at present to encourage people to invest in their own training and development. Encouraging employees to invest in themselves marks a new approach to policy. The Career Development Loans, which are being piloted, are one part of this approach. Another avenue is to give tax incentives to individuals to invest in training. The range of options is considerable but a start should be made in the 1987 budget by testing the effect of a limited tax incentive.

If individuals pay for their own training leading to a recognised qualification, but not directly related to their existing job, they would be given tax relief for spending up to £300 in a year. The qualification and the training body would need to be certified by the MSC and initially would be limited to a narrow range of qualifications. Tax relief could be given at source at the basic rate by the trainer on the basis of the individuals pay slip. (Annex E gives more details).

EMPLOYEE INVOLVEMENT

Employee involvement has been encouraged by tax incentives and this has increased the number of schemes. The legislation should be modified to encourage more employee share ownership.

Employee Stock Ownership Plans (ESOP's) are the most widespread vehicle for spreading employee ownership in the USA. The major features of ESOP's could be introduced in the UK largely by modifying the 1978 legislation and drawing on the US experience to avoid tax abuses. Tax incentives could be used to encourage ESOP's and could include relief from corporation tax on payments to the trust which holds employees' shares and some measure of tax relief on the interest paid on loans used to buy shares for the Trust. [A detailed set of proposals have been developed by Clifford Turner and New Bridge Street consultants.]

Additional changes in the tax treatment of employee share schemes introduced under existing legislation are outlined in annex F and seek to encourage employee ownership through a savings contract and to link the tax concessions in discretionary share option schemes with companies introducing schemes open to all employees.

'LEARN AS YOU EARN'

EMPLOYEE SHARE OWNERSHIP

Co-operatives offer a form of company ownership which is the ultimate in employee involvement since employees are owners. The proposals outlined in annex G seek to reduce the disadvantages faced by co-operatives compared to other small businesses. They do not represent an attempt to give special advantages to co-ops but are a set of changes in tax treatment to encourage their growth through greater equality of treatment.

The National Freight Consortium have encountered particular tax problems with existing legislation which are limiting the scope for their expansion while remaining an employee controlled company. It is ironic that the success of a company which has been successfully privatised and is employee controlled should be constrained by tax problems. Their difficulties are outlined in Annex H.

LABOUR MOBILITY

<u>LABOUR MOBILITY</u>

Housing shortages and regional inbalances in housing cost are a major factor influencing labour movement. Skill shortages, at quite low levels of skill are now arising in and outside the South-East. A major contributor to housing inflexibility is the slow death of private renting, caused partly by Rent Act controls, partly by the unfavourable financial comparison with owner-occupation.

Rent deregulation should remain the objective while in the meantime rent difficulties can be alleviated through developing assured tenancies.

Action on taxation would also help. The most obvious way would be to extend tax relief to private landlords on their rental income.

If this cannot be achieved there are a number of 'second best' possibilities: their effects are more limited but still worthwhile. Tax relief for people who offer "digs" would be particularly helpful. Two options are set out in Annex I.

COMPANY TAXATION ISSUES

Business Expansion Scheme

Small workshops provide a vital launch pad for small firms and new enterprises. Rule changes in BES should be used to encourage their development by allowing BES investments in companies running small units of less than 1250 square feet. (Annex J sets out the full rationale for this rule change).

Technical recommendations: Claims and elections and CGT rollover relief

Business decisions are sometimes distorted by the time limits which are set for different claims and elections which can be made by companies. Decisions would be improved by extending time limits in the cases set out in Annex K. This annex include recommendations to improve the operation of CGT rollover relief.

Deregulation

Most deregulation issues are being pursued in other contexts. But the P11D remains a perennial problem at the top of most firms complaints (after VAT).

The compliance costs for businesses filling in P11Ds are considerable. We have sought simplification wherever possible but some more radical change is needed to reduce the burden on businesses. The requirement to match up the P11Ds to the individual tax returns is a further burden on all taxpayers. This could be eliminated by requiring only taxable benefits to be submitted ie. only those benefits which will bear tax in the hands of the recipients. This will prevent the taxpayer being deprived of any concessions to which he is entitled. Simplification in this way could be introduced together with the abolition of the current limit of £8,500 so that information on taxable benefits to all employees is provided.

Annexes

A. Enterprise Companies

B. Appraisal Costs

C. "Chance in a lifetime"

D. Self-employment Status

E. "Learn as you Earn"

F. Employee involvement

G. Co-operatives

H. National Freight Consortium proposition

I. Mobility

J. Business Expansion Scheme

K. Claims and Elections

ANNEX A

ENTERPRISE COMPANIES

ANX A ENTERPRISE CO's

Enterprise companies (ECs) will be entirely private sector bodies. Government will provide incentive for private sector investment via BES style tax relief. The main additional features of EC investment compared with BES are:-

- investments from trading companies and institutions
- local bias
- bias towards investment in small firms

1. Objective

The objective of ECs is to supply the need of small businesses (both existing and start-ups) for capital in the most appropriate mix (between equity and loan), at a reasonable cost, on a long-term basis and with an appropriate level of pre-investment appraisal and post investment after-care.

2. The Concept

ECs will have the following features:-

a) The basic concept is that investors who are willing to invest risk capital in predominantly small local businesses will be able to subscribe for shares in the local enterprise company. The investors will receive tax relief on this investment. The local enterprise company will appoint directors from the local business community. The directors of the EC will invest its funds in local businesses, primarily in amounts of less than £100,000.

b) Unlike BES, investment in ECs will not be restricted to individuals. Companies, banks, financial institutions and other bodies prepared to invest risk capital in small businesses will all be eligible to invest.

c) They will be set up on a local basis - their constitutions could require that preference be given to local shareholding and local investment.

d) They will be limited companies and therefore separate continuing legal entitles.

e) They would be required to invest mainly in small companies in an appropraite mix of loan and equity capital. They will also be able to invest in partnerships/sole traders (which do not have share capital) by means of long term loans (possibly the interest charge being related to profits).

f) Investments would be predominantly in the range of £10,000 to £100,000. Requirements could stipulate that at each balance sheet date 50% of its invested funds (by value) and at least 70% of its investments (by number) would be represented by investments of less than £100,000. They could also be prohibited from making any investment which exceeded say £500,000 or say 15% of share capital plus reserves at the last balance sheet date. In addition these figures should be laid down by Statutory Instrument so that they can be varied in the light of experience.

f) Share capital could be called as required - at the end of the first year 50% of share capital received must have been invested and at each balance sheet date thereafter 75% must be invested.

h) They would be allowed to borrow funds from outside sources including their own shareholders.

i) They would be allowed to use a set percentage of their funds for management expenses (cost of raising capital, cost of appraisals, etc.).

3. Advantages

a) Simplicity - BES Funds cannot hold shares in their own name. When a BES Fund makes an investment in fact what happens is that each investor gets an apportionment of the shares acquired by the Fund. He therefore gets a very small direct holding in each target company. This is a particular problem where the BES Fund makes small investments as each investor therefore gets only a fraction of this small number of shares. The disadvantage for the company is that it gets a large number of shareholders, all of whom have to be kept on registers, sent copies of accounts, notices of meetings etc. This is an administrative burden particularly for small companies. Under the EC proposals, the investors buy shares in the EC which then makes a single investment in the target companies. Target companies therefore get only one new shareholder.

b) Risk spread marketability - investors spread risk by investing in EC because the EC has a spread of investment - EC shares should therefore be more marketable.

c) Involvement - under the BES Fund it is difficult for each individual shareholder to get involved in each of the companies whose shares are allocated to him by the BES Fund. Also the BES management have no ongoing responsibility to the investors and therefore little incentive to get involved or provide after care to target companies. The EC, on the other hand, is a continuing body whose management are continually answerable to its shareholders - they therefore have a strong incentive to manage the investments by keeping close to investee companies and providing extra help where required.

d) Industrial and institutional involvement - BES only allows individual investment. Investment by companies and institutions is a vast new source of investment money and backup expertise. EC would provide a strong and valuable link between successful local business and the local small firms. National/international companies and institutions could also purchase shares.

e) Continuity - the EC will be continuing legal entity and therefore a permanent land mark on the local scene and an important part of a local financial community.

4. Problems

a) Investment appraisal (the cost) - bad appraisal leads to bad investments. Appraisal of a small investment can be as costly as appraisal of a large one. Government assistance with appraisal costs for investment of less than £100k is a proposition which is often put forward as a measure of assistance which should be generally available. ECs would obviously take advantage of any general provision but an alternative, as a 'one off measure', would be to create special appraisal assistance for ECs in their first 3 years, in recognition of their obligations to invest in small businesses.

Limits for each appraisal might be set at the lower of 50% of the costs or 2% of the proposed investment plus an overall annual limit of 3% of LEC funds. EC would quickly become experts in apraising unquoted companies - initially assistance with training might be required. Government assistance with appraisals could be phased out after three years.

b) Marketability - always a problem with unquoted shares but EC would certainly be an improvement on present position. The expertise they will acquire, the profits made on successful companies moving up and their spread of risks would make their shares reasonably marketable.

5. Proposed Structure

a) Separate legal entity, ie. a limited company

b) Sources of Finance.

Equity - individuals, companies, institutions, others.

Loans - commercial sources and loans from equity investors.

Other - EC Regional/Social Funds, EIB, Local Authorities, NCB, BSC, etc.

c) Incentives to Invest.

Individuals - tax relief as for present BES.

Companies - corporation tax relief on eligible investment restricted to the lower of a fixed sum - say £40,000 - or a percentage of profits - say 10%. Additional sums could be invested without relief.

Institutions and others - those within the UK tax net would receive the same tax relief as companies - other amounts would be raised on local social/economic/regional aid grouonds.

Loans from equity investors could be given a tax concession (interest only 50% taxable) to enable the EC to borrow on reasonable terms.

A reasonable period must be allowed to enable EC to invest sensibly - the present BES "mad scramble" before the tax year end does not always lead to good investment decisions. Suggested rules on investment by EC's are therefore that 50% of funds must be invested at the first balance sheet date and 75% at each succeeding balance sheet date.

d) Financing Businesses.

Investment (in an appropriate mix of equity and loan) to be made to small companies. EC should be allowed maximum freedom in packaging the finance they provide. They will need to be able to adapt to new circumstances and different situations. Freedom will encourage them to find new ways of providing finance.

Stand alone loans (without equity) should not be excluded. This might bring a new element of competition in leading to small companies which might in turn stimulate more innovation from the banks. EC would not be allowed to give overdrafts. Loans could also be made to unincorporated businesses (subject to constraints). These businesses do not of course have equity but similar risk/profit sharing could be achieved by allowing the interest charge to be linked to profit.

e) Local Involvement.

The limited company status will make the EC management accountable to its shareholders. As these will be largely local, a great deal of shareholder involvement could be expected. In particular local companies and institutions which have invested could be expected to provide advice, resources and staff on secondment.

6. Is there a need for EC?

Representations we receive (including reports from REU and SFS) highlight the following difficulties for small business in raising capital. The Peat Marwick Report on BES also highlighted similar problems which were not being successfully addressed by BES.

a) Companies have difficulty raising small amounts of capital (in particular equity capital) - say up to £150,000 (some say up to £250,000)

b) Companies/partnerships/sole traders all have difficulty raising suitable loan finance where repayments are geared to their future cashflow - eg deferment of capital repayment and flexibility in interest charges.

c) Outside London the bank is often the only source of funds.

d) Companies would like to be able to obtain a balanced package of loan and equity from the same supplier.

e) Businesses would like a continuing local contact with the provider of funds so they could refer back for further assistance if unforeseen problems/opportunities arise.

f) Successful local businesses/professions/institutions have a local pride and would like to assist business developments in their area. There is an element of self interest for them in developing local business prosperity. There is no mechanism through which to channel their efforts at present.

The enterprise company attempts to answer these questions.

7. Why will EC's invest in smaller local companies?

The question has to be asked as to what prevent EC moving 'up market' to larger (less risky) ventures outside the local area.

In paractice it would be extremely difficult to tie enterprise companies to a 'local' area by statute. This is neither necessary nor desirable. Local communities are already showing their desire for such a body in attempts to set up local BES Funds (which are not really) suitable for the job) and the success of such bodies as the West Yorkshire Enterprise Board.

ECs might develop in the same way as the bulding society movement where societies were set up locally with strong local roots but with the most successful (in the fullness of time) developing into strong national institutions. As long as they continue to meet the needs of small local business (as the law would demand) expansion by the more successful EC's should be welcomed.

a) The EC company constitution and the prospectus on which its shares are issued could lay down the criteria for investments in small local businesses (eg the company will follow the criteria laid down from time to time by the Chancellor of the Exchequer for defining an EC). Directors will be in breach of duty if this is not followed.

b) It is not necessary or desirable to attempt restriction by definition of local areas in the initial legislation. However the fact that an EC is incorporated in a local area, with local shareholders and (generally) local directors, will give it a local identity which will in practice bias it to local investments.

c) The difficulty and cost in appraising and controlling small investments from long distance will give commercial incentives to invest in businesses close to the EC management centres.

d) If ECs do not follow the rules on investing the appropriate amount in small companies they will lose the beneficial tax status. EC's would need to renew their approved status with Inland Revenue each year when their accounts are presented. The requirements for BES is that rules must be met for 5 years. A similar rule could apply for EC with a slight adjustment so that shareholders lost 20% of their tax relief in each of the following five years in which the criteria were not satisfied. Shareholder pressure would keep the directors in line.

ANNEX C

'CHANCE IN A LIFE TIME'

Policies on enterprise concentrate on types of firm rather than individuals. Yet an essential part of spreading the enterprise culture is to increase individuals' knowledge and experience of running a business. The evidence is that the sons of self employed men are much more likely (2½ times more likely) than other people to enter self employment themselves. Encouraging more people now to try to run their own business will be a powerful effect in the future in encouraging a willingness and an awareness of enterprise.

One approach is to offer a package of assistance to anyone who wanted to set up a business but that package would only be available to them once in their life time.

The package might be targetted at an area of particular need - such as the North East - and might include enterprise training (eg. a one week self employment course), a voucher towards advice on finance or marketing, a tax holiday for the first two years and possibly free rates for the first year or two. This package would not be linked with any other scheme. People's 'rights' to the package would probably have to be through a separate administrative check based on the national insurance system. People who were already self employed would not be eligible, and there would need to be rules to prevent abuse such as exist under the EAS (eg "new businesses").

The cost of such proposals depends on the number and value of such incentives and the coverage of the scheme. Assuming the scheme were restricted to the North East (MSC Northern Region) the following costs are provisionally estimated.

Income tax forgone	£37 million
NI forgone	£ 8 million
Gross cost to Exchequer	£45 million

ANX C CHANCE IN A LIFE TIME

Annex B

Appraisal Costs

The supply of small loans is inhibited by the costs of investment appraisal, which can be proportionately much greater for small than for large investments. Funding bodies are therefore encouraged to make fewer, larger loans. Many small firms have suggested that assistance with appraisal costs would help them in obtaining funds. BIS and BTAS provide precedents for providing similar assistane. A grant scheme could have the following features:

(i) it would be limited to Enterprise Companies and BES investments. This would limit the costs, encourage people to channel investment through these schemes and prevent abuse of the cost limits;

(ii) it would be limited to appraisals on investments under £100,000, so that help goes where it is most needed;

(iii) it would be limited to 55% of the cost of each appraisal up to a maximum of £2,500 or 4% of the proposed investment whichever is smaller - this ties in with current BIS limits;

(iv) to prevent an open-ended commitment of funding, the grant 'pool' could be subject to an overall annual amount [or BES grants could be, with individual ECs subject to an annual limit of 3% of their funds].

ANX B APPRAI-SAL COSTS

ANNEX D

EMPLOYMENT STATUS

Processes for determining an individual's employment status are unclear and DHSS and Inland Revenue may give different decisions on the same facts. Employers may be faced with up to six years' back tax/NI because of reclassification by IR. In the long term the traditional concepts of "employee" and "self employed" need radical examination in the light of developments in the tax and NI systems, but the following changes should be made to offer immediate help:

- unification of the definition of self-employment for tax and NI purposes.

- a "one stop shop" giving individuals and employers a definitive written ruling on both tax and NI status which would be binding on both IR and DHSS on the basis of the given facts.

- a common appeal process via the Tax Commissioners.

ANX
D
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MENT
STATUS

ANNEX E "Learn as you Earn"

1. Tax relief is not generally available for vocational education and training undertaken on the employee's own initiative, although relief is available for the employer's spending on job related training. Tax incentives to employees to invest in training which is directly vocational but not related to their present job offers a new approach to training.

2. A number of options are available such as tax relief on savings accounts into which employees could contribute and tax relief on expenditure on agreed courses. At this stage a limited tax relief should be introduced to see whether this approach encourages more training by employees. Since spending by employees on their own training is very limited at present, the deadweight element in such tax relief is likely to be small.

3. The proposition is for tax relief on courses giving credits towards recognised vocational qualifications. These courses should be agreed with the MSC who would also recognise the trainers. Tax relief could be given at source at basic rate by the trainer on production of a pay slip detailing the employees tax code.

ANX E 'LEARN AS YOU EARN'

These gross costs would be reduced by flowbacks in benefits from induced entrants which might amount to about £5 million, bring the net cost of the scheme down to about £40 million. (These figures assume that 30% of entrants are new self employed induced by the scheme, of which 10% will displace other self employed people from business. About £1m will appear as an increase in EAS costs).

The total costs of the training package (assuming one week's MSC self-employment course) would be just under £2m and would come out of the MSC's existing Adult Training budget. About 75% of financial package marketing advice costs of about £2.6 million could be borne by the BIS budget, leaving about £0.65m to be financed separately.

[One extension to this approach could be a form of tax amnesty. This might include some level of forgiveness for tax debts, arrangements for scheduling tax debt repayments, freedom from penalties, and help with understanding tax requirements and putting in new accounting systems. This could be a permanent scheme as part of the "chance in a lifetime" package].

ANNEX F

EMPLOYEE SHARE OWNERSHIP

Tax relief for share purchase

The Industrial Participation Association (IPA) have suggested tax relief should be provided on amounts invested by employees to buy ordinary shares in their company through a savings contract. A condition of tax relief would be that shares would be held in trust for 5 years. Employees would however receive dividends and have voting rights. This proposal differs from the existing SAYE scheme in that the employee would immediately become a shareholder and would gradually build up his shareholding before having to decide in a once-for-all way whether to keep or sell his shares. There would of course be an element of risk for the individual in that the value of his shares could fall as well as rise. This is consistent with the principle of giving the individual a degree of financial commitment to the success of the company which is a constituent of the proposed Profit Related Pay Scheme.

Discretionary Share Option Schemes

Since their introduction in 1984 these schemes (often known as executive share schemes) have spread far more rapidly than the more long-standing all employee schemes. By June 1986 the Revenue had reportedly approved 1,676 discretionary share option schemes compared with 562 of the approved profit sharing (APS) schemes introduced in 1978 and 541 SAYE schemes introduced in 1980

The Wider Share Ownership Council have already made a case on grounds of wider share ownership for making tax concessions in discretionary share option schemes dependent on companies introducing a scheme open to all employees. If Profit Related Pay were to be introduced companies could be allowed to have a discretionary share option scheme only if they also had either Profit Related Pay or an all-employee share scheme.

Given the undoubted popularity of the discretionary share option schemes, it does seem that placing such a condition on the tax concession could indeed be a spur to the introduction of all-employee share schemes or Profit Related Pay.

ANX F EMPLOYEE SHARE OWNERSHIP

ANX G CO-OPS

ANNEX G

CO-OPERATIVES

Taxation changes

1. The Co-operative Development Agency has proposed a new type of co-operative - the Equity Participation Co-operative (EPCs) - which allows the injection of equity through a system of holding and subsidiary companies. The CDA have been in discussion with the Inland Revenue recently in order to sort out certain general taxation points relative to EPCs. BES money cannot be put into subsidiaries, so there is no way of using the BES even with EPCs. There would seem to be good grounds for seeking a change to the BES rules to allow BES finance to be put into EPCs.

2. Because co-ops generally distribute profits by way of interest on loans, rather than dividends on ordinary shares, the tax treatment is different from that of other companies. Ordinary company dividends are subject to Advance Corporation Tax, but this can be offset against Corporation Tax in the previous 6 years. The interest paid by a co-op is not subject to ACT, but the recipients have to pay Income Tax on it. This puts members of a co-op at a potential disadvantage vis-a-vis shareholders in a normal company in that there is no provision to offset this interest against losses in previous years. Some greater equality of treatment should be given to members of co-ops, although the full 6 years offset would probably be too generous.

Industrial and Provident Societies Act (IPS Act)

3. Many co-ops are registered under the Industrial and Provident Societies Act and various requirements/practices under this Act place those forming co-ops at a disadvantage in comparison with other groups forming companies under the Companies Act.

Registration Fees

4. The cost of registering a conventional company under the Companies Act is £50 (unchanged since 1979) whereas registration of a co-operative under the IPS Act costs £140 where approved model rules are used and £300 in all other cases; IPS fees have trebled since 1979.

5. These high fees are acting as a disincentive to new enterprises to register as bona fide co-operatives under the IPS Act and many would-be co-operatives are instead obtaining limited liability by registration under the Companies Acts. Co-operatives registered under the IPS Acts have to adhere to rules based on co-operative principles and therefore the co-operative movement would prefer to see registrations under the IPS Acts rather than under the Companies Acts. A reduction in IPS fees or at least a brake on further increases would greatly benefit co-operative formation.

Industrial and Provident Society Membership

6. The upper limit of £10,000 which can be held by a member of an industrial and provident society has reduced in value in real terms to a significant extent over the past few years. It is suggested that that limit should be increased to £15,000 and then kept annually in line with inflation.

Industrial and Provident Society Membership

7. In order to make it easier for smaller groups of people to set up co-operatives, it is recommended that the statutory minimum requirement of 7 founding members be reduced to 4 or 5; or possibly even to 2 in line with the requirement for forming a limited company under the Companies Acts.

ANNEX H

NATIONAL FREIGHT CONSORTIUM PROPOSITIONS

ANX H NFCP

1. In FA 1974 Schedule 1 para 10D (1), that (B) be deleted entirely.

This is the section which provides interest relief on money borrowed for investments in employee controlled companies, the sub-para (b) restricts that relief to investments made at the time of an employee buy-out or within 12 months of the company being set up. Other instances of relief, such as investment in close companies, co-operatives or unincorporated firms are not so restricted and there seems no logical reason why employee controlled companies should be singled out.

The effect of the restriction is to create two classes of employee shareholder within the same company and causes problems. It may prevent NFC continuing as an employee controlled company. Revenue losses are likley to be limited.

2. In FA 1978 Schedule 9 para 1 (1) that at the end of (B) the following word be added:

'Or of encouraging such persons to purchase shares in the company whose shares are the subject of the scheme'.

This part of the 1978 Finance Act is the main section relating to profit sharing schemes. Inland Revenue interprets the requirement in (b) so as to restrict the ability of complaints to offer schemes based on a mixture of saving to buy shares and bonus shares.

NFC has recently introduced a profit sharing scheme in two parts, part 'A' provides for bonus shares to be issued to employees who agree to purchase shares in the company via salary deduction, part 'B' is a straight forward profit sharing scheme requiring no investment by the individual. It is the revenue policy to refuse approval because of the wording of (b) where the amount required to be invested by the employee is more than the total amount set aside by the company. This gives rise to the odd situation that the Inland Revenue is compelling a company to be more generous than it would otherwise be and it is therefore a considerable constraint on the introduction of such a scheme. NFC would have preferred to have introduced a scheme which allowed employees to invest up to say 10% of their salaries and received say one free share for every 5 purchased. In practice they have reduced the amount which employees could invest and increased the number of free shares. This made the exercise much less effective from the point of view of increasing employee commitment and motivation. The extra wording set out above is suggested as a way through this particular difficulty.

There should be no measurable effect on tax since the free shares which will be issued as a result would not have been previously issued subject to tax.

ANNEX I

ANX 1 HOUSING FOR JOBS

Housing for jobs

(1) Resident Landlords

The DoE initiatives are targetted to new graduates incomes and above. At the other end of the range young single workers, who may be willing and able to move to new jobs or for training, may be satisfied with low standards of accommodation provided they can arrange it in advance and feel secure. The obvious solution is the large pool of unoccupied front bedrooms - and that is large even in the south-east. There are many reasons why people don't let their spare rooms but given the numbers, a massive response would not be needed to make an impact. We might succeed with a scheme of matching trainees/young job-seekers to landlords at the same time providing tax incentives. Amateur landlords are liable for CGT and income tax. Often (though not always) the liability is small given offsetting expenses but it is a considerable irritant. Relief on CGT and Income Tax could be generally available or limited to those taking young job-seekers (that might lead to justified resentment). If general, there would probably have to be a rent limit per tenant on the relief, say £30 a week.

(2) Employers

One of the DoE initiatives to help to ease geographical mobility is an expansion of assured (non Rent Act) tenancies in a part privately, part publicly funded scheme. These are housing association run. The finance envisaged for pilot schemes is 30% grant, 70% index-linked loan. This produces rents between fair rent and market levels. Although only the 30% will count against public expenditure totals, money is limited. To increase the number of housing units available for mobile workers on assured tenancies, employers might be prepared to purchase a number of such units, lease them to a housing association on a short lease negotiated at sub-market rents on conditions which would include the housing association making available to the employers' nominees the same number of units. The employer is relieved of housing management, he buys into a more flexible arrangement than he can have by straight purchase and he retains a capital asset. Nonetheless in exchange for foregoing market rates of interest on their capital employers will need a more specific incentive ie. <u>deferred corporation tax on their investment until time of sale.</u>

ANNEX J

BUSINESS EXPANSION SCHEME

Small Workshops

1. A report to the Department of Industry by Coopers & Lybrand and Drivers Jonas in 1980 found that a "shortage of small industrial premises persists in the country as a whole". Partly in response to this, the Small Workshops Scheme was introduced and ran, with modifications, until 1985. Reports by DTI economists showed that the SWS had a major impact on private sector provision of small workshops. By 1985 it was found that the supply of workshops in the 1250-2500 square feet range was generally adequate. For workshops below this size the picture varied in different areas, but in general the market became tighter the smaller the size, and the report concluded that "a tight market persists for small starter workshops in many areas of the country". Surveys by local authorities and Chambers of Commerce have confirmed this finding.

2. Premises are one of the basic requirements for any business. Lack of availability of premises will prevent businesses starting up or expanding, while forced reliance on unsuitable premises will reduce the prospects of success. As the demand for small premises increases with the growth of the small firms sector, there is a danger that a shortage of premises will become a serious obstacle to further progress.

3. Studies show that in the absence of incentives the private sector property market has difficulty in responding to emerging demands. Small premises developments tend to be speculative and carry a higher risk than large projects. Small business tenants also have a higher turnover and present other disadvantages to landlords. In many areas local authorities and other public sector agencies have stepped in to meet small firms' needs, but this in turn prevents an efficient private sector market developing.

4. Tax relief in BES for investment in companies running premises developments - units of less than 1250 or 1000 square feet could be justified within the philosophy of BES because of the speculative, high risk aspect of this activity. It is not likely that developments would be started just to obtain tax relief on an investment in land that could be sold after 5 years: few investors would be prepared to incur the cost of building workshops and receive no return for 5 years just to obtain the tax relief.

ANX J BES

5. Investment in workshops would have to compete with other BES investment opportunities. While the prospect of asset backing would be an attraction, the risks and costs of small premises development would discourage frivolous investment. It is likely that investment would be concentrated in those areas - mainly the South East and the Thames Valley - where demand for small premises is known to be strong. This is not a disadvantage, since these are the areas where shortages are most often felt.

6. Assuming that between 2% and 5% of total BES investment is directed to this use, investment of up to £5m per annum might be generated, at a cost in lost revenue of up to £2.5m. This would pay for the construction of up to 200 new workshops assuming an average floor area of 700 square feet. (From experience with the SWS, however, investment might tend to be concentrated around the upper size limit, whatever that may be).

7. Employment effects and cost per job are difficult to estimate. The standard methodology covers only first year costs and benefits. In the case of premises developments the first year employment effect would be mainly in the construction industry. The main economic benefit would be the jobs created or preserved in small firms occupying the premises in subsequent years, and the long term benefit of expansion by firms enabled to start up as a consequence of the measure. These effects are not readily quantifiable.

The main justification of the proposal must be that it helps to prevent what appears to be a growing shortage of premises which might otherwise become an obstacle to the growth of the small firms sector.

ANNEX K

ANX K CLAIMS + ELECTIONS

CLAIMS AND ELECTIONS

- Partnership Continuation Elections (S.154)

In the event of any change in the person comprising the partnership, the business is automatically treated as having ceased and a new business commenced at the date of change. However, election can be made, by all partners, either before or after the change, within two years of the change, to have the continuation basis applied. Partnership taxation is generally accepted to be one of the most difficult areas to cope with and this difficulty often leads to a loss of taxation to the partners when the time limits cannot be met. These time limits should be extended to three years.

- Disclaimer of WDAs FA1984 (S.59)

Such allowances may be disclaimed or reduced by written notice to the inspector within two years of the end of the relevant accounting period. Many businesses find it difficult to meet this time limit and it should be extended to three years.

- Rollover Relief

Expenditure on new assets must take place within one year before, or three years after, the disposal of the old but the Revenue may allow further time, for example, where it has not been practicable for the trader to acquire new assets within the time limits. This should be overcome by extending the three years after time limit to six years. Bearing in mind that the relief is restricted to investment in certain assets only the extension would provide for better tax planning.

- Group Relief

Claiming for group relief must be made within two years after the year of the claim relates. Where larger groups are involved it is often difficult to finalise individual accounts and still meet the group relief time limit which should be extended to three years.

CGT Rollover Relief

Two technical recommendations are made to improve the operation of rollover relief:

- indexation of rollover relief where a business sells assets and reinvests the proceeds into the purchase of other qualifying assets rollover relief is available to them. Whilst the introduction of indexation was tailored to exclude those inherent inflationary gains, there is a loss of indexation relief as a result of rollover relief being claimed by businesses. It is considered that no interactional cost should be attached to claiming such relief and we therefore seek an extension to S82 FA 1982 in these circumstances.

- Classes of Assets:

Rollover relief is currently restricted to reinvestment into fixed plant. We consider that relief should be extended into reinvestment into heavy moveable plant with a minimum monetary level of say £40,000 per asset. Additionally we suggest that relief be extended to reinvestment in other close company business assets.

RA3.81

cc Mr Scholar
Mr Pratt

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

3 October 1986

David Norgrove Esq
10 Downing Street
LONDON
SW1

Dear David,

DATE OF THE 1987 BUDGET

The Prime Minister may wish to be aware that the Chancellor is aiming to present his Budget on 17th March next year. However, it is not yet possible to make a final decision and the 10th and 24th March are still possible alternative dates. As you know, we normally announce the date of the Budget during the first business question in the New Year.

Yours
Alex

A C S ALLAN
Principal Private Secretary

10 DOWNING STREET

CH/EXCHEQUER

REC.	7 OCT 1986
ACTION	MR SCHOLAR
COPIES TO	SIR P MIDDLETON
	MR CULPIN
	MR PRATT

7/10

From the Private Secretary

7 October 1986

pwp

Dear Alan,

DATE OF THE 1987 BUDGET

Thank you for your letter of 3 October about the date of next year's Budget. 10 and 17 March would suit the Prime Minister's diary perfectly well. However, King Fahd of Saudi Arabia arrives for a state visit on 24 March. Cabinet would be held before the Prime Minister left to meet the King, but the Prime Minister might not be able to attend for as much of the Budget debates as she would wish. So 24 March (if the King sticks to this date) is the least attractive of the three.

Yours,

David.

David Norgrove

A. C. S. Allan, Esq.,
H.M. Treasury.

CONFIDENTIAL

INCOME TAX/EMPLOYEE SHARE SCHEMES

Starter No	Minister In Lead	Description of Starter	Comments
101	CX	Income Tax Allowances, Rates and Thresholds	For Chancellor's consideration.
102	FST	Car and Car Fuel Benefit Scale Charges	Provisionally decided
110	FST	Taxation of Payment of Invalid Care Allowance to married women	Early submission - discuss when received
111	FST	Taxation of income support paid to unemployed and strikers	Chancellor decided that this will be included in FB - submission to come on details
115	FST	(Employee Share Schemes - (Material Interest	These can be covered at a meeting along with submission from Treasury on Wider Share Ownership
116	FST	(Roll-over on options on take-over (	
117	FST	(S.79 loophole closure	

CAPITAL TAXES

Starter No	Minister In Lead	Description of Starter	Comments
104	FST	Inheritance Tax Rates and Thresholds	Major submission coming forward - discuss when received
144	FST	IHT - Exemption of Personal Pension Schemes Benefits	Consequent upon decision on personal pensions tax regime
146	FST	CGT : OTC Options and Futures	To be included in FB - Revenue consulting to make sure they get definition right
147	FST	CGT : Relief for Venture Capital Companies	No action - Revenue discussed with BVCA - you have written to them

CONFIDENTIAL

CAPITAL TAXES (Continued)

165	FST	IHT Business Relief	Chancellor has agreed to retain as Budget Starter on basis of 25% control test but without extention to agriculture. To be looked at again when overall shape of package clearer
105	CX	CGT Rate	)To be considered by Chancellor following decision)on CGT Reform
106	CX	CGT Annual Exempt Amount	)

BUSINESS TAXES

107	FST	CT Rate for Financial Year 1987	)Both are dependent on decisions on I.T. rate)so no decisions needed until New Year.
108	FST	Small Companies Rate of CT	)
122	FST	Exemption Limit for Trade Union Provident Benefits	Minor measure - submission next week
123	FST	B.E.S.	Sweeping-up submission following 1986 FA changes. Due late November.
124	FST	Relief for pre-trading R&D	Submission due shortly.
125	FST	Taxation of Woodlands	Submission received - being pursued
148	FST	Restriction of Revenue discretion	Being looked at by Revenue - submission early December.
149	FST	CT Payment dates	Submission received - being pursued.

CONFIDENTIAL

BUSINESS TAXES (Continued)

150	FST	Currency Exchange Differences (Tax Treatment of Exchange Losses)	Submission received - Revised S of P to be issued but no legislation in 1987 Finance Bill.
151	FST	Capital Allowances: Court's decision that Allowances for companies not mandatory	Need for legislation depends on Court of Appeal hearing in November - short note will be submitted next week.
152	FST	CAs - Updating of Provisions preventing double allowances	Submission by end of next week.
153	FST	CAs - Extension beyond 31 March 1987 for dwelling houses let on assured tenancies.	Submission by end of November.
154	FST	Tax Relief for Educational Secondments	Agreed - announcement in advance of Budget.
157A	FST	FSB Consequentials - Unit Trusts But with Consultation.	Decision taken - Revenue to proceed as recommended
157B	FST	FSB Consequentials - Definitions of Stock Exchange	Submission awaited - straightforward

OIL TAXATION

113	FST	PRT Valuation Rule	) Go-ahead given 22 October
114	FST	Manipulation of Brent Market	)
129	FST	Relaxation of Offshore Oil Tax Regime	Decision announced 6 November
159	FST	PRT Relief for Research	Go ahead given 22 October.
160	FST	N Sea Oil Companies A.C.T. & Ring Fence Profits	Further work requested 24 October. In present form rather expensive - but still under consideration.
161	FST	Relaxation of Uplift after Payback	~~Submission awaited.~~ Received - NO ACTION.

128	CX	ICI Case	Position should be clear by end 1986 - Submission at that stage.

PENSIONS

112	FST	Tax Regime for Personal Pensions	Submission very shortly - quick decision then needed.
135	FST	Renationalisation Current Pensions Law & Practice	Consequent on 112 which gives an opoortunity for review.

INTERNATIONAL TAXATION

126	FST	Offshore Funds	Submission awaited.
127	FST	Dual Resident Companies	Decision taken - (Minute 28 October) 1987 Legislation preceded by consultations.
158	FST	Double Taxation Relief - Banks: Foreign Withholding Tax	Submission very shortly - then quick decision needed.

MISCELLANEOUS

162	CX	Minimum Tax	Chancellor to decide very soon whether to pursue or to aim at individual tax shelters.
163	FST	Pre-Consolidation AMendments	Needed before 1988 Consolidated Act.
131	FST	Tax-Neutral Maintenance Payments	Joint Paper from IR/DHSS/DE Submission within two weeks.
132	FST	Tax appeals - Gen Commissioners for Northern Ireland	Submission shortly - probably recommend consultation.
133	FST	Tax appeals - Place of hearing by General Commissioners	Submission shortly. Consultation needed.
134	FST	Tax Information Requirements	Submission shortly.

MISCELLANEOUS (Continued)

164	FST	Amendment to S58 FA 969	Provisionally included - again, as last year, subject to space.
109	FST	Mortgage Interest Relief	Submission received - decision to keep option of restricting higher rate relief if limit increased.

3361/15

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

P8

FROM: J J HEYWOOD
DATE: 24 October 1986

MRS HUBBARD IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Cassell
Mr Scholar
Mr Robson
Miss Sinclair
Ms Leahy
Mr Graham
Mr Pitts IR
Miss Hill IR
PS/IR

BS.160: NORTH SEA OIL COMPANIES' ACT AND RING FENCE PROFITS (S.16 OTA 1975)

1. Further to your submission to the Financial Secretary of 10 October, covered by Mr Pitts' minute of the same date, I understand that you agreed at the Chancellor's meeting to examine the possiblity of extending your initial proposal to incorporate a per company monetary limit.

2. The Financial Secretary looks forward to seeing the results of this further work.

3. The other oily issues directed, in the first instance, at the Financial Secretary (BS.113, 114, 159) were dealt with at the Chancellor's meeting.

J.H

JEREMY HEYWOOD
Private Secretary

CONFIDENTIAL

CE14

SECRET

As requested in Mr Hudson's minute to me of 25 September.

MCS 28/10

FROM: MISS C EVANS
DATE: 28 OCTOBER 1986

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2. **CHANCELLOR OF THE EXCHEQUER**

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2. Where are we now on X?
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Caiys Evans

MISS C EVANS

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CE14

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MCS 28/10

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DATE: 28 OCTOBER 1986

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3661/038

FINANCIAL SECRETARY TO THE TREASURY

FROM: NIGEL WILLIAMS

DATE: 29 OCTOBER 1986

MR GILHOOLY/IR

cc PS/Chancellor of the Exchequer
PS/Chief Secretary
PS/Minister of State
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Monck
Mr Cropper
Mr Monger
Mr Graham
Mr P B G Jones/IR
PS/IR

1. The Financial Secretary was grateful for your minute of 21 October.

2. He is content at this stage for this item to be included in the list of starters for the 1987 Finance Bill and for discussions to be held with Department of Employment for the purposes of instructing Counsel.

N Williams

NIGEL WILLIAMS
(Assistant Private Secretary)

FROM: F GILHOOLY
DATE: 21 OCTOBER 1986

INLAND REVENUE
MANAGEMENT DIVISION
SOMERSET HOUSE

(1) MR P B ~~G~~ JONES J. 22/10/86

(2) FINANCIAL SECRETARY

BUDGET STARTER 1987

DISCLOSURE OF INDIVIDUAL ESTABLISHMENT EMPLOYMENT DATA TO LOCAL AUTHORITIES

1. Section 58 of the Finance Act 1969 empowers the Board of Inland Revenue to disclose to the Department of Employment the names and addresses of employers and the number of employees in each PAYE scheme for use in conducting the Census of Employment. The information is supplied from the Inland Revenue Employers' Index. Section 58 prevents the Department of Employment from disclosing this information other than to another Government Department for the purpose of a statistical survey. We obtained the approval of your predecessor last year to a proposal that a change should be made to the existing legislation in order that the information already provided by the Inland Revenue may be passed by the Department of Employment to local planning authorities and local education authority careers services. In the event the change was not made primarily because of a lack of space in the 1986 Finance Bill.

CC Chancellor of the Exchequer
Chief Secretary
Minister of State
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Monck
Mr Cropper
Mr Monger
Mr Graham

Chairman
Mr Isaac
Mr Painter
Mr Rogers
Mr Pollard
Mr Jones
Mr Corlett
Mr Walton
Mr Cherry
Mr Newcombe
Mr Sullivan
PS/IR

2. The initiative for the proposed change comes from the Department of Employment. The Employment and Training Act 1973 allows that Department to pass individual establishment data collected under the Statistics of Trade Act (i.e. non-Revenue information) to local planning authorities and local education authority careers officers to aid them in their statutory duties. Lists of establishments - showing name, address, standard industrial classification, and numbers of employees by sex and whether full or part-time as collected for the Census of Employment - have therefore been made available. So long as every employer was regularly surveyed, the Department of Employment could provide the information required. But for the future (following a Rayner review) so far as the smaller employers are concerned only a sample will be surveyed. The Department of Employment will not, therefore, have disclosable information from the Census of Employment about every employer.

3. The local authorities concerned have been pressing the Department of Employment for the shortfall in information to be met by their having access to data from the Inland Revenue Employers' Index on the same basis as they have access to data collected under the Statistics of Trade Act. They attach considerable importance to this information and stress that:-

a) they require the information in order to provide an effective local employment policy;

b) they could only otherwise obtain the information by duplication of the survey work; and

c) obtaining the information from the Department of Employment reduces the burden on small businesses which would otherwise be subject to a local authority enquiry.

4. For the local planning authorities it would, for example, serve as a basis for their own local employment survey, and help them chart the changes in employment structure of an area in the terms of the size and number of economic units. It is also important for the local education careers service to maintain a good knowledge of, and contacts with, employers in their area; employment information provides a basis for the maintenance of this knowledge and contact.

5. The information given to the Department of Employment is largely public knowledge already. For example, the name, address and industrial classification of an employer can be gleaned from a telephone directory (yellow pages). The main element which would not be generally available is the number of employees, but this will not be given in precise terms; the intention is for employers to be classified in bands (e.g. over 1,000 employees, 200-999 employees etc). Local authority access would be through the Department of Employment, and there would be no question of any additional material being made available. We do not think that provision for this information to be passed to a local authority is likely to be controversial. There will, of course, be no additional cost to the Revenue since we already provide the Department of Employment with this information.

6. Ministers are invited to give their agreement in principle to this matter being included in the list of starters for the 1987 Finance Bill and to authorise discussions with Department of Employment for the purposes of instructing Counsel.

F Gilhooly

F GILHOOLY

CE14

SECRET

As requested in Mr Hudson's minute to me of 25 September.

MCS 28/10

pmp

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Inland Revenue

Policy Division
Somerset House

b/f with FST's response ?

CONFIDENTIAL

FROM: MRS C B HUBBARD
DATE: 6 NOVEMBER 1986

1. MR PITTS Please see my note at the end. 6/11.

2. FINANCIAL SECRETARY

BS. 161: RELAXATION ON RESTRICTION OF UPLIFT AFTER PAYBACK (S.111 FA 1981)

Background

1. This starter emanates from representations made by the Dorset group of companies who are 50% participators in the Wytch Farm oilfield following the purchase of BGC's share in 1984; the other 50% is owned by BP. The Dorset group's concern is about the non-availability of uplift (a 35% addition given to initial exploration and development expenditures) in respect of the additional expenditure in developing the Wytch Farm Sherwood sands reservoir which is likely to be incurred between 1987-1990.

The Problem

2. S.111 FA 1981 sets a time limit for the allowance of uplift. Uplift is given on qualifying (mainly capital)

---

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State
Mr Cassell
Mr Scholar
Mr Williams
Miss Sinclair
Ms Leahy
Mr Graham - Parliamentary Counsel
Mr Painter
Mr Pollard
Mr Beighton
Mr Pitts
Mr Elliss - OTO
Mr Cleave
Mr Beauchamp - OTO
Mrs Hubbard
Miss Hill
Mr Parker
Mr Pang
PS/IR

expenditure incurred in the development of a field up until the time at which the field makes a cumulative net profit (ie until it reaches payback). The rationale underlying this cut-off point is that uplift is a broad substitute for financing costs which are specifically excluded from the categories of expenditure attracting PRT relief, and once a field has reached payback, future expenditure can be met out of cash flow from the field.

3. There is, however, a relaxation to this rule in S.113 FA 1981. This provides that if a field reaches payback but within a period of three years returns to a cumulative net deficit, then uplift is given in respect of qualifying expenditure in those three years or until a cumulative profit position is again reached, whichever is the earlier. This relaxation was introduced at the behest of the oil industry. The Revenue were however concerned to avoid the situation in which claims for uplift were continued on a provisional basis for a long time, just in case the situation of overall net loss might recur. The industry themselves suggested that a three year time limit would be sufficient to meet their concern. Wytch Farm reached payback in the first half of 1983 and is not expected to go into a cumulative net loss position again until the second half of 1987. They will not therefore benefit from the S.113 relaxation.

4. The Wytch Farm participators (including BP) will thus get no uplift to compensate for the (non-PRT relievable) financing costs of the additional development of the Sherwood sands reservoir. The development costs are estimated to be about £m250 compared with field cash flows of about £m110 during the period between payback and the completion of the Sherwood Sands development. It is therefore apparent that significant financing costs will accrue in respect of the additional development of the Sherwood sands reservoir which, in this unusual case, is the major development phase (7 x larger than the original development). (As some of the cost of the development can be met out of current cash flow, the net financing cost is, of course, significantly lower than the cost of the remedy sought (£100m - see paragraph 6 below).) There are other examples of

significant post-payback development expenditures, but none which have returned a field to a cumulative net deficit position. The Dorset group have made representations that the denial of uplift in these circumstances is inequitable, and further argue that but for the protracted negotiations of the purchase of BGC's share and subsequent planning delays which were outside their control, the additional development would have proceeded earlier so that at least some uplift under the S.113 relaxation would have been obtained.

5. We accept that the situation described above is in principle anomalous. Indeed we introduced legislation (S.91 FA 1985) which dealt with somewhat similar problems relating to extended production tests (pre Annex B production to determine the economic viability of a field) where early payback might be triggered as a result of such a test with the result that uplift and safeguard benefits were curtailed. However, extended production tests are a rather different case. Where payback is reached during the period of such a test (because the value of the oil exceeds the cost of undertaking the test), uplift and safeguard would be prematurely cut off before the field even receives development consent. Thus all of the subsequent development costs would be denied uplift, even though there would be no current cash flow from the field out of which to finance the development.

6. The Wytch Farm circumstances are much more unusual and, so far as we are aware, there is only one future field (offshore) where a similar situation might possibly arise. The fact that any change would have a narrow application only does not, of course, weaken the argument for remedial action, but there are further factors which muddy the waters. It seems reasonable to assume that the Dorset Group would have been aware, at the time of the Wytch Farm purchase, that under the present law there was a risk, or possibly even a likelihood, that at least some of the additional development expenditure would not get uplift and that that probability is reflected in the purchase price. Even at today's oil prices we think that Wytch Farm remains an extremely

economic development, and that the Sherwood Sands development will go ahead anyway. It is interesting that BP, the other 50% participator who would appear likewise to have a case for complaint, have not so far made any representations on this issue. The cost of relaxing the rules to allow uplift, which, as we have explained above, we think is largely deadweight, would not arise until the early nineties, because, on present projections, no PRT will be payable until then, but could then amount to around £100m.

Possible Solutions

7. The most straightforward solution would be simply to disapply the 3 year time limit in S.113 FA 1981. For the reasons set out in paragraph 3 above, we would not want to remove the time limit altogether. Otherwise there would be an incentive for companies to continue to claim uplift for a long time, just in case they might revert to an overall deficit in the field. This would delay unduly the settling of claims. Refinements could be made to tailor any solution specifically to the Wytch Farm situation - the Dorset Group's tax advisers have suggested the restoration of uplift where a field goes into cumulative overall deficit within two years of a new Annex B. But a more restrictive solution risks the possibility of further representations from anybody who might in the future fall outside - at present we see only one future field which might fall into this category.

Conclusion

8. We can understand why the Dorset Group have made this representation but as explained in paragraph 6 are not entirely convinced of its merit. Irrespective of the question of principle, the crucial question seems to us to be whether Ministers are prepared to introduce legislation which will benefit an already highly profitable field to the tune of some £m100, albeit not until the early 1990s, especially given that the actual disadvantage suffered as a result of having to finance

the development without any PRT relief for interest is considerably short of that figure (see Paragraph 4 above). Given other priorities we do not see this starter as one which ranks particularly highly on the starters list.

9. We should be grateful to know whether Ministers wish us to continue further work on this starter or whether it can be rejected, even at this early stage.

CH

MRS C B HUBBARD

There is a case in equity for doing something to meet the point put to you last July on behalf of the five 'small' companies which have minority interests in the Wytch Farm field. The purpose of 'uplift' is broadly to compensate for the fact that the finance costs of developing an oilfield are not allowable for PRT; this relief is usually available for part or all of the time these costs cannot be met from field revenues. But in the circumstances of this further development of an existing field, the uplift rules do not apply, although revenues won't be sufficient to cover the costs.

As against that, the tax cost of giving relief would be quite high, although not immediate: the normal uplift allowance would be overgenerous - ~~it~~ would more than compensate: and our present judgement is that this further development will go ahead even in the absence of relief.

The Department of Energy won't be ready to give their own final view on this for some weeks; but subject to any need to reconsider to which that may give rise, you may like to leave this to see if an amendment is tabled to the Finance Bill, then to test the strength of the argument made.

6/11.

RA7.37

Pomy Stoked

Ch
I have alerted Peter that this is on agenda for this afternoon. AA

FROM: A C S ALLAN
DATE: 10 November 1986

CHANCELLOR

MEETINGS ON TAX

It seems to us you are going to want to hold five meetings on tax over the next few weeks:

(i) IT/CGT Reform

(ii) Minimum Tax

(iii) Portable Pensions and AVCs

(iv) Consumer Credit Tax (the credit card tax)

(v) Monger on Tax Reform

Roughly in that order of priority.

2. The most important is IT/CGT, and the first choice is whether you want to launch straight into a medium-sized meeting (about four from Treasury and four from Revenue) or whether you want to preceed that with a meeting with just, say, Tony Battishill, John Isaac and Michael Scholar. We are expecting very shortly the further material you requested on CGT; and the additional material from Brian Mace should follow on Wednesday. We could try to slot in a quick meeting on Thursday (perhaps instead of free-standing AVCs), but otherwise would have to arrange it for Tuesday - John Isaac is away all Friday.

3. On minimum tax, you have asked for FST and FP comments. We do need an early decision if the Revenue are to go ahead with a proper minimum tax, as opposed to piecemeal action on forestry, farming

etc. We could, again, steal the Thursday slot from free-standing AVCs or - possibly - go ahead on Friday without John Isaac.

4. Free-standing AVCs has a slot on Thursday afternoon - though vulnerable to being presented by (i) or (ii). It could if necessary be shunted to Friday week after the Debate on the Address and the TCSC hearing.

5. We are promised the paper on consumer credit tax tomorrow. We would try for a meeting this Friday afternoon.

6. Monger on tax reform can be slotted in a little later after the four meetings above.

AA

A C S ALLAN

CONFIDENTIAL

pmp

FROM: J J HEYWOOD
DATE: 10 November 1986

MRS HUBBARD IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Cassell
Mr Scholar
Mr Williams
Miss Sinclair
Ms Leahy
Mr Graham OPC
Mr Pitts IR
PS/IR

BS. 161: RELAXATION ON RESTRICTION OF UPLIFT AFTER PAYBACK (S.111 FA 1981)

The Financial Secretary was grateful for your submission of 6 November. He agrees with Mr Pitts' suggestion that we should not proceed with this, but wait and see whether an amendment is tabled in the Finance Bill.

JJH

JEREMY HEYWOOD
Private Secretary

SECRET

28

FROM: A W KUCZYS

DATE: 10 November 1986

MISS EVANS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Cassell
Mr Monck
Mr Scholar
Mrs Lomax
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Ross Goobey
Mr Battishill - IR
Mr Isaac - IR
Sir A Fraser - C&E

TAX: FORWARD PLANNING

The Chancellor has seen your minute of 28 October. He has suggested one change in the Ministerial allocation: the Minister of State to take on Insurance Premium Tax and, in exchange, the Chancellor to take on Consumer Credit Tax (on which the Chancellor has asked to see papers as soon as possible).

2. Apart from this, the Chancellor is content with the timetable and Ministerial allocations you set out.

AWK

A W KUCZYS

Inland Revenue

Policy Division
Somerset House

28

FROM: C STEWART
DATE: 13 NOVEMBER 1986

1. Mr Corlett ACB 14/11
2. Financial Secretary

BUDGET STARTER 132: TAX APPEALS - GENERAL COMMISSIONERS FOR NORTHERN IRELAND

1. This starter is concerned with the arrangements for hearing tax appeals in Northern Ireland, which are at present out of step with the rest of the United Kingdom.

Background

2. In England, Wales and Scotland most appeals against tax assessments are heard by General Commissioners (local lay tribunals). But a taxpayer may elect in many cases to take his appeal to the Special Commissioners (a full-time specialist tribunal based in London) instead. In 1984 arrangements were introduced to divert "delay" cases to the General Commissioners - ie cases where the Inspector has made an estimated assessment but the information needed to settle the appeal is lacking, the real purpose of the hearing is to try to prise accounts, returns or information out of the taxpayer rather than to settle any dispute of substance.

---

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State
Mr Scholar
Miss Sinclair
Mr Wilson
Mr Cropper
Mr Tyrie
Mr Ross Goobey
Mr Graham (Parliamentary Counsel)

Mr Isaac
Mr Corlett
Mr Beighton
Mr Calder
Mr Cleave
Mr Hinson
Mr Pattison
Mr Yard
Mr Nield
Mr Boyce
Mrs Gomes
Mr Stewart
PS/IR

3. In Northern Ireland, however, for historical reasons there have never been General Commissioners. Most appeals, including delay appeals, are heard by the Special Commissioners who visit the province from time to time. There is an alternative right of appeal to the County Court, but it is little used in practice.

4. The Northern Ireland arrangements are unsatisfactory because -

a. dealing with large numbers of delay cases where there is no point in dispute is a waste of the Special Commissioners' time. This is high-lighted by the 1984 provisions directing delay cases away from them in the rest of the country;

b. as the Special Commissioners can only visit Northern Ireland occasionally, there is peaking of work, for professional advisers as well as the Revenue; and if the Commissioners have adjourned an appeal to allow the taxpayer more time to produce accounts or information, he has little incentive to do so until the next appeal hearing is due.

5. We have therefore been considering the possibility of setting up General Commissioners in Northern Ireland. The Special Commissioners themselves are keen that this should be done.

6. Such a change would need legislation in a Finance Bill (probably 1-2 pages at most) but we think it would be right to have a period of consultation in advance of legislation, and we have been preparing a consultative document for the purpose.

7. The Lord Chancellor has a strong interest in all this. He is responsible for the Special Commissioners. He also appoints General Commissioners in England and Wales, and would do the same in Northern Ireland if General Commissioners were introduced there. The General Commissioners appoint their own Clerk (almost always part-time), and operate as independent local tribunals.

They are unpaid, but their expenses, including the Clerk's salary, are carried on the Inland Revenue Vote. We estimate tentatively that the cost of running General Commissioners in Northern Ireland would be of the order of £70-90,000 a year.

But to the extent that a General Commissioner system resulted in appeals being settled more quickly, there could be some cash flow benefit to the Exchequer in earlier payment of the tax.

Present position

8. At present, we are awaiting comments on our draft consultative document from the Lord Chancellor's Department, who we understand are consulting the Northern Ireland Court Service about it. We have also consulted the Northern Ireland Office, who are content.

9. If the Lord Chancellor's Department respond fairly quickly, it might be possible to publish the document, allow (say) 2 months for consultation, and still leave open the possibility of legislation in 1987 - although this would imply our instructing Parliamentary Counsel pretty late in the day, and at a time when he is likely to be heavily involved in other, more important matters. We assume you would not in any event want at this stage to make a firm commitment to legislation in 1987.

10. There is no guarantee how quickly we will hear from the Lord Chancellor's Department. Meanwhile you may wish to consider whether you regard this as an item worth retaining as a possible starter for this year. If it has little attraction, an alternative way of proceeding might be to take a rather slower train, by having a longer consultation period and working towards legislation a year later - ie Spring 1988. This may prove to be the only course open to us if the Lord Chancellor's Department do not respond fairly quickly.

11. It would be helpful to know whether

a. you see this as a strong candidate for the coming Finance Bill (assuming we get a fairly quick response from the Lord Chancellor's Department); or

b. you would prefer in any event to leave it until the 1988 Bill, and issue in due course a consultative document with a rather longer period for discussion.

Cs

C STEWART

3362/014

FINANCIAL SECRETARY TO THE TREASURY

FROM: N WILLIAMS

DATE: 17 November 1986

MR STEWART/IR

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State
Mr Scholar
Miss Sinclair
Mr Wilson
Mr Cropper
Mr Tyrie
Mr Ross Goobey
Mr Graham (Parliamentary Counsel)
Mr Corlett/IR
PS/IR

BUDGET STARTER 132: TAX APPEALS - GENERAL COMMISSIONERS FOR NORTHERN IRELAND

1. The Financial Secretary was grateful for your submission of 13 November.

2. Having read your submission, the Financial Secretary's view is that this should not be a candidate for the coming Finance Bill.

3. The Financial Secretary would prefer you to proceed on the basis outlined in paragraph 11(b) of your submission ie that this starter should be left until the 1988 Bill with a consultative document issued beforehand.

N Williams

NIGEL WILLIAMS
(Assistant Private Secretary)

3743/038

CONFIDENTIAL

PPS ~~?~~

RP

ECONOMIC SECRETARY TO THE TREASURY

FROM: P D P BARNES
DATE: 17 November 1986

MR STEWART - IR

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Mr Scholar
Miss Sinclair
Mr Wilson
Mr Cropper
Mr Tyrie
Mr Ross Goobey
Mr Isaac - IR
Mr Corlett - IR
PS/IR

BUDGET STARTER 130 - PAYROLL GIVING LIMIT

The Economic Secretary was grateful for your submission of 12 November.

2. On the tax relief limit, the Economic Secretary is attracted by £120, which would cover both £10 per month and £2 per week.

3. On the question of whether any increase would take effect from April 1987 or 1988, the Economic Secretary would prefer 1987. He wonders whether an announcement in March 1987 really would be impractical for use in 1987-88.

PB

P D P BARNES
Private Secretary

4366/028

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

DP

FROM: J J HEYWOOD

DATE: 28 November 1986

MR FARMER - IR

cc PS/Chancellor
PS/Chief Secretary
Sir P Middleton
Mr Cassell
Mrs Lomax
Mr Scholar
PS/IR

BUDGET STARTERS: 116 AND 117

The Financial Secretary has been considering these items in the Budget Starters File. He has decided that it would not be appropriate to proceed with S117 this year and that this starter can therefore be dropped.

2. He would like a submission on S116 as soon as possible so that he can form a judgement on whether this too can be dropped.

JJH

JEREMY HEYWOOD
Private Secretary

IMPERIAL TOBACCO LIMITED

Imperial Tobacco Limited
PO Box 244, Hartcliffe, Bristol BS99 7UJ
Telephone: 0272 781111 Telex: 44744

FROM THE CHIEF EXECUTIVE

3rd December, 1986.

HM T[illegible] - MCU tobacco taxation
RECD. - 4 DEC 1986
ACTION CE - Will a short acknowledgement suffice?
cc APS/CHX
EP
CHX
29309/86

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

IMP. TOBACCO → CH/EX 3/12

Dear Chancellor,

My colleagues and I were most grateful to you for taking time out of your busy schedule to come and have lunch with us.

I am afraid that you were subjected to some heavy lobbying on tobacco taxation. I, therefore, particularly appreciated your patience and courtesy in listening to our case.

There is now a real risk that U.K. cigarette manufacturers will not be able to raise their prices because of the threat from imports. Imperial is giving serious consideration to a price freeze in January '87. This is bad news in our industry, but we must compete for market share.

You expressed an interest in our negative attitudes towards own label manufacture. I am, therefore, taking the opportunity of enclosing a short paper setting out the comparison between the relative positions of the food and tobacco industries, which I hope may be helpful to your officials.

Yours sincerely,

John Bloxcidge

J.A. BLOXCIDGE

Enclosure:

Incorporated in England No. 1860181 Registered Office: Hartcliffe, Bristol
A Hanson Trust Company

OWN-LABEL MARKET

Before considering the development and manufacturers' involvement in the own-label market for cigarettes in the UK, it is relevant first to look briefly at what has happened in the UK grocery market.

UK Grocery Market

The own-label grocery market began to develop in the 1950s at the end of rationing. There was steady growth throughout the 1960s and then rapid development in the early 1970s when 20%+ inflation created greater price sensitivity.

From 1971 to 1981 the market share held by own-label packaged groceries increased from 13% to 24% and currently it is believed to account for nearly 30%.

Many manufacturers appear to have entered the own-label market with considerable reticence, their concern being that -

- power would shift from manufacturers to large retail chains/sectors who would then be able to dictate their own terms;
- as a consequence profit margins would be squeezed;
- supply contracts would tend to be short term and unpredictable with one manufacturer being played off against another.

These concerns have to some extent been realised and retailer strength has led to a transfer of marketing initiative from manufacturers to retailers. For example, Fine Fare's stated attitude is "We now see ourselves as the customer's manufacturing agent rather than the manufacturer's selling agent."

There are nevertheless a number of advantages in own-label manufacture of packaged grocers, particularly for those manufacturers lacking leading image brands, the most important being that it at least provides a reasonable profit return, albeit at a lower level than for branded products. We believe that manufacturers' profit margins on own-label brands are generally not less than 10% and in some cases up to 20% or more on selling prices.

Other principal advantages are -

- in certain areas (e.g. tinned/frozen goods) own-label tends to expand the overall packaged market at the expense of the non-prepared foods sector, thus reducing the potential effect of own-label on branded products;

- savings in advertising/promotional costs;

- economies of manufacturing scale;

- distribution gains in supplying to national multiple chains;

- consumer acceptance of own-label products has been helped by the fact that most packaged food products become anonymous once opened.

For Imperial's Food Division, the development of own-label has been beneficial for those companies with no leading image brands e.g. Ross. For some other companies, however, (e.g. HP), it would probably have been preferable and more profitable if own-label manufacture of their main products had not developed: but with other manufacturers supplying own-label, HP had little option but to follow.

A continuing problem in the own-label grocery market has been the multiples' constant desire to obtain their products from the lowest price source, plus the absence of effective supply contracts. This is well illustrated by a situation encountered by one of our Food Division subsidiaries (Ross) supplying ice-cream to Sainsbury.

Originally, Ross were the sole supplier to Sainsbury of own-label vanilla ice-cream; however, Sainsbury then divided this business equally between Ross and Creamery Fare - a small specialist London firm with low overheads - and subsequently a third source of supply was obtained from Walls. With the option of three suppliers, Sainsbury then announced their intention to reduce their ice-cream prices to a level which clearly would not cover even Ross' marginal costs and they therefore refused to supply. However, Creamery Fare and Walls accepted Sainsbury's price and Ross thus lost all their Sainsbury ice-cream franchise.

While there are certainly problems for manufacturers in the own-label grocery field, with large retail chains dictating their own terms, it is also true that, for certain manufacturers, the development of own-label has been a positive benefit and their entry has forced most manufacturers to follow suit (notable exceptions being Brooke Bond, Oxo, Nestle and Kellogg).

<u>Own Label Market for Cigarettes</u>

The own-label market for cigarettes is different to that in the grocery field in a number of important respects -

- the market has developed mainly through exports from West Germany at little more than at marginal cost which, because of the ad valorem element in UK cigarette taxation, has created a very significant price advantage at retail level. If UK manufacturers were to match these prices directly, the resultant margins would be barely sufficient to cover manufacturing overhead costs;

- leaving aside handrolling tobaccos, there is no real substitute for packeted cigarettes. Own-label cigarettes do not in themselves, therefore, expand the total market, except when given an artificial boost through inflationary taxation increases, and expansion of the own-label market is at the expense of profitable branded products;

- there still exists a much stronger brand loyalty for cigarettes than exists within the grocery products market and own-label cigarettes are generally less acceptable than well-known branded products because cigarettes are frequently on public view and, unlike packaged food, products do not become anonymous once opened. If leading manufacturers were to supply own-label a degree of respectability would be given to these products which would be likely to further stimulate growth with consequent adverse profit implications for manufacturers;

- cigarettes already achieve very wide distribution, largely through independent CTNs who cannot effectively compete with own-label. Any further transfer of trade to multiples, through the supply of own-label by main manufacturers, would almost certainly lead to the demise of independent CTNs and a <u>reduction</u> in distribution.

... ...

There are a number of ways in which to compete with own-label, and indeed with very low price cigarettes generally - to supply own label products directly, to compete directly on price on at best a marginal costing basis with branded products or to position image brands at prices between 'mainstream' and very low priced products in order to limit the growth of the latter while still maintaining a reasonable profit margin.

<u>United States experience</u>

In the United States, Liggett & Myers opted to supply own-label products directly and, while they were allowed a free run by the other tobacco manufacturers, this strategy was successful. However, when Brown & Williamson entered the own-label market in 1984, Liggett & Myers were forced to delay price increases in order to remain competitive and the effect on their profitability has been disastrous -see Appendix I attached.

<u>German experience</u>

In West Germany, the strategy adopted initially to compete with an upsurge in sales of own-label brands was substantially to reduce prices of branded products.

Prior to 1982 own-label brands had an insignificant share of the West German market. However, following a very heavy cigarette duty increase in June 1982, this sector grew quickly to 2% of market in weeks, to 5% in four months and to 9% in six months.

In January 1983 Reemtsma, the largest West German manufacturer, reduced the price of its leading brand by 15%. Other manufacturers had no option but to follow and, as a result, by May 1983 the cheap cigarette market accounted for 35% of all cigarette sales. By July 1983, in order to restore some sanity back into the market, a major price realignment had taken place. The pricing activity had, however, already taken its toll on profitability - see Appendix II attached.

... ...

UK position

In the light of the reasons set out earlier and Liggett & Myers experience in the United States, Imperial has taken the view that now is not the time to supply the own-label market in the UK; although this situation could change if we could be sure that the own-label market had reached its natural level and would be unlikely to be expanded further as a result of our entry.

Clearly, other UK tobacco manufacturers have taken the same view for the same reasons, in the sure expectation that as soon as one main manufacturer moved, the rest would be forced to follow.

The experience in West Germany, leading to a severe price war, is also a salutory one for all UK manufacturers.

The strategy which has developed in the UK has therefore been to limit the growth of own-label (currently around 7% of total market) by offering image brands at prices between 'mainstream' and very low priced products, as follows -

	Price per 20
Mainstream (typified by John Player Superkings)	£1.50/1.52
Cheap (typified by Lambert & Butler KS)	£1.32/1.33
Own-label	£1.19/1.21

This strategy has certainly been preferable to the alternatives of a price war or the inherent risks in supplying own-label. Nevertheless, the supply of own-label from the Continent at little more than at marginal costs poses a threat to UK manufacturers, particularly when sales are given an artificial boost as a result of inflationary taxation increases.

IMPERIAL TOBACCO LIMITED
2nd December 1986
5OLM.REP

CONFIDENTIAL

Appendix I

ESTIMATED BREAKDOWN OF LIGGETT & MYERS' PROFITS (1980-1985)

	1980	1981	1982	1983	1984	1985
CIGARETTE SALES - mn.						
'Generic'	60	2,600	5,670	17,420	23,910	20,050
Mainstream	14,290	12,850	12,230	11,180	10,030	9,560
Total	14,350	15,450	17,900	28,600	33,940	29,610
GROSS PROFIT						
Total - $ mn.	24.0	28.8	47.9	60.5	66.7	6.4
- $ per 1,000	1.67	1.86	2.68	2.12	1.97	0.22
AVERAGE TRADE PRICE (excl. Federal Excise Tax) - $ per 1,000						
'Generic'	9.65	9.65	11.37	9.72	11.01	11.95
Mainstream	13.81	15.58	18.86	20.40	22.40	23.67
Total	13.80	14.58	16.49	13.89	14.38	15.73
AVERAGE DIRECT COSTS - $ per 1,000						
(i.e Labour, Leaf, Packaging, etc.)	12.13	12.72	13.81	11.87	12.41	15.51

IMPERIAL TOBACCO LIMITED
2nd December 1986
21EBL.REP

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Appendix II

PROFITABILITY OF WEST GERMAN CIGARETTE MANUFACTURERS

The table below shows the latest available data on the post-tax profitability of the West German cigarette manufacturers from 1979 to 1985 -

	1979	1980	1981	1982	1983	1984	1985
Reemtsma Cigarettenfabriken Net Income (DM. mn.)	54.8	-118.4	20.1	29.3	3.0	22.0	43.0
B.A.T. Cigarettenfabriken Net Profit (DM. mn.)	59.9	62.7	64.1	44.8	11.7	54.7	45.5
Martin Brinkmann AG (y/e March) Net Profit (DM. mn.)	48.9	47.1	16.4	0.9	-58.5	87.1	n.a.
Reynolds Tobacco GmbH Net Profit (DM. mn.)	n.a.	15.8	8.0	1.7	0.5	2.3	n.a.
Philip Morris GmbH Net Profit (DM. mn.)	n.a.	n.a.	21.9	11.3	3.0	20.0	35.0 (est)

Notes

(i) Financial years are calendar years except for Martin Brinkmann, which is year ending 31st March. Thus the Brinkmann figure shown for 1984, for example, relates to the year ended March 1985.

(ii) In 1980, Reemtsma's profits were adjusted following a revaluation of its holding in Deutsche Brau AG, resulting in an extraordinary write-off of DM.180 mn. In 1985, Reemtsma's profits included earnings from the sale of a majority holding in Tucher Brau AG for an undisclosed sum.

(iii) Whilst Martin Brinkmann made a trading loss of DM.58.5 mn. in 1983, this was offset by a transfer of funds from its parent company - Brinkmann Holding. In 1984 Martin Brinkmann sold its Canadian business to another part of the Rothmans group; the sale realised DM.225 mn., which is included in the year's profit of only DM.87.1 mn.

(iv) The estimate shown for Philip Morris relates to a report early in 1986 that the company was anticipating post-tax profits of around DM.35 mn. for 1985.

IMPERIAL TOBACCO LIMITED
2nd December 1986
25PROF.REP

4366/038

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

PPS tii?

RP

FROM: N WILLIAMS

DATE: 4 December 1986

MR MUNRO / IR

cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Minister of State
Miss Sinclair
Miss Noble
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Graham-Parl Counsel
PS/IR

BUDGET STARTER 112 : PERSONAL PENSIONS

1. The Financial Secretary was grateful for your minute of 1 December.

2. He is content for you to instruct Counsel on a provisional basis.

N Williams

NIGEL WILLIAMS
Assistant Private Secretary

Chancellor

RLP

Treasury Chambers, Parliament Street, SW1P 3AG

Colin Clive Esq
Chairman
British Venture Capital Association
1 Surrey Street
LONDON
WC2R 2PS

8 December 1986

Dear Mr Clive

Thank you for your letter of 17 November. I have also seen your letter of 28 November with a copy of the BVCAs Budget representations. I understand that the Revenue do indeed see Section 79 problems with your proposals, and John Isaac will be replying to Ronald Cohen shortly to that effect. I would be happy to meet you to discuss the way forward, and my private secretary will be in touch with yours shortly to arrange a convenient date.

Yours sincerely

Norman Lamont

NORMAN LAMONT

ANNEX B
TRIPPIER TO CH/EX 15/12

EB/7 ANNEX B

Department of Employment
Caxton House Tothill Street London SW1H 9NF
Telephone Direct Line 01-213 4884
Switchboard 01-213 3000
Facsimile 01-213 5465

Parliamentary Under Secretary of State

DAVID TRIPPIER RD JP MP

15.12.86

The Rt Hon Norman Lamont MP
Financial Secretary
HM Treasury
Great George Street
London
SW1

Dear Norman,

We are still in the process of finalising our 1987 Budget Submission which should be with the Chancellor towards the end of next week. But I thought it might be helpful to send to you, in advance, some details of two ideas which David Young is likely to emphasise in our submission. Both seek to encourage enterprise. "Enterprise companies" aims to create local venture capitalists which will concentrate on the expansion and development of small firms. "Chance in a lifetime" aims to encourage the creation of an enterprise culture through greater self-employment.

I am sure you will regard these as new and exciting ideas. I look for to seeing you soon.

Yours ever

David

374 End Rep.

ANNEX A
BS/EMP → CH/EX 17/12

SECRET

ANNEX A

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213 6460
Switchboard 01-213 3000 GTN Code 213
Facsimile 01-213 5465 Telex 915564

URGENT

CH/EXCHEQUER	
REC.	18 DEC 1986
ACTION	MR MONCK
COPIES TO	CST FST EST MST SIR P MIDDLETON SIR T BURNS MR F E R BUTLER MR SCHOLAR MR BURGNER MR MACAUSLAN MR CROPPER

✓18/12

MR TYRIE
MR ROSS GOODBEY
PS/IR

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

17 December 1986

Ch
Since this arrived only today [illegible] hardly expect a considered reply. Suggest [illegible] of this letter [illegible] + brief at [illegible]
AA

Dear Nigel,

BUDGET 1987

I hope you can make enterprise a key feature in your 1987 Budget.

Our submission sets out a number of proposals to encourage the spread of an enterprise culture and the growth of small firms. I will be writing to you separately both on my Department's own measures and on incentives and tax changes.

I would like to highlight five issues in the submission.

First, 'enterprise companies'. I have been concerned for some time about the difficulties faced in obtaining a mix of finance by smaller companies. I am also aware of the importance of local banks and venture capitalists in developing new enterprises in the US. Our proposal for enterprise companies seeks to create local venture capitalists who can invest in smaller expanding companies. The approach we suggest should minimise tax abuse and direct tax relief where it is most needed.

Second, the idea of a 'chance in a lifetime' scheme to encourage people to take the plunge of self employment and starting a business could be a potent force in overcoming the risk aversion which seems to permeate attitudes in our economy. The suggestion that this is piloted in the North East is both to reduce the costs and to test the effects of this opportunity in an area in which the spur of enterprise is so badly needed.

Third, we need to encourage employees to invest in their own training and so start to develop a training market. 'Learn as you earn' gives employees an incentive to pay for their own training and achieve a vocational qualification. It could be an important part of our new approach. I would like to see a limited tax incentive given to help develop this.

BUDGET PURDAH

LESTER TO PS/FST 12/12

ps5/44L

UNCLASSIFIED

FROM: MRS D C LESTER

DATE: 12 December 1986

PS/FINANCIAL SECRETARY

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

BUDGET PURDAH

The Chancellor has now confirmed that absolute purdah will start from the end of January and that qualified purdah (ie no press) from mid-January.

2. This means that the Financial Secretary is free to accept the invitation from the City Liaison Group on 21 January.*

Debbie Lester

MRS D C LESTER
Diary Secretary

* I enclose your papers on this

CHANCELLOR OF THE EXCHEQUER

Ch

John Isaac said starter no. 111 (Taxation of income support paid to unemployed & strikers) is held up by D/Employment.

He promised a note if you wanted to raise this with Lord Young: we have not received this yet.

AK

18/12

Tony /

94/028

Mr McGuigan's phone no
is 2913 - 5101

Sue

S

CE

MISC

MINISTER OF STATE TREASURY

FROM: DIARY SECRETARY

DATE: 22 December 1986

MR McGUIGAN - C&E

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
90/1 Mr Scholar
Ms Sinclair
Mr Romanski
Mr D Walters
Mr McKenzie
Mr Cropper
PS/C&E
Mr Jefferson Smith

MINISTER OF STATE'S MEETING WITH JIM LESTER MP AND A DELEGATION FROM THE TOBACCO INDUSTRY

You have the action copy of Jim Lester's letter of 24 November to the Minister of State.

The Minister has now agreed to a meeting with Mr Lester and a delegation from the Tobacco Industry on Thursday 22 January at 10.30am.

I should be grateful if you could arrange for the Minister to receive briefing and official support please.

J. Murphy

MISS J MURPHY
Diary Secretary

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

RP

FROM: J J HEYWOOD
DATE: 23 December 1986

MRS HUBBARD IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Cassell
Mr Scholar
Mr Williams
Miss Sinclair
Ms Leahy
Mr Wilson
Mr Graham OPC
PS/IR

BS 159: PRT TREATMENT FOR RESEARCH EXPENDITURE: VARIATION OF DECISIONS ON CLAIMS FOR ALLOWABLE EXPENDITURE

The Financial Secretary has now agreed that you should instruct Parliamentary Counsel to extend S.40 Finance Act 1983 to both Schedules 7 and 8, as recommended in your minute of 12 December.

JJH

JEREMY HEYWOOD
Private Secretary

3747/035

RP

FROM: IAN STEWART
DATE: 29 December 1986

MR LILLEY

cc Chancellor
Chief Secretary
Financial Secretary
Minister of State
Michael Lord
David Heathcoat-Amory
Michael Stern
Barry Henderson
Peter Cropper
Alistair Ross Goobey
Andrew Tyrie

PRE-BUDGET PARTY CONSULTATION

Thank you for your minute of 20 December.

2. I am content with the suggested list of Members for me to see.

IS

IAN STEWART

SECRET AND PERSONAL

Alex (o/r)
pwp

COPY NO 15 OF 15

FROM: A W KUCZYS

DATE: 30 December 1986

MR SCHOLAR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Cropper
Mr Battishill - IR
Sir A Fraser - C&E

The Chancellor would like the following two points taken into account in further work for the 1987 Budget.

(i) Consumer Credit Tax. The rate, for the purposes of further work, to be 15 per cent, by analogy with VAT.

(ii) CGT. To deal with the problem of lumpy assets, a form of spreading (over, say, 3 years) to be considered where appropriate.

AWK

A W KUCZYS