PREM 19/993

Interim Report of the Working Group on Tax and Savings

Tax Relief for Housing

Green Paper on Taxation of Husband and Wife.

PART 1

ECONOMIC POLICY

March 1980.

| Referred to | Date | Referred to | Date | Referred to | Date | Referred to | Date |
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PREM 19/993

TAXATION OF HUSBAND [illegible]

ATTACHED TO FILE.

PART 1 ends:-

[redacted]

Sir J Boreham to PM 23.12.83

PART 2 begins:-

DB to Sir J Boreham 10.1.84

14/1

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# CABINET OFFICE

*Central Statistical Office*

Great George Street, London SWIP 3AQ Telephone 01-233 6117

*From the Director:* Sir John Boreham, K.C.B.

23 December 1983

Dear Prime Minister

I think you will be interested in the enclosed off-print of the latest in a series of annual articles analysing the effects of taxes and benefits on household incomes, published in November Economic Trends.

Based on an analysis of the Family Expenditure Survey 1982, this work shows how taxes and benefits reduce income inequality. Before taxes and benefits, the 20 per cent of households with the lowest incomes got only ½ per cent of total income; after taxes and benefits they got 7 per cent. The share of the top 20 per cent fell from 47 per cent to 39 per cent.

The special feature of this year's article is an assessment of the impact of the tax-benefit system on households classified by the employment status of their head. This additional analysis shows how taxes and benefits reduce the gap in income between households in which the head is working and those in which he (or she) is not working, for whatever reason. The range of average incomes is reduced from (£1,720-10,750) to (£4,890-8,140).

I would welcome any comments and suggestions you might have on that analysis. We can do special analyses on request, for example to examine the effects of particular taxes or benefits on household incomes.

Yours sincerely

John Boreham

JOHN BOREHAM

The Rt Hon Margaret Thatcher, MP
Prime Minister
10 Downing Street
LONDON
SW1

Enc

5 January 1984

Prime Minister

MR BARCLAY

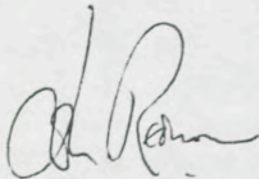
9/1

THE EFFECTS OF TAXES AND BENEFITS ON HOUSEHOLD INCOME

The survey shows just how complex the cash benefit and tax relief systems are. The help does not always go to those in need. The top 20 per cent of income-earners receive £540 a year in cash benefits from the state, particularly in the form of Child Benefit. Twelve per cent of the top one-fifth of earners in the country (grossing £18,000 per household in 1982) were public sector tenants benefiting from the housing subsidies that that implies. In addition, the top one-fifth of earners benefited most from the public education system, as on average they have more children. They are also likely to be larger beneficiaries of rail subsidies.

Most of the other findings of the survey of the impact of taxes and benefits are unremarkable. Tables illustrate that income tax is indeed a progressive tax, that unemployed households rely extensively on state benefits, and that the payment of cash benefits does more than anything else to narrow the income differentials.

The only clear message that I can see from the report is that the total system is complex and costly, and that it needs detailed analysis to find out who loses and who wins from it. A reply to John Boreham could thank him for the enclosure, but need not request any additional information or analysis.



JOHN REDWOOD

Extracts from *Economic Trends*, No. 361, November 1983

# The effects of taxes and benefits on household income 1982

# The effects of taxes and benefits on household income, 1982


**Summary of main results**

During 1982 the Government raised and spent £128 billion. Directly or indirectly, most of the revenue is raised from UK households, and the expenditure benefits households. For any one household, payments and benefits will not necessarily be equal; the aim of this article is to examine how the balance varies by income level, and therefore how the distribution of income is altered by the tax-benefit system.

The main results of the analysis are:

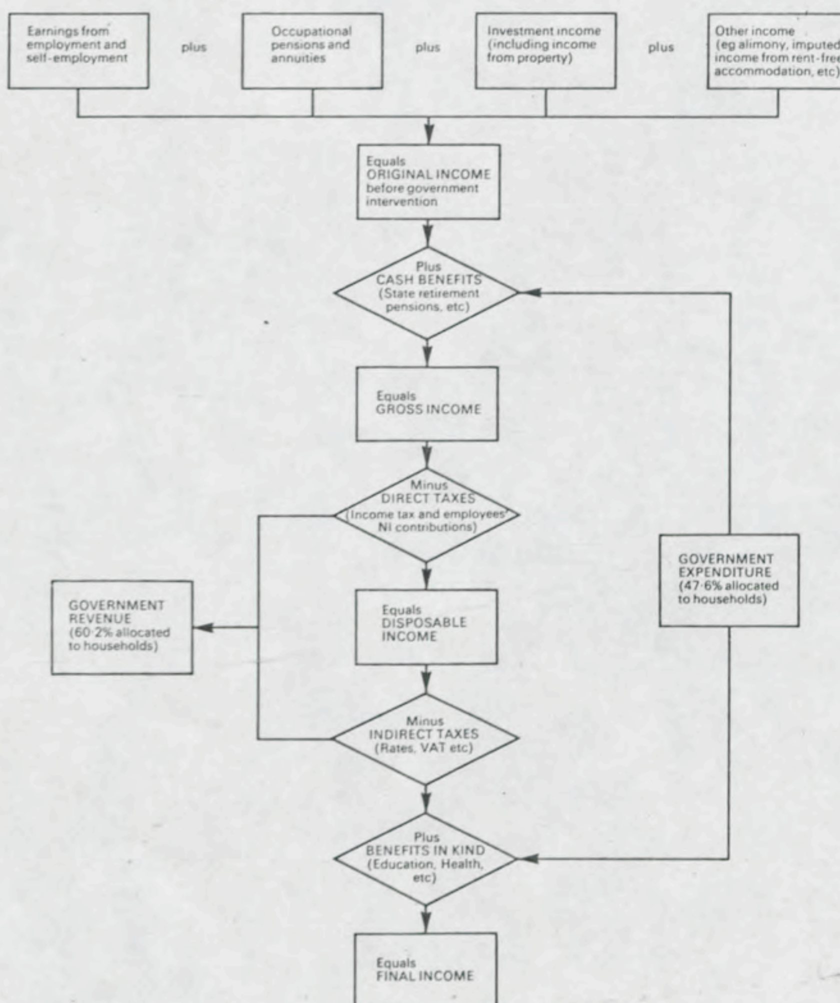
(i) The tax-benefit system as a whole has the effect of reducing income inequality. In 1982 its effect was to increase the share of total income of the bottom 20 per cent of households from $\frac{1}{2}$ per cent to 7 per cent. The payment of cash benefits plays the largest part in reducing income dispersion.

(ii) The income of a household depends to a large extent on its size and composition. Households are divided into ten groups according to their composition and the effect of the tax-benefit system on each group is examined. This analysis shows that the greatest reductions in income inequality brought about through the tax-benefit system occur within the groups of retired households, lone parent households and households with three or more children.

(iii) The special feature in this year's article is an analysis of the effect of the tax-benefit system on households classified by their employment status. The analysis shows how taxes and benefits reduce the gap in income between households in which the head is working and those where he (or she) is not working.

(iv) Special attention is paid to households where the head is under retirement age but is not able to work or to seek work. This group contains many one-parent families, student households, and households headed by a disabled person. Many cash benefits are designed to help such people and it is shown that their position is substantially improved by the social security system.


CHART 1
**Stages of redistribution**



**Introduction**

Chart 1 illustrates the stages of redistribution examined in this article. Initially, households receive income from various sources: as a result of their employment (eg, wages and salaries, income from self-employment); from occupational pensions; from their investments; from other households (eg, gifts and alimony payments) and from private non-profit making institutions such as charities. Total income from these sources constitutes *original income,* that is, the income received by a household before Government intervention. The flow chart shows the various ways in which Government then raises revenue from households and distributes benefits to them both in cash and in kind. This article aims to quantify the effects of these actions on the distribution of income amongst households.

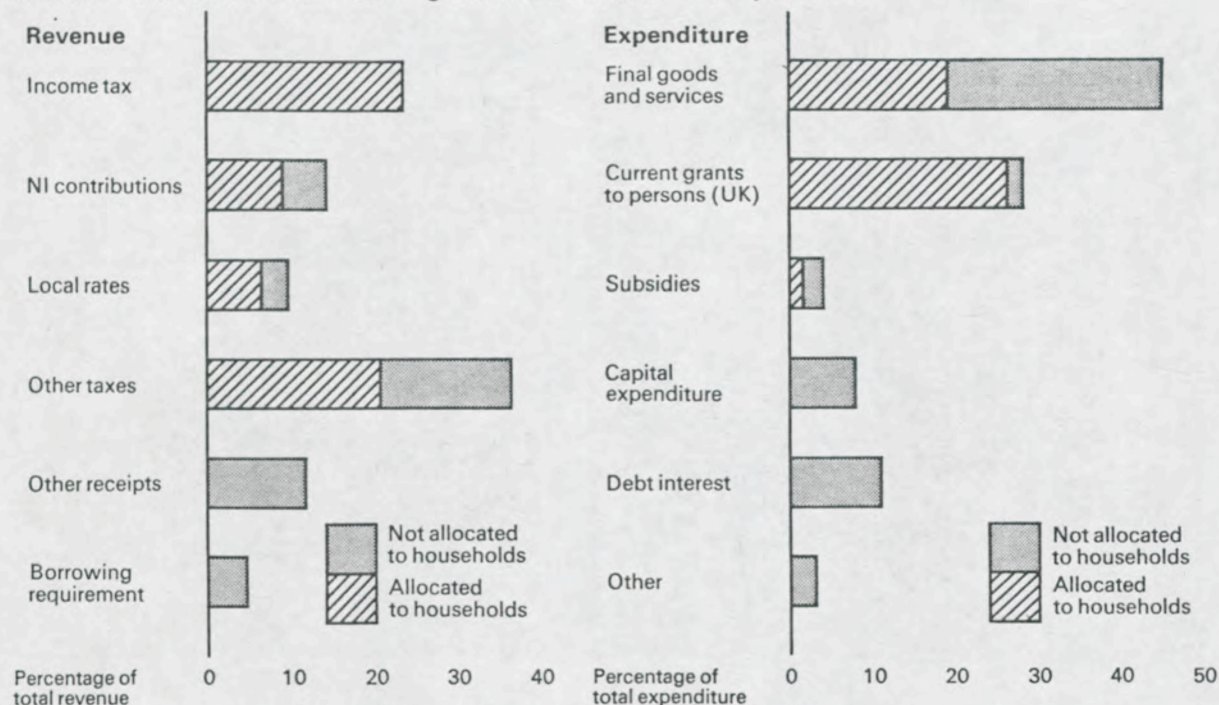
The main source of data is the Family Expenditure Survey (FES), 1982. This survey collects information from households on their composition and on the income, direct tax payments and expenditure of each household member. The improved response rate to the survey observed in 1981 was maintained in 1982, when 7 428 households participated, a response rate of 71.8 per cent. FES data is supplemented by other sources, particularly in the imputation of benefits in kind.

It has been possible to allocate to individual households only 60 per cent of Government revenue and 48 per cent of expenditure (Charts 1 and 2). The remaining items of revenue and expenditure have not been allocated to households either because it would be inappropriate to do so (eg, the Government Borrowing Requirement) or because the data required to do so are not available (eg, expenditure on personal social services). Since the total amount of revenue allocated exceeds the total amount of benefits, less significance must be attached to the exact figures of 'gains' and 'losses' than to broad patterns of redistribution, particularly in the middle income ranges.

The methods used in preparing the estimates are explained in Appendix 1 and the detailed results are given in Appendix 3.

CHART 2

**Allocated and unallocated items of government revenue and expenditure**

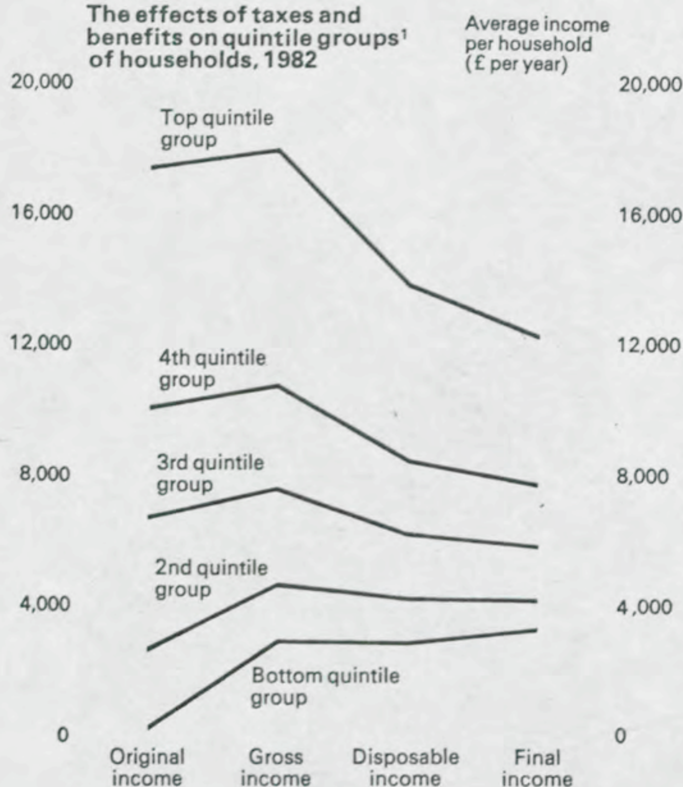


## Summary of the effects of taxes and benefits, 1982

TABLE A

| | Quintile groups of households ranked by original income | | | | | Average over all house-holds |
|---|---|---|---|---|---|---|
| | Bottom | 2nd | 3rd | 4th | Top | |
| **Average per household (£ per year)** | | | | | | |
| Original income .. .. .. .. | 150 | 2 620 | 6 690 | 10 040 | 17 390 | 7 380 |
| *plus* cash benefits .. .. .. .. | 2 690 | 1 970 | 890 | 680 | 540 | 1 350 |
| Gross income .. .. .. .. | 2 830 | 4 580 | 7 580 | 10 720 | 17 920 | 8 730 |
| *less* direct taxes .. .. .. .. | 10 | 430 | 1 430 | 2 280 | 4 100 | 1 650 |
| Disposable income .. .. .. .. | 2 820 | 4 160 | 6 150 | 8 440 | 13 820 | 7 080 |
| *less* indirect taxes .. .. .. .. | 740 | 1 220 | 1 710 | 2 190 | 3 050 | 1 780 |
| *plus* benefits in kind .. .. .. .. | 1 140 | 1 200 | 1 360 | 1 420 | 1 490 | 1 320 |
| Final income .. .. .. .. | 3 220 | 4 130 | 5 790 | 7 670 | 12 260 | 6 620 |
| *Percent that are public sector tenants* .. | *57* | *38* | *33* | *20* | *12* | *32* |
| **Average per household (number)** | | | | | | |
| Children (ie, under 16) .. .. .. | 0.4 | 0.5 | 0.9 | 0.9 | 0.7 | 0.7 |
| Adults .. .. .. .. .. .. | 1.4 | 1.7 | 2.0 | 2.2 | 2.7 | 2.0 |
| Retired people .. .. .. .. .. | 0.9 | 0.7 | 0.2 | 0.1 | 0.1 | 0.4 |
| Economically active people[1] .. .. | 0.1 | 0.7 | 1.4 | 1.7 | 2.2 | 1.2 |

[1] See Appendix 1, para 11 for definition of economically active.




The size of the original income of a household depends to a large extent on how many economically active people it contains (Chart 4). This chart shows clearly that the average original income in each decile group is closely related to the number of economically active household members. It also shows that this relationship remains true after the effects of the tax-benefit system have been taken into account, though the relationship is slightly less pronounced. Only one in seventeen households in the lowest quintile group contain one or more economically active persons. Over two-thirds of the households in this group are retired (Table B) – defined as households where at least half the total gross income comes from retired people – and the majority of these have virtually no original income. The remainder include households either containing no earners (such as single full-time students and lone parent households) or whose only earners are unable to work for all or part of the year. Only 2 per cent of households in this lowest quintile group contain one or more people who were in employment for the whole year.

## The composition of each quintile group of households ranked by original income,[1] 1982

TABLE B

| | Quintile group | | | | | |
|---|---|---|---|---|---|---|
| | Bottom | 2nd | 3rd | 4th | Top | Total |
| **Percentages** | | | | | | |
| Household type | | | | | | |
| 1–2 adults retired | 68 | 38 | 5 | 1 | — | 23 |
| 1 adult (other) | 9 | 16 | 14 | 7 | 2 | 9 |
| 2 adults (other) | 5 | 15 | 24 | 28 | 28 | 20 |
| 2 adults with children | 8 | 16 | 41 | 39 | 24 | 26 |
| 3 or more adults | 3 | 9 | 15 | 24 | 45 | 19 |
| 1 adult with children | 7 | 5 | 1 | 1 | — | 3 |
| Total | 100 | 100 | 100 | 100 | 100 | 100 |

[1] Appendix 3, Table 7 gives fuller details.

## PART I

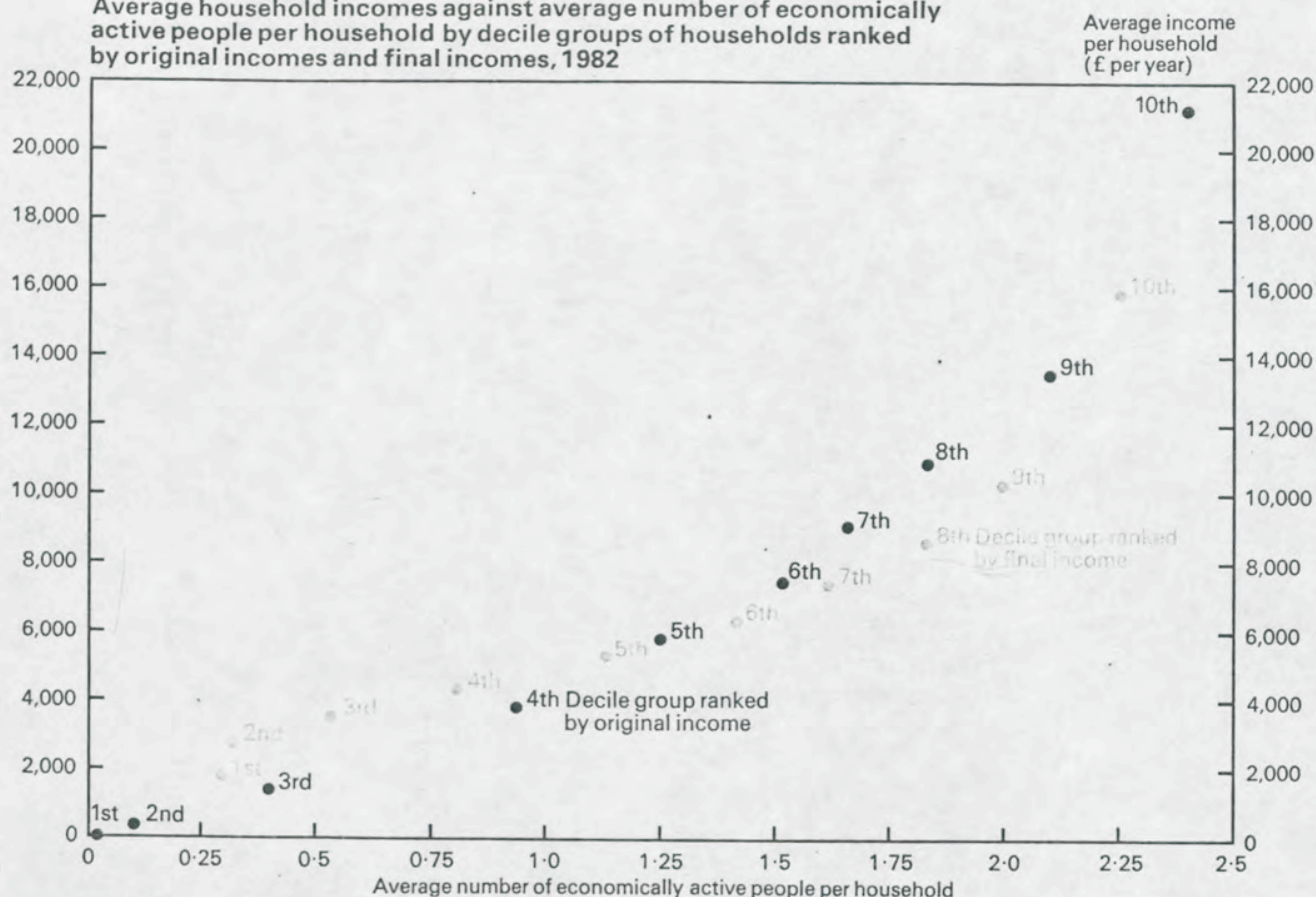
## RESULTS FOR ALL HOUSEHOLDS

### *Original income*

Distribution of household original income is highly unequal (Table A and Chart 3). The 20 per cent of households with lowest original income (the lowest 'quintile group') had an average original income of only £150 per annum in 1982, compared with an average original income of about £17 400 per annum in the highest quintile group.

CHART 4

**Average household incomes against average number of economically active people per household by decile groups of households ranked by original incomes and final incomes, 1982**




## Average value of cash benefits[1] for each quintile group of households ranked by original income, 1982

TABLE C

| | Quintile group | | | | | |
|---|---|---|---|---|---|---|
| | Bottom | 2nd | 3rd | 4th | Top | Total |
| **£ per household** | | | | | | |
| Age-related | 1 340 | 1 110 | 280 | 160 | 110 | 600 |
| Income-related | 990 | 480 | 200 | 140 | 130 | 390 |
| Child-related | 100 | 150 | 280 | 290 | 230 | 210 |
| Other[2] | 250 | 230 | 130 | 90 | 60 | 150 |
| Total | 2 690 | 1 970 | 890 | 680 | 540 | 1 350 |
| Cash benefits as a percentage of gross income | 95 | 43 | 12 | 6 | 3 | 15 |

[1] Appendix 3, Table 5 gives more details of cash benefits.
[2] Mainly related to sickness and disability.

## Direct taxes as a percentage of gross income for each quintile group of households ranked by original income, 1982

TABLE D

| | Quintile group | | | | | |
|---|---|---|---|---|---|---|
| | Bottom | 2nd | 3rd | 4th | Top | Total |
| Income tax | 0.3 | 7.4 | 13.9 | 15.8 | 18.1 | 14.5 |
| National Insurance contributions | — | 2.0 | 5.0 | 5.4 | 4.8 | 4.4 |
| Total | 0.4 | 9.3 | 18.9 | 21.2 | 22.9 | 18.9 |

Chart 3 shows how the dispersion of incomes is reduced at each stage of redistribution, so that average final income ranges from £3 220 to £12 260, a ratio of about 1 : 4 compared with the ratio of original incomes of about 1 : 120. Each stage will now be examined in more detail.

### *Cash benefits*

Most cash benefits are designed to help the *aged*, the *sick* and *disabled*, and people on *low incomes* (Table C); such individuals are concentrated in households located in the lowest original income ranges. The major exceptions are *child-related benefits* (mainly Child Benefit), which on average are much larger in the top half of the distribution than the bottom half because in the top half there are more children per household than at the lower end. Nevertheless, the overall effect of the payment of cash benefits is to make a significant reduction in income inequality.

### *Direct taxes*

Direct taxes are assessed mainly on original income. Although certain cash benefits such as retirement pensions and (from July 1982) unemployment benefits are subject to income tax, the personal tax allowances are large enough to prevent households at the lower end of the income scale from paying much tax. The percentage of gross income paid in *income tax* rises from 0.3 per cent for the lowest quintile group to just over 18 per cent for the highest (Table D). The size of *employees' National Insurance contributions* paid by each household varies with the number of persons who are in employment and with household income, although the existence of an earnings ceiling and the freedom of some working wives to elect to pay reduced contributions means that the correlation between income and contributions is not as strong as that between income

## Indirect taxes[1] as a percentage of disposable income for each quintile group of households ranked by original income, 1982

TABLE E

| | Quintile group | | | | | |
|---|---|---|---|---|---|---|
| | Bottom | 2nd | 3rd | 4th | Top | Total |
| Domestic rates (net)[2, 3] | 3.4–7.3 | 5.4–6.0 | 4.5–4.7 | 3.8–3.9 | 2.9 | 3.7–4.2 |
| VAT | 5.1 | 7.2 | 7.3 | 7.4 | 6.8 | 7.0 |
| Duty on beer | 0.7 | 1.0 | 1.2 | 1.1 | 0.9 | 1.0 |
| Duty on wines and spirits | 0.7 | 1.2 | 1.1 | 1.0 | 1.2 | 1.1 |
| Duty on tobacco | 3.5 | 3.5 | 3.1 | 2.3 | 1.5 | 2.4 |
| Duty on hydrocarbon oils | 0.6 | 1.4 | 1.8 | 1.8 | 1.6 | 1.6 |
| Car tax and vehicle excise duty | 0.4 | 0.9 | 1.0 | 1.0 | 0.9 | 0.9 |
| Other taxes on final goods and services | 1.6 | 1.6 | 1.5 | 1.4 | 1.1 | 1.3 |
| Intermediate taxes | 6.2 | 6.6 | 6.1 | 5.9 | 5.1 | 5.8 |
| Total[2] | 23.0–26.2 | 28.9–29.5 | 27.7–27.9 | 25.8–25.9 | 22.1 | 24.8–25.2 |

[1] Appendix 3, Table 6 gives more detailed figures on indirect taxes.
[2] Net of rate rebates, but including water, etc. charges.
[3] The ranges reflect the alternative treatment of rates – see box below.

and income tax. However, the payment of direct taxes further evens out the income distribution as Chart 3 illustrates.

*Indirect taxes*

Unlike cash benefits and direct taxes, indirect taxes as a whole do not have the effect of reducing income inequality, as measured by final income. Their overall impact is very similar in both the lowest and the highest quintile groups (Table E). However, within the broad group of indirect taxes, individual taxes have divergent effects on income inequality.

Households in the bottom quintile group, particularly the retired, pay on average a smaller proportion of their disposable income in VAT than other households because low income households tend to spend a higher proportion of their income on goods which are zero-rated, such as food. They are also less likely to be car owners and will hence pay less car tax and vehicle excise duty. Taxes on housing, in the form of domestic rates (together with water charges etc, but net of rebates), form a comparatively high proportion of expenditure of the lower quintile group, though this proportion declines if rates payments covered by Supplementary Benefit are excluded (See Box). On the other hand, these households pay the largest proportion of disposable income on tobacco duty.

## Average value of benefits in kind[1] for each quintile group of households ranked by original income, 1982

TABLE F

| | Quintile group | | | | | Average over all households |
|---|---|---|---|---|---|---|
| | Bottom | 2nd | 3rd | 4th | Top | |
| **£ per household** | | | | | | |
| Education | 290 | 440 | 620 | 710 | 730 | 560 |
| Welfare foods | 30 | 30 | 20 | 20 | 20 | 30 |
| Health | 680 | 610 | 570 | 540 | 550 | 590 |
| Housing subsidy | 120 | 90 | 80 | 50 | 40 | 80 |
| Other | 10 | 30 | 60 | 90 | 150 | 70 |
| Total | 1 140 | 1 200 | 1 360 | 1 420 | 1 490 | 1 320 |
| Benefits in kind as a percentage of final income | 35 | 29 | 23 | 18 | 12 | 20 |

[1] Appendix 3, Table 6 gives more detailed figures on benefits in kind.

### INDIRECT TAXES

*Intermediate taxes*

Some taxes, such as VAT and excise duties on petrol or spirits, have a *direct* effect on the final price of goods and services. However, the producers of these goods and services also incur taxes such as employers' National Insurance contributions and surcharge, non-domestic rates and duty on hydrocarbon oils, part of which they may pass on to households through increases in the price of their products. These are called intermediate taxes.

*Rates paid by Supplementary Benefit recipients*

The FES records in full the rent and rates payments of households receiving Supplementary Benefit (SB), despite the fact that these costs are met in part or in full by the DHSS. In other words, although they themselves pay their rent and rates bills, at least part of the money to do so is provided by the DHSS specifically for this purpose. There is thus a dilemma in deciding how to treat the rates payments of SB recipients: whether (*a*) to show the full payment as part of their indirect tax payments, or (*b*) to show them paying only the amount not covered by SB on the argument that this represents their effective rates burden. In Tables E, N and T, ranges are given for rates payments: the higher point has been calculated on assumption (*a*), and the lower point on assumption (*b*). In all other tables the payment is shown in full. The Unified Housing Benefit scheme, which came into operation on 22 November 1982 for certain SB recipients, meant that such households were switched to a rebate system of housing benefit which had the effect of reducing their income with a matching reduction in their rent and rates payments. The effect of this change on 1982 FES data is considered to have been minimal and therefore no adjustments have been made. Treatment of the new scheme will be discussed in detail in next year's article.

For the remaining 80 per cent of households, total indirect tax payments as a proportion of disposable income decline as one ascends the income scale. Apart from spending patterns, one factor which affects the impact of indirect taxes is the proportion of disposable income which is saved. Thus, as Table E shows, the overall impact diminishes from about 29 per cent in the second quintile to 22 per cent in the top quintile, partly because higher income households save a larger proportion of their income than households with more modest incomes. The impact of most indirect taxes taken individually also declines for the top quintile group.

*Benefits in kind*

Government expenditure in providing certain goods and services to households either free at the time of use or at subsidised prices is converted by imputation into the equivalent of an income flow to individual households in order to arrive at final income. The two major items for which such imputations are made are *health* and *education* services, which together accounted for 20.4 per cent of total general government expenditure in 1982. Other items for which imputations are made are *welfare food (mainly school meals)*, the *housing subsidy*, the *passenger rail travel subsidy*, and expenditure on the *option mortgage scheme* and on *life assurance premium relief*, together accounting for a further 2.5 per cent of general government expenditure. Details of the methodology used for making the imputations are given in Appendix 1 (paragraphs 29–36).

Education benefit to individual households is imputed by reference to the number of pupils and students in the household (students living away from home are excluded). Since households in the upper half of the income distribution have, on average, more children than those in the lower half (Table A) and children in high income households tend to spend longer in education, education benefit increases as income increases (Table F). On the other hand, although most welfare foods benefit children too, their impact is greatest in the lower income groups since children from low income households are more likely to take school meals and to have them provided free of charge.

Expenditure on health services has been allocated to individuals according to the average cost to the Exchequer of each type of service and to the estimated use made of each service by people of different age and sex. Benefits are then summed for the members of the household to yield figures on a household basis, so that not only the sex-age composition but also the size of the household determines the distribution of health service benefits. Age and sex are by no means the only possible determinants on which the allocation of health service expenditure might be based but age is certainly a very important factor. Data availability also limits the choice of variables. Since old people tend to use health services more than the young and since the services they use are generally more costly than other forms of care, households in the lowest quintile group, in which the elderly predominate, are allocated the highest imputed benefit (£680).

Broadly speaking, the housing subsidy is regarded as the extent to which local authority current expenditure exceeds income on the housing revenue account; in the calculations, tax relief on mortgage interest is regarded not as a housing subsidy but as an adjustment to direct taxes. The housing subsidy has been spread between public sector tenants. As the proportion of households who are public sector tenants is 57 per cent in the lowest quintile group compared with only 12 per cent in the highest group (Table A), the imputed housing subsidy is larger for low income households than for others.

The remaining three items, grouped as 'Other' in Table F, tend to benefit people of working age, most of whom are in the middle and upper ranges of the income distribution.

Table F shows that in absolute terms the average of all benefits in kind as a result of these government expenditures increases with household income, from £1 140 for the lowest quintile group to £1 490 for the highest. However, as a proportion of final income, benefits decrease from 35 per cent in the lowest quintile to 12 per cent in the highest quintile, indicating that this expenditure contributes to the reduction in income inequality.

**Percentage shares of total household income, 1982**

TABLE G

| | Percentage in each quintile group of households, re-ranked at each stage | | | |
|---|---|---|---|---|
| | Original income | Gross income | Disposable income | Final income |
| **Quintile group** | | | | |
| Bottom | 0.4 | 5.7 | 6.8 | 6.9 |
| 2nd | 7 | 11 | 12 | 12 |
| 3rd | 18 | 18 | 18 | 18 |
| 4th | 27 | 25 | 24 | 24 |
| Top | 47 | 41 | 40 | 39 |
| Total | 100 | 100 | 100 | 100 |
| **Decile group** | | | | |
| Bottom | — | 2.3 | 2.8 | 2.7 |
| Top | 29 | 25 | 24 | 24 |
| Gini coefficient (per cent) | 48.2 | 36.2 | 33.2 | 33.0 |

**Summary**

Taken together taxes and benefits reduce income inequality. Cash benefits have the greatest impact and only indirect taxes actually increase inequality, though marginally. An alternative way to illustrate the extent of income redistribution is to examine how income shares are modified by the tax-benefit system (Table G). For example, households in the highest quintile group receive 47 per cent of all original income. After receiving cash benefits, this group's share falls to 41 per cent. At the other end of the scale, the share of the lowest quintile group rises from 0.4 per cent to 5.7 per cent. Further, but comparatively smaller, compressions of the income distribution occur at the stages of *disposable* and *final* income.

Though not without its drawbacks the Gini coefficient is the most widely used single summary measure of the inequality of the distribution of income (see paragraph 38 of Appendix 1). It takes values between 0 and 100 per cent – the higher values indicating greater inequality. While it is dangerous to draw detailed conclusions from isolated changes in the Gini coefficient, the reduction in the Gini values from 48.2 per cent to 36.2 per cent shown in Table G clearly confirm that cash benefits produce the largest reduction in income inequality.

## REDISTRIBUTION WITHIN HOUSEHOLDS CLASSIFIED BY COMPOSITION

The income of a household depends on its composition as well as on the incomes of its individual members. Therefore the following section examines redistribution within groups of households of similar size and composition. Households are classified into ten groups according to their composition

## The ten household types, 1982

TABLE H

| | 1 adult retired | 2 adults retired | 1 adult non-retired | 2 adults non-retired | 3 or more adults | 1 adult with children | 2 adults 1 child | 2 adults 2 children | 2 adults 3 or more children | 3 or more adults with children | All house-holds |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Sample numbers .. .. .. | 939 | 746 | 701 | 1 497 | 843 | 209 | 626 | 897 | 375 | 595 | 7 428 |
| Average per household | | | | | | | | | | | |
| Children .. .. .. .. .. | — | — | — | — | — | 1.7 | 1.0 | 2.0 | 3.4 | 1.6 | 0.7 |
| Adults .. .. .. .. .. | 1.0 | 2.0 | 1.0 | 2.0 | 3.4 | 1.0 | 2.0 | 2.0 | 2.0 | 3.4 | 2.0 |
| Economically active people[1]–full-time | — | — | 0.7 | 1.2 | 1.9 | 0.2 | 1.1 | 1.0 | 1.0 | 1.8 | 0.9 |
| Economically active people[1]–part-time | — | — | 0.1 | 0.3 | 0.5 | 0.2 | 0.3 | 0.4 | 0.3 | 0.6 | 0.3 |
| Retired people .. .. .. .. | 1.0 | 1.7 | — | 0.2 | 0.3 | — | — | — | — | 0.1 | 0.4 |
| Average original income (£ per year) .. | 790 | 1 700 | 5 080 | 9 430 | 12 220 | 2 190 | 9 060 | 9 120 | 8 240 | 12 420 | 7 380 |
| *Percentage that are public sector tenants* | *46* | *40* | *29* | *25* | *30* | *62* | *26* | *21* | *40* | *35* | *32* |

[1] See Appendix 1, para 11 for definition of economically active.

## Percentage shares of income at each stage within each household type,[1] 1982

TABLE J

| | Percentages in each quintile group of households, re-ranked at each stage | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1 adult retired | 2 adults retired | 1 adult non-retired | 2 adults non-retired | 3 or more adults | 1 adult with children | 2 adults 1 child | 2 adults 2 children | 2 adults 3 or more children | 3 or more adults with children |
| **Original income** | | | | | | | | | | |
| Bottom fifth .. .. .. .. | — | — | 1 | 5 | 6 | — | 5 | 7 | 2 | 6 |
| Next fifth .. .. .. .. | 1 | 3 | 9 | 13 | 14 | — | 14 | 15 | 13 | 13 |
| Middle fifth .. .. .. | 5 | 9 | 19 | 19 | 19 | 8 | 18 | 19 | 19 | 18 |
| Next fifth .. .. .. .. | 17 | 21 | 27 | 25 | 24 | 27 | 23 | 23 | 24 | 23 |
| Top fifth .. .. .. .. | 77 | 67 | 45 | 38 | 36 | 64 | 39 | 36 | 43 | 40 |
| Total .. .. .. .. .. | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| **Gross income** | | | | | | | | | | |
| Bottom fifth .. .. .. | 13 | 12 | 6 | 8 | 10 | 10 | 9 | 10 | 9 | 9 |
| Next fifth .. .. .. .. | 16 | 15 | 12 | 14 | 15 | 14 | 14 | 15 | 14 | 14 |
| Middle fifth .. .. .. | 17 | 17 | 18 | 18 | 19 | 17 | 18 | 19 | 18 | 18 |
| Next fifth .. .. .. .. | 20 | 21 | 24 | 24 | 23 | 22 | 22 | 23 | 22 | 22 |
| Top fifth .. .. .. .. | 34 | 36 | 40 | 35 | 33 | 36 | 37 | 34 | 37 | 37 |
| Total .. .. .. .. .. | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| **Disposable income** | | | | | | | | | | |
| Bottom fifth .. .. .. | 14 | 13 | 8 | 9 | 11 | 11 | 10 | 11 | 11 | 10 |
| Next fifth .. .. .. .. | 16 | 16 | 13 | 14 | 15 | 15 | 14 | 15 | 15 | 14 |
| Middle fifth .. .. .. | 18 | 18 | 18 | 18 | 19 | 18 | 18 | 19 | 18 | 17 |
| Next fifth .. .. .. .. | 20 | 21 | 23 | 23 | 23 | 22 | 22 | 22 | 22 | 21 |
| Top fifth .. .. .. .. | 31 | 33 | 38 | 35 | 32 | 33 | 36 | 33 | 36 | 37 |
| Total .. .. .. .. .. | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| **Final income** | | | | | | | | | | |
| Bottom fifth .. .. .. | 13 | 13 | 7 | 9 | 10 | 10 | 10 | 11 | 12 | 11 |
| Next fifth .. .. .. .. | 17 | 16 | 13 | 14 | 15 | 15 | 14 | 16 | 16 | 15 |
| Middle fifth .. .. .. | 19 | 19 | 17 | 18 | 18 | 18 | 18 | 19 | 18 | 18 |
| Next fifth .. .. .. .. | 22 | 22 | 23 | 23 | 23 | 23 | 22 | 23 | 22 | 21 |
| Top fifth .. .. .. .. | 30 | 31 | 39 | 36 | 34 | 33 | 36 | 32 | 33 | 36 |
| Total .. .. .. .. .. | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| **Gini coefficients (per cent)** | | | | | | | | | | |
| Original income .. .. .. | 74 | 65 | 45 | 33 | 30 | 66 | 34 | 28 | 40 | 34 |
| Gross income .. .. .. | 21 | 23 | 34 | 27 | 24 | 26 | 28 | 24 | 28 | 28 |
| Disposable income .. .. | 17 | 19 | 30 | 25 | 21 | 23 | 26 | 22 | 25 | 27 |
| Final income .. .. .. | 17 | 18 | 32 | 27 | 23 | 23 | 26 | 21 | 21 | 25 |

[1] Appendix 3, Table 4 gives more data for each household type.

## Average number of economically active[1] people per household by quintile group of original income within household type, 1982

TABLE K

| | Household type[2] | | | | | |
|---|---|---|---|---|---|---|
| | 1–2 adults retired | 1 adult non-retired | 2 adults non-retired | 2 adults with children | 3 or more adults | 1 adult with children |
| **Average per household (number)** | | | | | | |
| Bottom fifth .. .. .. .. .. | — | 0.2 | 0.9 | 0.9 | 1.3 | — |
| Middle three-fifths .. .. .. | — | 0.9 | 1.6 | 1.5 | 2.5 | 0.5 |
| Top fifth .. .. .. .. .. | 0.1 | 1.0 | 1.8 | 1.7 | 3.0 | 0.9 |

[1] See Appendix 1, para 11 for definition of economically active.
[2] In Tables K to N some of the ten household types have been combined. The quintile groups have not been recalculated; the figures shown are simply weighted averages of the quintile groups of the constituent household types.

(Table H). Quantile analysis at each stage of the redistribution process may then be carried out for each group separately. The ten groups chosen comprise two containing retired persons, three including adults only, and five including adults and children. Their exact definitions are given in Appendix 1 (paragraphs 6 to 10).

The highly skewed distribution of original income within the *retired* household groups is very striking (Table J), with the top quintile group receiving over two-thirds of the income. The main components of original income for retired households are occupational pensions and investment income which are concentrated in a small number of households, whilst the majority have very little cash income other than their state pension (a cash benefit).

Since income from employment is the largest component of original income for *non-retired* households, the spread of original income within these groups could be expected to be related to the variation in the number of earners per household. This is particularly true of single adult households, whether or not they have children: at the lower end of the income distribution within lone parent families and single adult households there are substantial numbers of economically inactive persons (Table K).

Table J indicates that income dispersion within each household group is reduced by government intervention through the tax-benefit system. The reductions are particularly marked for retired households, one-parent families, and households with two adults and three or more children. The individual components of the system vary in importance for different groups of households and the following paragraphs examine each redistributive stage separately.

*Cash benefits*

*Age-related* benefits and *child-related* benefits are fairly evenly distributed within the retired household groups and household groups with children respectively (Table L).

## Cash benefits by quintile group of original income within each household type, 1982

TABLE L

| | Household type[1] | | | | | |
|---|---|---|---|---|---|---|
| | 1–2 adults retired | 1 adult non-retired | 2 adults non-retired | 2 adults with children | 3 or more adults | 1 adult with children |
| **Average per household (£ per year)** | | | | | | |
| Age-related | | | | | | |
| Bottom fifth .. .. .. .. .. | 1 850 | 350 | 810 | 50 | 890 | 80 |
| Middle three-fifths .. .. .. | 1 950 | 300 | 230 | 20 | 270 | 190 |
| Top fifth .. .. .. .. .. | 1 860 | 20 | 80 | 10 | 140 | — |
| Child-related | | | | | | |
| Bottom fifth .. .. .. .. .. | — | — | 10 | 580 | 270 | 490 |
| Middle three-fifths .. .. .. | — | — | — | 560 | 250 | 590 |
| Top fifth .. .. .. .. .. | — | — | — | 550 | 240 | 540 |
| Income-related | | | | | | |
| Bottom fifth .. .. .. .. .. | 620 | 1 180 | 800 | 1 490 | 1 440 | 1 990 |
| Middle three-fifths .. .. .. | 310 | 110 | 90 | 90 | 420 | 1 660 |
| Top fifth .. .. .. .. .. | 30 | 30 | 10 | 10 | 190 | 160 |
| Other[2] | | | | | | |
| Bottom fifth .. .. .. .. .. | 200 | 340 | 430 | 230 | 670 | 80 |
| Middle three-fifths .. .. .. | 180 | 50 | 100 | 50 | 190 | 60 |
| Top fifth .. .. .. .. .. | 90 | 40 | 40 | 30 | 80 | 20 |
| Total cash benefits as a percentage of gross income | | | | | | |
| Bottom fifth .. .. .. .. .. | 100 | 92 | 47 | 49 | 47 | 100 |
| Middle three-fifths .. .. .. | 81 | 9 | 4 | 8 | 9 | 66 |
| Top fifth .. .. .. .. .. | 32 | 1 | 1 | 3 | 3 | 9 |

[1] See footnote [2] to Table K.
[2] Mainly related to sickness and disability.

## Direct taxes as a percentage of gross income by quintile group of original income within each household type, 1982

TABLE M

| | Household type[1] | | | | | |
|---|---|---|---|---|---|---|
| | 1–2 adults retired | 1 adult non-retired | 2 adults non-retired | 2 adults with children | 3 or more adults | 1 adult with children |
| *(a)* Income tax | | | | | | |
| Bottom fifth | — | 0.7 | 5.7 | 4.7 | 5.9 | — |
| Middle three-fifths | 2.1 | 16.6 | 16.3 | 14.3 | 14.8 | 1.6 |
| Top fifth | 16.6 | 20.6 | 19.3 | 19.0 | 17.7 | 12.1 |
| *(b)* National Insurance contributions | | | | | | |
| Bottom fifth | — | — | 2.1 | 2.8 | 2.7 | — |
| Middle three-fifths | — | 5.2 | 5.5 | 5.5 | 5.3 | 1.0 |
| Top fifth | — | 5.5 | 4.8 | 4.2 | 4.6 | 4.6 |

[1] See footnote [2] to Table K.

## Indirect taxes as a percentage of disposable income by quintile group of original income within each household type, 1982

TABLE N

| | Household type[3] | | | | | |
|---|---|---|---|---|---|---|
| | 1–2 adults retired | 1 adult non-retired | 2 adults non-retired | 2 adults with children | 3 or more adults | 1 adult with children |
| *(a)* Domestic rates (net)[2] | | | | | | |
| Bottom fifth[1] | 2.9– 7.8 | 5.0– 8.8 | 4.5– 5.7 | 3.7– 5.6 | 2.6– 4.2 | 1.9– 9.7 |
| Middle three-fifths[1] | 5.4– 7.1 | 5.8– 5.9 | 4.0– 4.1 | 4.4 | 3.0– 3.3 | 2.8– 7.0 |
| Top fifth | 6.5 | 3.8 | 3.0 | 3.3 | 2.4 | 4.4 |
| *(b)* VAT | | | | | | |
| Bottom fifth | 4.3 | 7.3 | 8.0 | 7.1 | 8.1 | 5.8 |
| Middle three-fifths | 5.2 | 7.5 | 7.2 | 7.5 | 8.0 | 5.1 |
| Top fifth | 6.0 | 6.7 | 6.6 | 6.0 | 6.9 | 6.1 |
| *(c)* Duty on beer | | | | | | |
| Bottom fifth | 0.4 | 1.9 | 1.0 | 1.1 | 1.5 | 0.5 |
| Middle three-fifths | 0.6 | 1.4 | 1.1 | 1.0 | 1.4 | 0.2 |
| Top fifth | 0.4 | 1.0 | 0.7 | 0.5 | 1.2 | 0.6 |
| *(d)* Duty on wines and spirits | | | | | | |
| Bottom fifth | 0.5 | 1.0 | 1.4 | 0.5 | 1.2 | 0.4 |
| Middle three-fifths | 1.0 | 1.3 | 1.2 | 0.9 | 1.1 | 0.3 |
| Top fifth | 1.8 | 1.7 | 1.3 | 0.9 | 1.2 | 0.8 |
| *(e)* Duty on tobacco | | | | | | |
| Bottom fifth | 2.7 | 4.1 | 4.8 | 5.1 | 4.7 | 4.9 |
| Middle three-fifths | 2.2 | 2.8 | 2.5 | 2.4 | 2.9 | 3.5 |
| Top fifth | 1.2 | 1.4 | 1.0 | 1.0 | 1.6 | 1.7 |
| *(f)* Duty on hydrocarbon oils | | | | | | |
| Bottom fifth | 0.5 | 0.9 | 1.6 | 1.5 | 1.7 | 0.2 |
| Middle three-fifths | 0.7 | 1.6 | 1.8 | 1.8 | 2.0 | 0.7 |
| Top fifth | 1.3 | 1.5 | 1.4 | 1.5 | 1.6 | 1.7 |
| *(g)* Car tax and vehicle excise duty | | | | | | |
| Bottom fifth | 0.4 | 0.4 | 0.9 | 0.8 | 0.8 | — |
| Middle three-fifths | 0.5 | 1.0 | 1.0 | 1.0 | 1.0 | 0.3 |
| Top fifth | 1.0 | 1.0 | 0.8 | 0.8 | 0.9 | 0.8 |
| *(h)* Other taxes on final goods and services | | | | | | |
| Bottom fifth | 1.6 | 1.7 | 1.7 | 1.6 | 1.4 | 1.7 |
| Middle three-fifths | 1.7 | 1.3 | 1.3 | 1.5 | 1.3 | 1.6 |
| Top fifth | 1.5 | 1.1 | 1.0 | 1.1 | 1.0 | 1.6 |
| *(j)* Intermediate taxes | | | | | | |
| Bottom fifth | 5.8 | 8.0 | 6.9 | 6.8 | 6.9 | 6.8 |
| Middle three-fifths | 5.9 | 6.1 | 5.6 | 6.3 | 6.0 | 6.4 |
| Top fifth | 5.6 | 4.9 | 4.7 | 5.1 | 4.9 | 5.5 |
| *(k)* Total | | | | | | |
| Bottom fifth[1] | 19.8–23.9 | 31.3–34.1 | 31.2–32.1 | 28.8–30.2 | 29.3–30.5 | 23.8–29.9 |
| Middle three-fifths[1] | 23.5–24.8 | 28.9–29.0 | 25.7–25.8 | 26.8 | 26.7–27.0 | 21.8–25.2 |
| Top fifth | 25.3 | 23.1 | 20.6 | 20.2 | 21.7 | 23.2 |

[1] The ranges reflect the possible different treatment of rates – see box on page 86.

[2] Net of rate rebates but including water, etc. charges.

[3] See footnote [2] to Table K.

*Income-related* benefits are, of course, concentrated in the lowest quintile within each household group. *Other* benefits, most of which are related to sickness and disability, are also mainly concentrated in this quintile since their recipients are often economically inactive and therefore have little or no original income.

Thus, much the highest average cash benefit as a proportion of gross income goes to the lowest quintile within each household group. This means that cash benefits reduce income inequality within each group. The reduction is particularly large for retired households where cash benefits, mainly in the form of the state retirement pension, form virtually the whole of their gross income.

*Direct taxes*

Retired households and single-parent households pay very little direct tax, except those in the highest quintile (Table M). Within other household groups *income tax* as a percentage of gross income increases as income rises. However, *National Insurance contributions* form a smaller proportion of gross income at the upper end of the income scale than they do in the middle, because above a certain level of income contributions are at a fixed rate. The combined effect of these two direct taxes is to reduce income inequality within each household group, although they have considerably less impact than do cash benefits.

*Indirect taxes*

Table N shows that indirect taxes reduce income inequality only within the *retired* household group. This reduction is caused mainly by the pattern of their payments of VAT, since retired households spend a high proportion of their income on zero-rated goods such as food and heating. Apart from domestic rates, whose payment may be covered by Supplementary Benefit, only duty on tobacco has its greatest impact on low income households in this group.

In contrast, the overall effect of indirect taxes is to increase income dispersion within most of the *non-retired* household groups. As discussed in the all-households analysis, the percentage of disposable income paid in indirect taxes depends not only on the spending pattern of a household but also on the proportion of disposable income which is saved. The payment of most indirect taxes by non-retired household groups illustrates this general tendency. The highest quintile group pay less as a proportion of disposable income than those in the middle of the income distribution and, in many cases, less than the lowest quintile too. A notable exception is duty on wines and spirits, which rises with household incomes since consumption of these items is more common in higher income households. The fall in the incidence of tobacco duty in absolute terms is particularly marked (tobacco consumption tends to be negatively correlated with income).

*Benefits in kind*

Broadly speaking, benefits from expenditure on education and health are fairly evenly distributed within each household group, although for a variety of reasons low income households tend to receive larger benefits. The highest average benefits from welfare foods go to households with low incomes because of their higher than average use of school meals and the greater likelihood of them being provided free of charge. The average benefit from the housing subsidy is also substantially higher for low income households within each group, because a higher proportion of low income households are public sector tenants. The average value of the 'other' benefits (passenger rail travel subsidy, option mortgage expenditure and life assurance premium relief) is much higher for high income than for low income households in each group. The overall effect of benefits in kind is to reduce income inequality within each household group (see Appendix 3, Table 4).

## PART II

## REDISTRIBUTION WITHIN HOUSEHOLDS CLASSIFIED BY THE EMPLOYMENT STATUS OF THE HEAD

As already shown, the income of a household both before and after redistribution is highly correlated with the number of economically active members it contains. This section of the article will examine in some detail a further aspect of the relationship between income and activity: the way in which taxes and benefits vary according to the employment status of the head of the household.

The FES data allow households to be classified by the employment status of their head, and this is used as the criterion for deriving the following six groups or categories chosen for this analysis:

Households headed by—

A: a self-employed person or an employee who has been in paid work for at least nine months out of the twelve months preceding interview;

B: an employee who has been away from work (either through sickness or unemployment)
- (i) for between three and six months of the year preceding interview;
- (ii) for between six and twelve months of the year preceding interview;
- (iii) for more than 12 months prior to interview;

C: a retired person or an unoccupied person over minimum NI pension age;

D: an unoccupied person under minimum (National Insurance) pension age.

Table P shows the number of households responding to the FES in 1982 which fall into each of these categories and further details of the definitions are given in Appendix 2. For the sake of simplicity the following shorthand labels will be used from time to time in this section.

A – in employment

B – away from work (i) short term
(ii) medium term
(iii) long term

C – retired

D – unoccupied

**Summary of main results**

The impact of the tax-benefit system is different on each of the employment status groups and each is examined separately below. The main results of the analysis are:

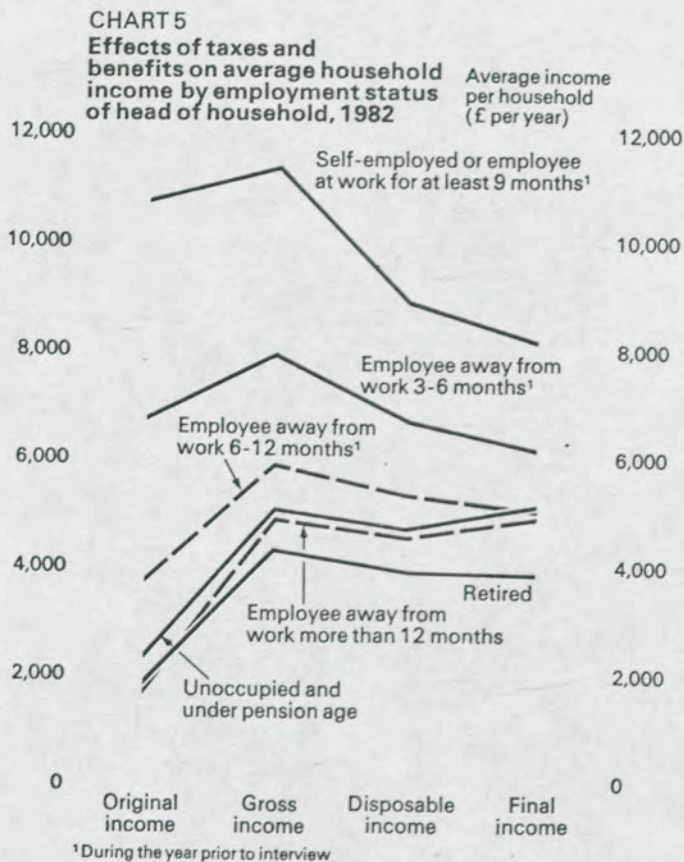
(i) It is the households whose head is not in employment (Categories B–D) which naturally gain most through the tax-benefit system compared with those in employment (Category A). In terms of current cash flows, there is redistribution of income from those working to those not working, and hence a reduction in the disparity of income between the two categories (Table P and Chart 5).

## Summary of the effects of taxes and benefits by employment status category, 1982

TABLE P

| | Employment status of head of household | | | | | | |
|---|---|---|---|---|---|---|---|
| | Self-employed or employee at work[1] for at least 9 months | Employee away from work[1] for 3–6 months | Employee away from work[1] for 6–12 months | Employee away from work[1] for More than 12 months | Retired or unoccupied and over pension age | Unoccupied and under pension age | Average over all households |
| Number of households in the sample .. | 4 474 | 127 | 218 | 218 | 1 887 | 504 | 7 428 |
| **Average per household (£ per year)** | | | | | | | |
| Original income .. .. .. .. | 10 750 | 6 640 | 3 750 | 1 720 | 1 850 | 2 360 | 7 380 |
| *plus* cash benefits .. .. .. | 620 | 1 260 | 2 130 | 3 110 | 2 440 | 2 650 | 1 350 |
| Gross income .. .. .. .. .. | 11 370 | 7 900 | 5 880 | 4 830 | 4 290 | 5 010 | 8 730 |
| *less* direct taxes .. .. .. | 2 450 | 1 180 | 580 | 320 | 400 | 340 | 1 650 |
| Disposable income .. .. .. | 8 920 | 6 710 | 5 300 | 4 520 | 3 890 | 4 680 | 7 080 |
| *less* indirect taxes .. .. .. | 2 190 | 2 020 | 1 650 | 1 400 | 980 | 1 380 | 1 780 |
| *plus* benefits in kind .. .. .. | 1 410 | 1 480 | 1 390 | 1 770 | 920 | 1 790 | 1 320 |
| Final income .. .. .. .. | 8 140 | 6 170 | 5 030 | 4 890 | 3 830 | 5 090 | 6 620 |
| Percent that are public sector tenants .. | 23 | 42 | 52 | 62 | 42 | 55 | 32 |
| Percent with female heads of household | 10 | 16 | 12 | 8 | 47 | 48 | 22 |
| **Average per household (number)** | | | | | | | |
| Children .. .. .. .. .. | 0.9 | 1.0 | 1.0 | 1.3 | — | 0.7 | 0.7 |
| Adults .. .. .. .. .. .. | 2.2 | 2.1 | 2.2 | 2.1 | 1.6 | 1.8 | 2.0 |
| People .. .. .. .. .. .. | 3.1 | 3.1 | 3.1 | 3.4 | 1.6 | 2.6 | 2.7 |
| Retired people .. .. .. .. .. | 0.1 | 0.1 | 0.1 | 0.1 | 1.3 | 0.1 | 0.4 |
| **Average age of head of household (years)** | 42 | 41 | 41 | 42 | 72 | 44 | 50 |

[1] During the year prior to interview.




(ii) Of those households whose head is not in employment (Categories B–D), the ones gaining most through the tax-benefit system are those away from work long term, whose final income is nearly three times their original income. The final income of retired and unoccupied households is just over twice their original income.

(iii) Within the group of households whose head is in employment or self-employment (Category A), it appears that there is very little redistribution between high income and low income households.

**Comparison between households classified by employment status**

Table Q shows where households classified by employment status are situated in the distribution of *original income*. Those households in which the head is in employment for more than nine months of the year are situated in the upper part of the distribution, with nearly 90 per cent of them in the top three quintile groups. This is to be expected since the main component of original income is earnings from employment and self-employment. Those households where the head has not worked at all during the previous year, whether because he/she is, for example, retired, unemployed, sick or disabled, are concentrated in the bottom two quintile groups, with over half of households in each of these three categories falling in the lowest quintile group.

An examination of the distribution of each employment status group amongst all households ranked by *final income* shows that, although households in employment remain concentrated in the upper part of the distribution, most other categories are much more evenly spread throughout all quintile groups (Table R). The exception is the retired household group where 79 per cent of households remain in the bottom two quintiles.

## The composition of each employment status category by quintile groups of original income, 1982

TABLE Q

| | Quintile groups of original income | | | | | |
|---|---|---|---|---|---|---|
| | Bottom | 2nd | 3rd | 4th | Top | Total |
| **Percentages** | | | | | | |
| Employment status of head of household | | | | | | |
| Self-employed or employee at work[1] for at least 9 months | 1 | 11 | 27 | 30 | 32 | 100 |
| Employee away from work[1] for | | | | | | |
| —3–6 months | 2 | 42 | 31 | 15 | 10 | 100 |
| —6–12 months | 17 | 57 | 14 | 8 | 5 | 100 |
| —more than 12 months | 68 | 19 | 6 | 5 | 2 | 100 |
| Retired or unoccupied and over pension age | 54 | 34 | 8 | 3 | 2 | 100 |
| Unoccupied and under pension age | 52 | 30 | 10 | 6 | 3 | 100 |
| All households | 20 | 20 | 20 | 20 | 20 | 100 |

[1] During the year prior to interview.

Average original income ranges from £1 720 per annum where the head of household has not worked for twelve months or more, to £10 750 per annum where the head has not worked for three months or less, a ratio of 1 : 6; after all taxes and benefits this ratio is reduced to 1 : 2 (Table P). However, when the groups in Table R are ranked by their final income, those away from work long term move up the income scale and their place at the bottom is taken by households where the head is retired. As illustrated by Chart 5, these two groups start out with very similar original incomes but those away from work long term gain more per household from the tax-benefit system than the retired, mainly because of their receipts of child-related benefits both in cash and in kind. Two other groups switch positions in the income distribution as a result of taxes and benefits: the unoccupied and those away from work medium term, with the unoccupied starting out with about two-thirds the average original income of those away from work medium term but ending up with a slightly higher average final income.

*Category A: Head of Household Self-employed or an Employee In Paid Work For At Least Nine Months*

In 60 per cent of households the head had been in paid employment or self-employment for at least nine months of the preceding year. Thus this group received the highest average original income (£10 750), 95 per cent of which was derived from wages and salaries or self-employment income. Nearly a quarter of this income was earned by members of the household other than the main earner, indicating the importance of second incomes.

Cash benefits form a very small proportion of gross income (5 per cent) and the only payment of any size is of child benefit, which is, of course, related not to income but to the number of children in the household (Table S). Small receipts of other benefits reflect the presence in some households of dependants who may, for example, be retired, full-time students, or unemployed.

This group of households contribute more to government revenue than any other of the employment status groups. Their payments of direct taxes amount to 22 per cent of their gross income, and they are the only group who pay more in direct taxes than in indirect taxes (Table P). Those in employment spend more in absolute terms on VAT-rateable goods than other employment status groups and have higher payments of domestic rates (Appendix 2, Table 1). They pay more than other groups in duties on wines, spirits, and hydrocarbon oils, and, since they are more likely to be car owners, more in car tax and vehicle excise duty. Since most owner-occupiers are to be found in this group, payments of stamp duty on house purchase are also concentrated here. However, this group pays less than most others in duties on tobacco and beer. Nevertheless, although high in cash terms, payments of indirect taxes as a proportion of disposable income are lower than in most other groups because those in employment are

## The composition of each employment status category by quintile groups of final income, 1982

TABLE R

| | Quintile groups of final income | | | | | |
|---|---|---|---|---|---|---|
| | Bottom | 2nd | 3rd | 4th | Top | Total |
| **Percentages** | | | | | | |
| Employment status of head of household | | | | | | |
| Self-employed or employee at work[1] for at least 9 months | 6 | 13 | 23 | 28 | 30 | 100 |
| Employee away from work[1] for | | | | | | |
| —3–6 months | 17 | 22 | 24 | 24 | 13 | 100 |
| —6–12 months | 25 | 28 | 25 | 16 | 7 | 100 |
| —more than 12 months | 34 | 23 | 20 | 12 | 10 | 100 |
| Retired or unoccupied and over pension age | 46 | 33 | 13 | 5 | 3 | 100 |
| Unoccupied and under pension age | 34 | 25 | 19 | 10 | 12 | 100 |
| All households | 20 | 20 | 20 | 20 | 20 | 100 |

[1] During the year prior to interview.

## Average value of cash benefits for each employment status category, 1982

TABLE S

| | Cash benefits | | | | | Cash benefits as a percentage of gross income |
|---|---|---|---|---|---|---|
| | Age-related | Income-related | Child-related | Other[1] | Total | |
| **Average per household (£ per year)** | | | | | | (per cent) |
| Employment status of head of household | | | | | | |
| Self-employed or employee at work[2] for at least 9 months | 140 | 140 | 280 | 70 | 620 | 5 |
| Employee away from work[2] for | | | | | | |
| —3–6 months .. .. .. .. .. | 100 | 730 | 290 | 130 | 1 260 | 16 |
| —6–12 months .. .. .. .. .. | 80 | 1 520 | 290 | 240 | 2 130 | 36 |
| —more than 12 months .. .. .. .. | 20 | 2 500 | 360 | 220 | 3 110 | 64 |
| Retired or unoccupied and over pension age .. .. | 1 960 | 330 | 10 | 140 | 2 440 | 57 |
| Unoccupied and under pension age .. .. .. | 230 | 1 280 | 240 | 900 | 2 650 | 53 |
| Average over all households .. .. .. .. | 600 | 390 | 210 | 150 | 1 350 | 15 |

[1] Mainly related to sickness and disability.
[2] During the year prior to interview.

more likely to save than the other employment status groups (Table T).

Although cash benefits are relatively insignificant to the income of this household group, benefits in kind are more important (Table U). In-kind benefits allocated to households in employment (£1 410 per annum) are similar in total to the amount allocated to other non-retired household groups, although as a percentage of final income they are much lower (17 per cent). Imputed income from education and health services accounts for nearly 90 per cent of the total.

Quantile analysis within this category of households produces some interesting results. The distribution of original income amongst quintile groups of households is scarcely different from the distribution of final income (Appendix 2, Table 2), and it thus appears that there is very little redistribution between high income and low income households whose head is in employment/self-employment. However, the fact that these results are on a *household* rather than an *individual* basis means that care must be taken in their interpretation. As already shown, a household's income is highly correlated with the number of earners it contains and therefore there is a natural tendency for the upper quintile groups to have a higher share of both original and final income. A household with several earners will not only, in general, show a higher household original income but the personal tax allowances for the household will be higher than if an equivalent income had been earned by one household member only. The fact that there is little redistribution between high and low income households *on average* does not necessarily mean that there is no redistribution between high and low income households of a given size and composition.

*Category B: Head of Household Away From Work for Three Months or More*

The head of a household may be an employee who has been away from work for a period during the 12 months prior to interview either because of unemployment or because of sickness. Broadly speaking, such persons consider themselves members of the labour force but they have experienced a spell in which they have not been in paid employment. Information derived from the FES indicates that 8 per cent of heads of households in the 1982 sample experienced

## Indirect taxes as a percentage of disposable income for each employment status category, 1982

TABLE T

| | Indirect taxes | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Domestic rates (net)[1, 2] | VAT | Duty on beer | Duty on wine and spirits | Duty on tobacco | Duty on hydro-carbon oils | Car tax and vehicle excise duty | Other taxes on final goods and services | Inter-mediate taxes | Total[1, 2] |
| Employment status of head of household | | | | | | | | | | |
| Self-employed or employee at work[3] for at least 9 months .. .. .. .. | 3.7 | 7.1 | 1.0 | 1.1 | 2.1 | 1.7 | 0.9 | 1.3 | 5.6 | 24.5 |
| Employee away from work[3] for | | | | | | | | | | |
| —3–6 months .. .. .. .. | 3.6–4.1 | 8.4 | 1.4 | 1.0 | 3.8 | 2.0 | 0.9 | 1.4 | 7.0 | 29.7–30.1 |
| —6–12 months .. .. .. .. | 3.4–4.7 | 7.9 | 1.7 | 1.1 | 4.9 | 1.8 | 1.1 | 1.6 | 6.4 | 30.2–31.2 |
| —more than 12 months .. .. .. | 2.0–5.5 | 7.3 | 1.4 | 1.0 | 5.9 | 1.2 | 0.7 | 1.5 | 6.6 | 28.4–31.0 |
| Retired or unoccupied and over pension age .. | 4.8–6.2 | 5.8 | 0.7 | 1.3 | 2.1 | 1.0 | 0.7 | 1.5 | 5.8 | 23.9–25.1 |
| Unoccupied and under pension age .. .. | 3.3–5.4 | 7.8 | 1.0 | 0.9 | 3.9 | 1.4 | 0.7 | 1.5 | 7.0 | 27.9–29.5 |
| Average over all households .. .. .. | 3.7–4.2 | 7.0 | 1.0 | 1.1 | 2.4 | 1.6 | 0.9 | 1.3 | 5.8 | 24.8–25.2 |

[1] Net of rate rebates, but including water, etc, charges.
[2] The ranges reflect the alternative treatment of rates – see box, page 86.
[3] During the year prior to interview.

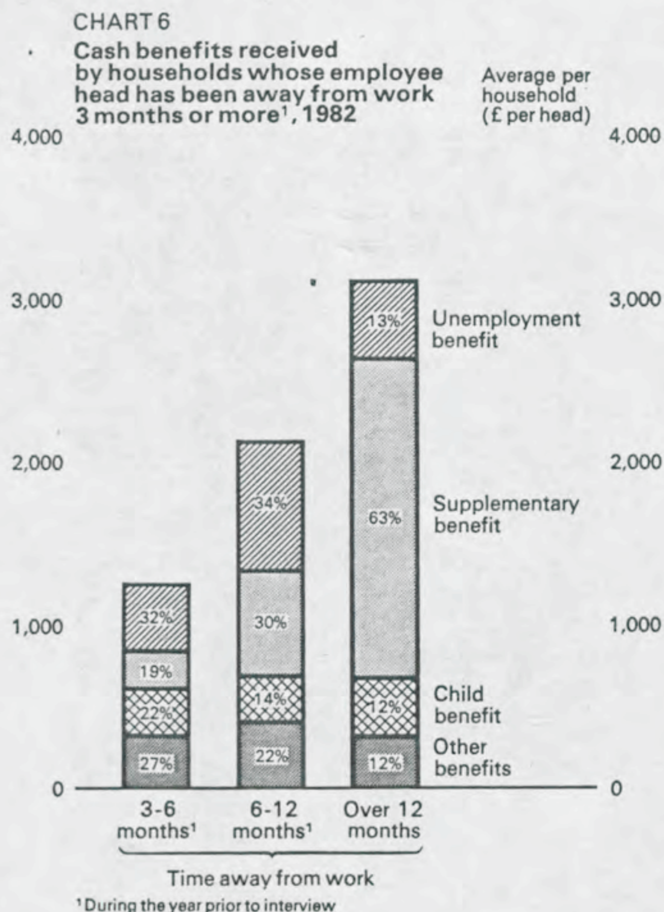
periods of absence totalling three months or more. These households have been further subdivided by the period their head spent away from work: 3–6 months (short term); 6–12 months (medium term); more than 12 months (long term). Most of the absence is due to unemployment rather than sickness.

Before examining the effects of the tax-benefit system on these three groups, some of their basic household characteristics are worth noting and in particular how these vary according to the period spent away from work. Though the average number of adults in the household remains almost the same for each of the three groups, those away from work long term tend to have more children (Table R). The proportion of public sector tenants is higher than average within all three groups and tends to rise as the period away from work increases. The average age of the head of household, around 41 years, hardly varies between the three groups and is also virtually identical to the average age of heads in employment. The age distribution of all four groups is also very similar, the only major difference being a rather higher proportion of young heads of households (20–25 year olds) away from work than in the households in employment. Subject to one qualification, it would thus appear from the FES that older economically active heads of households are on average not more likely to experience longer periods away from work than their younger counterparts. The qualification is that an older person who has been away from work for a long period may be more likely to consider himself unoccupied and so be classified as such (see section on the unoccupied below).

As might be expected, average original income drops sharply as the period away from work increases, ranging from £6 640 per annum where the head has been away from work short term to £1 720 for those away from work long term (Table P). Apart from the length of time away from work, another factor in this dispersion is that for those households where the head is married, the longer the period away from work of the head, the less likely his spouse is to be employed.

Chart 5 shows what an important effect the tax-benefit system has in reducing inequality in income between these three household groups (see broken lines on chart). The way in which dispersion is reduced between those away from work long term and those away medium term is particularly striking. Though the former group have, on average, only about half the original income of the latter, the two groups end up with a very similar average final income.

As the period of absence from work increases cash benefits play a more and more important part in household gross income, rising from an average of 16 per cent for those away from work short term to 64 per cent for those away from work long term. Those away from work long term receive the highest cash benefits of all the employment status groups, averaging £3 110 per annum in 1982 (Table S), the bulk of which is income-related. Chart 6 illustrates how the various cash benefits alter in importance in the income of these households as the period away from work increases. The structure of the benefit system is such that the longer households are away from work the more important Supplementary Benefit becomes, both in absolute and percentage terms, whilst receipts of Unemployment Benefit,




## Average value of benefits in kind for each employment status category, 1982

TABLE U

| | Benefits in kind | | | | | | Benefits in kind as a percentage of final income |
|---|---|---|---|---|---|---|---|
| | Education | Welfare foods | Health | Housing subsidy | Other | Total | |
| **Average per household (£ per year)** | | | | | | | (per cent) |
| Employment status of head of household | | | | | | | |
| Self-employed or employee at work[1] for at least 9 months | 700 | 20 | 530 | 60 | 100 | 1 410 | 17 |
| Employee away from work[1] for | | | | | | | |
| —3–6 months | 730 | 60 | 530 | 80 | 80 | 1 480 | 24 |
| —6–12 months | 670 | 60 | 500 | 120 | 40 | 1 390 | 28 |
| —more than 12 months | 900 | 130 | 580 | 120 | 30 | 1 770 | 36 |
| Retired or unoccupied and over pension age | 20 | — | 790 | 90 | 10 | 920 | 24 |
| Unoccupied and under pension age | 1 110 | 60 | 450 | 130 | 40 | 1 790 | 35 |
| Average over all households | 560 | 30 | 590 | 80 | 70 | 1 320 | 20 |

[1] During the year prior to interview.

which is only payable for a year, decline. Child Benefit is highest in absolute terms for households where the head has been away from work long term since on average these households contain more children.

Direct taxes decline as a percentage of gross income as the period away from work lengthens.

Payment of indirect taxes forms a very similar percentage of disposable income for all three groups, about 30 per cent (Table T), a higher proportion than for the other three employment status groups. The contrast between those away from work short term (30 per cent) and those in employment (25 per cent) is particularly marked, although in absolute terms the difference is only slight. This implies that when a head of household is away from work for a relatively short period, household savings may immediately fall but the level of expenditure may be maintained as far as possible. As a proportion of disposable income the payment of indirect taxes remains about the same as the period away from work increases. However, looking at these taxes and duties individually it is interesting to note that tobacco duty rises sharply as a proportion of disposable income whilst most other indirect taxes fall.

Total benefits in kind are not correlated with the period away from work because the bulk of such benefits are not means-tested (Table U). However, the imputed allocations of welfare foods are on average much larger for those absent long term than for any other of the household groups not only because the numbers of children per household are above average but also because these households are more likely to be entitled to free school meals. Imputed income from the housing subsidy is also high reflecting mainly the substantial proportion of public sector tenants in these groups.

*Category C: Head of Household Retired or Unoccupied and Over Minimum NI Pension Age*

This group of households is very similar to, though not identical with, the 1–2 adult retired households groups discussed earlier in this article. The effects of the tax-benefit system are therefore much the same for both groups and so no detailed analysis will be presented in this section. Briefly, original income is low, comprising mainly occupational pensions, which are received by about half of these households, and investment income. Cash benefits, mainly the state retirement pension, form 57 per cent of average gross income. Compared to the other two groups where the head has not worked throughout the previous year (those away from work long term and the unoccupied) retired households pay, on average, a slightly higher proportion of their income in direct taxes. However, they pay, on average, less in indirect taxes than any of the other employment status groups, both in absolute terms and as a proportion of disposable income. Health services comprise 86 per cent of their imputed income from benefits in kind, which in total form 24 per cent of their final income.

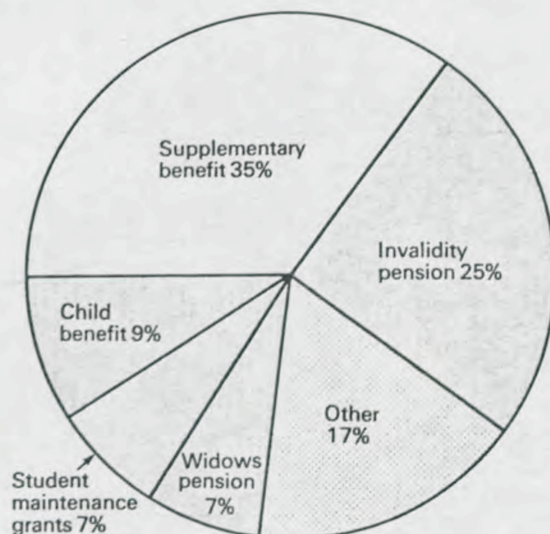
*Category D: Head of Household Unoccupied and Under Minimum NI Pension Age*

This group comprised 7 per cent of FES responding households in 1982. In these households the head is unable either to work or to seek work for a wide variety of reasons: for example, he/she may be disabled, a lone parent looking after young children or a full-time student. A high proportion (55 per cent) are public sector tenants. Nearly half the heads of these households are women, compared with the proportion for all non-retired households of 14 per cent. Many of these women are heading one-parent families but a significant proportion are living alone. The age distribution of the heads of households in this group shows an interesting pattern, with concentrations in the under–25 age range (mainly students) and in the 55–65 age range: in fact 38 per cent of heads are between 55 and 65 years of age. Since most are also men, a possible explanation is that a man of this age who becomes unemployed may not consider it worthwhile to seek work and would thus describe himself as unoccupied and out of the labour force. This would tie in with the rather surprisingly young age distribution of those away from work long term (see above).

It is not surprising that original income within this household group is fairly low, averaging £2 360 per annum (Table R) – the main earner in a household may not necessarily be its head (Appendix 2, paragraph 2). *Other* income is larger than in other household groups averaging £415 per annum compared with an average over all households of £80 (Appendix 2, Table 1). Most of this *other* income comprises contributions from individuals outside the household, such as allowances from absent husbands or alimony.

Cash benefits constitute just over half the average gross income of this household group. The types of cash benefit received reflect the diverse composition of the group (Chart 7). Supplementary Benefit plays the major role since most households are on low incomes: it may be recalled that over half of households whose head is unoccupied appear in the lowest quintile group when all households are ranked by original income (Table Q). Other cash benefits are directly linked to the reason the head of household cannot work, for example, invalidity pensions and student maintenance grants. Since many households are lone-parent families or women living alone, child benefits and widows pensions are also important.

CHART 7
**Composition of cash benefits received by households whose head is unoccupied and under pension age, 1982**



On average these households pay only 7 per cent of their gross income in direct taxes because most of the cash benefits they receive are non-taxable. Table T shows that their payment of indirect taxes as a proportion of disposable income is higher than the average over all households and that the proportions paid in VAT, duty on tobacco, and intermediate taxes are well above the average for these items. However, because of their expenditure pattern they pay less than average in duties on wines and spirits, and in car tax, vehicle excise duty and duty on hydrocarbon oils.

Households where the head is unoccupied are, on average, the recipients of the highest benefits in kind (Table U). Imputed receipts of education benefit are nearly twice the average for all households and constitute 62 per cent of all such benefits allocated to this household group. The explanation is not that the average number of children per household is higher in this group than in any of the other non-retired household groups – it is lower – but that there are a significant number of households comprising only students in higher education for whom the cost per head to the Exchequer is substantially greater than the cost per school pupil.

# APPENDIX 1

## Methodology and Definitions

**The allocation of government expenditure and its financing**

1. There are considerable difficulties in moving from the aggregates of government expenditure and financing published in the *National Income and Expenditure* Blue Book to apportioning taxes and benefits to individual households. We can obtain information about the types of household that receive cash benefits and pay direct taxes through surveys such as the Family Expenditure Survey (FES). From the replies respondents give to questions on their expenditure we can impute their payments of indirect taxes, and from information they supply about such factors as their ages and the number of children in the household we can estimate the average costs of providing them with social services, such as health and education. But there are other kinds of financing, such as corporation tax and government receipts from public corporations, which are not covered in the FES and which are difficult to apportion to individual households. Indeed, most people would probably not think of these as leading to a reduction in their personal incomes. Similarly, there are other items of government expenditure, such as capital expenditure and expenditure on defence and on the maintenance of law and order, for which there is no clear conceptual basis for allocation, or for which we do not in any event have sufficient information to make an allocation.

**Family Expenditure Survey**

2. The estimates in this article are based mainly on data derived from the FES. The FES is a continuous survey of the expenditure of private households. People living in hotels, lodging houses, and in institutions such as old peoples' homes are excluded. Each adult keeps a full record of payments made during 14 consecutive days and answers questions about hire purchase and other payments. He also gives detailed information, where appropriate, about income (including cash benefits received from the state) and payments of income tax. Information on age, occupation, education received, family composition and housing tenure is also obtained.

3. One of the main purposes of the FES is to yield information on household expenditure patterns to produce the weights used in compiling the index of retail prices. The survey is conducted by the Office of Population Censuses and Surveys on behalf of the Department of Employment who analyse and report on it. The *Family Expenditure Survey Report* for 1982, containing detailed data on household characteristics, income, and expenditure, will be published shortly. Details of the survey method are set out in *Family Expenditure Survey Handbook* by W F F Kemsley, R U Redpath and M Holmes. Both are published by Her Majesty's Stationery Office.

4. The number of households co-operating in the FES in 1982 was 7 428. The response rate was 71.8 per cent.

5. The available evidence suggests that older households, households where the head is self-employed, those without children and higher income households, are less likely to co-operate than others. In addition response in Greater London is noticeably lower than in other areas (see 'Family Expenditure Survey: a study of differential response based on a comparison of the 1971 sample with the census' by W F F Kemsley, *Statistical News* No. 31, November 1975 (HMSO)). It is not practicable at present to correct for any consequential non-response bias: the results in the article are based on the responses of those households which actually co-operated in the survey. This means that some of the figures differ from those produced by other surveys (see also 'Differential response in the Family Expenditure Survey: the effect on estimates of redistribution of income' by R Harris in *Statistical News* No. 39, November 1977 (HMSO)).

**Unit of analysis**

6. The basic unit of analysis in the article is the household, and not the family or the individual. A household is defined in the FES as comprising people who live at the same address and who share common catering for at least one meal a day. Spending on many items, particularly on housing, fuel and light and food, is largely joint spending by the members of the household. Without further information or assumptions it is impossible to apportion indirect taxes between individuals or other sub-divisions of households. It would also be far from simple to apportion income, direct taxes and benefits.

7. In classifying the households, adults have been taken as all people aged 16 and over. Most of the 'extra' adults in households with at least three adults are sons or daughters of the head of household rather than retired people.

8. A *retired* household is defined as one in which the combined income of members who are at least 60, and who describe themselves as retired or unoccupied, amounts to at least half the total gross income of the household; or in which the head is over state pension age, and more than three quarters of the household's income consists of national insurance retirement and similar state pensions, or related supplementary benefit.

9. By no means all retired people are in retired households; about one in three households comprising three or more adults contain retired people, for example, and households comprising one retired and one non-retired adult are often classified as non-retired.

10. The sample households have been classified according to their compositions at the time of the interview; it is particularly important to bear this in mind for households comprising one adult with children – it is likely that many of these households changed their composition at some time during the year.

11. *Economically active* people comprise employees, the self-employed and others not in employment but who are seeking or intending, when able, to seek work. In 1982 there were changes in the FES in the definition relating to economic activity. The effect of these changes is to exclude *all* those out of employment for more than a year rather than five years. This exclusion applies regardless of the fact that they may still describe themselves as seeking work. Also excluded are those who have not been in paid employment since leaving full-time education unless they have worked within the previous year; certain of the part-time self-employed with very small incomes; and those whose only economic activity is working as mail-order agents or baby-sitters. Therefore figures on economic activity given in this article are not comparable with those given in previous articles in this series.

**Income: redistributive stages**

12. *Stage one*

Original income *plus* cash benefits = Gross income.

*Stage two*

Gross income *minus* direct taxes = Disposable income.

*Stage three*

Disposable income *minus* indirect taxes *plus* other benefits = Income after all taxes and benefits (final income).

13. The starting point of the analysis is *original income*. This is the annual income in cash and kind of all members of the household before the deduction of taxes or the addition of any state benefits. It includes income from employment, self-employment, investment and occupational pensions. Employment income is based on the last payment received before the interview or, where different, the amount usually received. Allowance is made for any periods of absence from work through sickness and unemployment in the preceding twelve months, and for bonuses. Income from self-employment is recorded in the FES for a past period. This is brought up to current levels using an index of income from self-employment derived from the National Accounts. Income from interest, dividends and rent is taken as the amount received in the 12 months before the interview. Income from occupational pensions is based on the last payment received.

14. Households living in rent-free dwellings are each assigned an imputed income based upon the rateable value of the dwelling. This is counted as employment income if the tenancy depends on the job.

15. The next stage of the analysis is to add on *cash benefits* to original income to obtain *gross income*. This is slightly different to the 'gross normal weekly income' used in the FES Report, mainly because it excludes the imputed rent of owner-occupiers. Cash benefits are:

*Age-related*

Retirement and old persons' pension, Widows' benefit, Christmas bonus for pensioners.

*Child-related*

Child benefit, Maternity allowance, Maternity grant.

*Income-related*

Unemployment benefit, Family Income Supplement, Supplementary benefit, Rent rebates and rent allowances, Student maintenance awards.

*Other cash benefits*

War pension, Invalidity pension, Non-contributory invalidity pension, Housewives non-contributory invalidity pension, Invalid care allowance, Attendance allowance, Sickness benefit, Industrial injury disablement benefit, Death grant, other benefits.

16. This division involves some arbitrary allocations (for example, most income-related benefits depend on the number of children in the household), and it differs from classifications used elsewhere. It is adopted in the article purely for the purpose of shedding further light on the redistributive effects of cash benefits.

17. Income from short-term benefits is taken as the product of the last weekly payment and the number of weeks the benefit was received in the 12 months prior to interview. Income from long-term benefits, and from rent rebates and allowances, is based on current rates. The National Accounts (and Table 1 of Appendix 3) include payments made by local authorities to the Department of Health and Social Security in respect of recipients of Supplementary Benefit as 'rent rebates and allowances'. Supplementary Benefit includes all supplementary allowances where they are separately distinguished by respondents.

18. *Direct taxes* are then deducted to give *disposable income*. Direct taxes are:

Income tax
Employees' and self-employed contributions to national insurance and national health services.

19. The estimates are based on the amount deducted from the last payments of employment income and pensions, and on the amount paid in the last 12 months in respect of income from self-employment, interest, dividends and rent. The income tax payments recorded will therefore take account of a household's tax allowances including tax relief on mortgage interest, but not on life assurance premiums, where administrative arrangements are different.

20. As original income includes some elements not actually received in cash, disposable income as defined here does not correspond exactly to money available for the household to spend. It does however give an indication of the resources which are available to the household, and which influence spending decisions.

21. The order in which the remaining allocated items are presented is to some extent arbitrary.

22. *Indirect taxes on final consumer goods and services* are:

Local authority rates on dwellings (after rebates)
Duties on beer, wines, spirits, tobacco, oil, betting, etc.
Value added tax (VAT)
Customs (import) duties
Car tax
Motor vehicle duties
Driving licences
Television licences
Stamp duties

23. These taxes are either levied directly on the consumer (for example domestic rates) or are assumed to be fully incident on the consumer. For example, the amount of VAT which is paid by the household is calculated from the household's total expenditure on goods and services subject to VAT.

24. The figures for *domestic rates* include, as well as local authority rates, charges made by water authorities for water, environmental and sewerage services, although these charges to households in England and Wales are no longer counted as general government receipts in the National Accounts. (In Scotland these payments go to the local authorities and are so counted.) As explained in the article, local authority rates are paid in full by most recipients of supplementary benefit, as the supplementary benefit payments they receive include an allowance for this item. Where ranges are shown (in Tables E, N and T) for the burden of rates (and total indirect taxes), the lower end has been calculated by excluding the rates payments of most SB households, and by subtracting corresponding sums from their gross incomes. For each household where the SB received is less than the total rent and rates bill, however, its gross income and rates payment have been reduced by only a proportion of the SB – the proportion that rates represents of rent and rates combined.

25. VAT and car tax affect the prices of secondhand cars and are therefore assumed to be incident on the purchasers and vendors of such cars. In allocating taxes, expenditures recorded in the FES on alcoholic drink, tobacco, ice cream, soft drinks and confectionery are weighted to allow for the known under-recording of these items in the sample. The true expenditure in each case is assumed to be proportional to the recorded expenditure.

26. The incidence of stamp duty on house purchase on an owner-occupying household has been taken as the product of the hypothetical duty payable on buying the current dwelling (estimated from rateable values) and the probability of a household of that type moving in a given year (estimated from the General Household Survey).

27. *Indirect taxes on intermediate goods and services* are:

Local authority rates on commercial and industrial property
Motor vehicle duties
Duties on hydrocarbon oils
Customs (import) duties
Stamp duties
Employers' contributions to national insurance, the National Health Service, the industrial injuries fund and the redundancy payments scheme
National insurance surcharge.

28. These are taxes that fall on goods and services purchased by industry. Only the elements attributable to the production of subsequent goods and services for final consumption by the UK personal sector are allocated in the article, being assumed to be fully shifted to the consumer. Their allocations between different categories of consumers' expenditure are based on the relation between intermediate production and final consumption using input-output techniques.

29. Finally, we add the effects of *benefits in kind* for which there is a reasonable basis for allocation to households, to obtain *final income*. Benefits in kind are:

State education
School meals, milk and other welfare foods
National Health Service
Housing subsidy
Rail travel subsidy
Option mortgage expenditure
Life assurance premium relief

30. *Education benefit* is estimated by the Department of Education and Science as the cost per pupil or student in special schools, primary, secondary and direct grant schools, universities, and other further education establishments. The value of the benefit attributed to a household depends on the number of people in the household recorded in the FES as receiving each kind of education (students away from home are not counted).

31. The value of *school meals and other welfare foods* is based on their cost to the public authorities. Any payment by the individual households is subtracted to arrive at a net contribution.

32. Each individual in the FES is allocated a benefit from the *National Health Service* according to the estimated average use made of health services by people of the same age and sex, and according to the total cost of providing those services. The benefit from the maternity services is assigned separately to those households receiving maternity grant.

33. In this article public sector tenants are defined to include the tenants of local authorities, New Town Corporations, the Scottish Special Housing Association (SSHA) and the Northern Ireland Housing Executive (NIHE). The total *housing subsidy* includes the net excess of current expenditure over income on the housing revenue accounts of local authorities; and grants paid to the New Town Corporations, the SSHA, the NIHE and the Housing Corporation. Within Greater London, the rest of England, Wales, Scotland and Northern Ireland each public sector tenant has been allocated a share of the region's total relevant subsidy based on the gross rateable value of his dwelling. The grant to the Housing Corporation has been similarly allocated to housing association tenants in the UK. Housing subsidy does not include mortgage interest tax relief, rent rebates and allowances or rate rebates (see paragraphs 19, 15 and 24 respectively).

34. The *rail travel subsidies* allocated are those to British Rail and to London Transport railways (the Underground). They are estimated by calculating the ratio of the cost of the subsidy to consumers' expenditure on rail fares. In allocating the British Rail subsidy the total subsidy paid is apportioned between freight and passenger services by the receipts of British Rail for their freight and passenger business, and then a further apportionment between the personal and the business and other sectors is made. This gives the amount of subsidy attributable to rail travel by the personal sector. In allocating the subsidy to London Transport railways the total subsidy to London Transport is apportioned between tube and bus services by the receipts of these sectors, with an allowance for the use of the Underground for business purposes.

35. *Option mortgages* are those where the building societies (or other bodies) charge a low rate of interest, being compensated for this by payments from central government. The interest payments do not then qualify for tax relief, the scheme being primarily for the benefit of non-taxpayers. The benefit to each household holding an option mortgage is assumed to be in proportion to its last interest payment.

36. Central government makes payments to *life assurance* funds enabling them to reduce their premiums to most policy-holders. The benefit to each household of this expenditure is assumed to be in proportion to its premium payments.

37. It must be emphasised that the analysis in this article provides only a very rough guide to the kinds of household which benefit from government expenditure, and by how much, and to those which finance it. Apart from the fact that large parts of expenditure and receipts are not allocated, the criteria used both to allocate taxes and to value and apportion benefits to individual households could be regarded as too simplistic. For example, the lack of data forces us to assume that the incidence of direct taxes falls on the individual from whose income the tax is deducted. This implies that the benefit of tax relief for mortgage interest, for example, accrues directly to the tax payer rather than to some other party, for example, the vendor of the land. It also implies that the working population is not able to pass the cost of the direct tax back to employers through lower profits, or to consumers through higher prices. And, in allocating indirect taxes we assume that the part of the tax falling on consumers' expenditure is borne by the households which buy the item or the service taxed, whereas in reality the incidence of the tax is spread by pricing policies and probably falls in varying proportions on the producers of a good or service, on their employees,

on the buyer, and on the producers and consumers of other goods and services. Another example is that we know only an estimate of the total financial cost of providing benefits such as education, and so we have to treat that cost as if it measured the benefit which accrues to recipients of the service. In fact, the value the recipients themselves place on the service may be very different to the cost of providing it; moreover, there may be households in the community, other than the immediate beneficiaries, who receive a benefit indirectly from the general provision of the service.

**Gini coefficient**

38. The Gini coefficient is the most widely used summary measure of the degree of inequality in an income distribution. It can most easily be understood by considering a Lorenz curve of the income distribution, ie, a graph of the cumulative income share against the cumulative household share. The curve representing complete equality of income is thus a diagonal line, as in Diagram A, while complete inequality (with only one recipient of income) is represented by a curve comprising the horizontal axis and the right-hand vertical axis.

39. A more typical Lorenz curve is illustrated in Diagram B. The area between the Lorenz curve and the diagonal line of complete equality, as a proportion of the triangular area between the curves of complete equality and inequality, gives the value of the Gini coefficient. This is the shaded area in Diagram B. Thus a distribution of perfectly equal incomes has a Gini coefficient of zero; as inequality increases (and the Lorenz curve bellies out), so does the Gini coefficient until, with complete inequality, it reaches its maximum value of 1 (or 100 per cent).

**Previous articles**

40. This article is the latest in an annual series. Earlier articles covering the years 1957 to 1981 were published in the following issues of *Economic Trends*: November 1962, February 1964, August 1966, February 1968, 1969, 1970, 1971, 1972, November 1972 and 1973, December 1974, February 1976, December 1976, February 1978, January 1979, 1980, 1981 and 1982, December 1982. The January 1981 article contains a comprehensive account of the changes in treatment over the years. As far as is practicable with the resources available, the Central Statistical Office will provide on request analyses for 1982 on a basis comparable with those for earlier years. Enquiries should be addressed to D Westcott, Branch 8, Central Statistical Office, Great George Street, London SW1P 3AQ, Telephone 01-233 8300.

DIAGRAM A

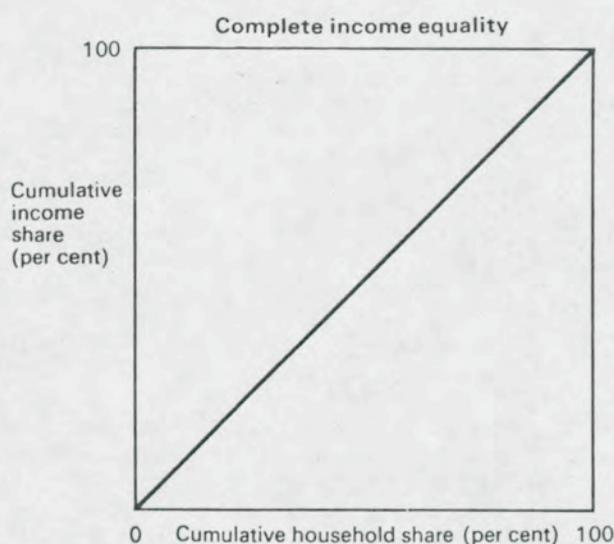
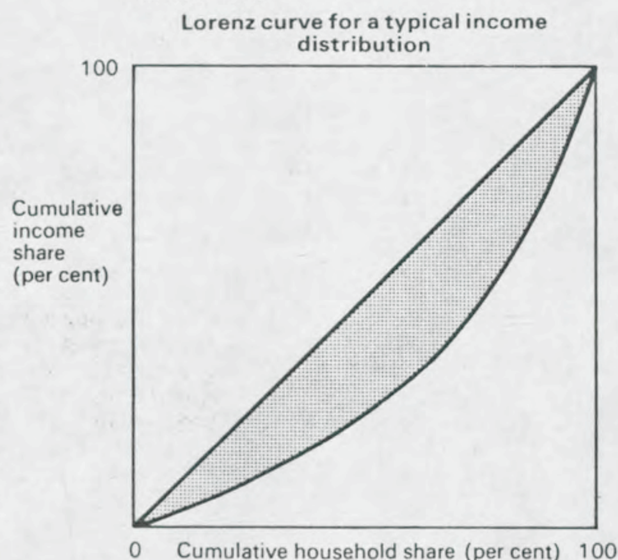



DIAGRAM B



# APPENDIX 2

## Effects of taxes and benefits on households classified by the employment status of the head:

### Notes, definitions and detailed tables.

1. Part II of this year's article examines the way in which taxes and benefits vary according to the *employment status* of the head of the household. The following six categories of households are defined for this analysis:

Households headed by:

Category A: a *self-employed* person, or an *employee* who has been *in paid work for at least nine months* out of the twelve months preceding interview;

Category B: an *employee* who has been *away from work* (either through sickness or unemployment)
- (i) for between *three and six months* of the year preceding interview;
- (ii) for between *six and twelve months* of the year preceding interview;
- (iii) for *more than twelve months* prior to interview;

Category C: a *retired* person or an *unoccupied* person over minimum NI pension age;

Category D: an *unoccupied* person under minimum NI pension age.

2. The *head of household* is broadly defined by the FES to be the owner of the accommodation or the person responsible for the rent. However, if this person proves to be the wife of another household member the latter is taken as the head, and so the head will generally be male.

3. An *employee* may be either:

(*a*) someone who at the time of interview has an arrangement with an employer to work for a wage or salary. He may be on holiday, on strike, or unable to work through illness or injury, as long as he has a job to return to. Also included are those who have an arrangement to work intermittently with the same employer, and casual or seasonal workers and students in full time education if they are working at the time of interview;

*or*(*b*) someone out of employment at the time of interview but who is looking for work or about to start work. This includes those out of employment because of sickness or injury who intend to seek work or are about to start work as soon as they are able. People may be classified as 'employees out of employment' for a period of up to 5 years, after which they are regarded as unoccupied.

4. An employee may have been *away from work* for part or the whole of the year preceding interview due to sickness, maternity leave or unemployment. The period for which he has been away from work is calculated as the total number of weeks for which he did not receive employment income during the 12 months preceding interview. Thus an employee who is in paid work at the time of interview will still be classified in Category B above if he has spent more than three months of the year prior to interview out of paid employment. Some heads of households, whilst still regarded as employees for the purposes of this analysis because they describe themselves as seeking work, may have been out of paid employment for more than 12 months. This group – Category B (iii) – will of course contain no heads currently working or temporarily away from work through sickness or injury.

5. *A self-employed* head of household is someone who works on their own account rather than receive a wage or salary from an employer, and this includes those who are temporarily sick who would be working as a self-employed person if they were well. In the FES, a person is only defined as self-employed if this is their employment status at the time of interview. In practice, few heads who have experienced long periods of absence from work in the recent past will still be self-employed when interviewed. In many respects this category of households is very similar to those headed by employees who have worked for at least nine months of the year and so the two types have been combined as Category A.

6. The *retired* are those who have retired from their full-time occupation, are of the appropriate retirement age for that occupation and are not seeking further employment of any kind. In practice the definition depends on whether or not the respondent describes himself as retired.

7. The term *unoccupied* is used to describe those who have never been in paid employment or who have been away from work for five years or more, and are not seeking employment. This includes people of independent means; women engaged in unpaid domestic duties; students over the age of 16 in full-time education not employed at the time of interview; and people out of paid employment for more than five years even if they claim to be seeking work.

**Detailed tables**

8. Table 1 shows in detail the taxes and benefits received by each employment status group.

9. Table 2 presents the results of carrying out quantile analysis within the group of households whose head has been in employment/self-employment for at least nine months of the preceding year. In part (*a*) of the table, households are ranked by their original income and the percentage shares of each quintile group at each stage of the redistributive process are shown. In part (*b*) households have been re-ranked and re-grouped into quintiles at each stage of the analysis. Thus (*a*) shows how each quintile group, based on original income, has fared as a result of the tax-benefit system whereas (*b*) shows how the distribution of income within this category of households as a whole has altered.

10. As discussed in the text of the article (page 94), great care must be taken in interpreting the results in Table 2 since *household* income before and after re-distribution is strongly related to the number of economically active persons in the household. This is illustrated in Table 2 (*c*) which shows how the average number of economically active household members increases as household income increases.

## Average incomes, taxes and benefits, 1982

**By employment status category**

TABLE 1

£ per year

| | Employment status of head of household | | | | | | |
|---|---|---|---|---|---|---|---|
| | Self-employed or employee at work[2] for at least 9 months | Employee away from work[2] for – 3–6 months | 6–12 months | more than 12 months | Retired or unoccupied and over pension age | Unoccupied and under pension age | Average over all households |
| Number of households in the sample | 4 474 | 127 | 218 | 218 | 1 887 | 504 | 7 428 |
| **Original income** | | | | | | | |
| Earnings of main earner | 7 842 | 4 421 | 2 367 | 937 | 593 | 1 163 | 5 125 |
| Other earnings | 2 394 | 1 655 | 887 | 211 | 60 | 270 | 1 536 |
| Occupational pensions, annuities | 78 | 342 | 214 | 287 | 741 | 258 | 273 |
| Investment income | 363 | 149 | 182 | 261 | 429 | 258 | 361 |
| Other income | 69 | 72 | 98 | 23 | 24 | 415 | 80 |
| Total | 10 745 | 6 640 | 3 748 | 1 719 | 1 848 | 2 365 | 7 376 |
| **Cash benefits** | | | | | | | |
| Age-related | | | | | | | |
| Retirement and old persons' pension | 107 | 54 | 52 | 23 | 1 937 | 42 | 562 |
| Widows' pension | 30 | 42 | 28 | — | 13 | 183 | 35 |
| Christmas bonus for pensioners | 1 | — | 1 | 1 | 13 | 3 | 4 |
| Child-related | | | | | | | |
| Child benefit | 263 | 281 | 289 | 361 | 7 | 234 | 200 |
| Maternity allowance | 13 | 10 | 2 | 1 | — | 4 | 8 |
| Maternity grant | 1 | 2 | 1 | 2 | — | 1 | 1 |
| Income-related | | | | | | | |
| Supplementary benefit | 48 | 241 | 630 | 1 955 | 245 | 925 | 234 |
| Unemployment benefit/TOPS etc, awards | 53 | 411 | 807 | 482 | 16 | 95 | 87 |
| Rent rebates and allowances | 15 | 48 | 69 | 38 | 69 | 75 | 36 |
| Student maintenance grants | 19 | 24 | 3 | 28 | 2 | 185 | 26 |
| Family income supplement | 7 | 8 | 8 | — | 1 | 2 | 5 |
| Other | | | | | | | |
| Invalidity pension and allowance | 10 | 33 | 105 | 115 | 35 | 670 | 68 |
| Sickness, Industrial injury benefit | 25 | 75 | 96 | 33 | 4 | 53 | 25 |
| Attendance allowance | 8 | — | 4 | 29 | 21 | 25 | 13 |
| Disablement and war disability pension | 6 | 4 | — | — | 18 | 22 | 10 |
| Industrial injury disablement pension | 7 | 8 | 2 | 25 | 20 | 37 | 13 |
| Mobility allowance | 5 | — | 4 | 21 | 5 | 53 | 9 |
| Non-contributory invalidity pensions | 3 | — | 4 | — | 10 | 26 | 6 |
| Miscellaneous cash benefits | 4 | 14 | 24 | — | 23 | 12 | 10 |
| Total | 625 | 1 256 | 2 127 | 3 114 | 2 441 | 2 647 | 1 351 |
| **Gross income** | 11 370 | 7 896 | 5 876 | 4 833 | 4 289 | 5 012 | 8 727 |
| **Direct taxes** | | | | | | | |
| Income tax | 1 870 | 817 | 367 | 249 | 364 | 263 | 1 269 |
| National insurance contributions | 583 | 366 | 211 | 68 | 38 | 73 | 380 |
| Total | 2 453 | 1 183 | 577 | 317 | 402 | 336 | 1 649 |
| **Disposable income** | 8 917 | 6 713 | 5 298 | 4 516 | 3 886 | 4 676 | 7 078 |
| **Indirect taxes** | | | | | | | |
| Domestic rates (net of rebates)[1] | 331 | 274 | 251 | 250 | 241 | 252 | 297 |
| Taxes on final goods and services | | | | | | | |
| VAT | 632 | 565 | 416 | 331 | 224 | 363 | 494 |
| Duty on tobacco | 190 | 258 | 257 | 268 | 83 | 183 | 168 |
| Duty on beer | 92 | 97 | 90 | 61 | 27 | 46 | 71 |
| Duty on wines | 29 | 16 | 14 | 8 | 10 | 13 | 22 |
| Duty on spirits | 67 | 52 | 43 | 37 | 38 | 32 | 55 |
| Duty on hydrocarbon oils | 152 | 132 | 97 | 54 | 39 | 65 | 113 |
| Car tax | 23 | 16 | 14 | 7 | 5 | 7 | 17 |
| Vehicle excise duty | 60 | 44 | 44 | 24 | 23 | 24 | 46 |
| Television licences | 35 | 30 | 30 | 24 | 28 | 26 | 32 |
| Stamp duty on house purchase | 12 | 4 | 2 | 1 | 2 | 2 | 8 |
| Customs' duties | 35 | 32 | 23 | 19 | 14 | 21 | 28 |
| Other | 31 | 29 | 31 | 22 | 16 | 19 | 26 |
| Intermediate taxes | | | | | | | |
| Commercial and industrial rates | 167 | 155 | 113 | 98 | 76 | 108 | 136 |
| Employers' NI contributions | 217 | 201 | 145 | 125 | 96 | 140 | 176 |
| Duty on hydrocarbon oils | 70 | 67 | 49 | 45 | 32 | 48 | 57 |
| Vehicle excise duty | 22 | 20 | 15 | 14 | 9 | 15 | 18 |
| Other | 25 | 23 | 17 | 15 | 12 | 16 | 21 |
| Total indirect taxes | 2 188 | 2 018 | 1 654 | 1 401 | 976 | 1 379 | 1 783 |
| **Benefits in kind** | | | | | | | |
| Education | 696 | 732 | 666 | 899 | 24 | 1 110 | 559 |
| Welfare foods | 24 | 62 | 63 | 133 | 2 | 64 | 26 |
| National Health Service | 535 | 527 | 501 | 582 | 786 | 450 | 593 |
| Housing subsidy | 57 | 81 | 117 | 123 | 93 | 130 | 75 |
| Rail travel subsidy | 36 | 19 | 8 | 12 | 6 | 21 | 25 |
| Option mortgage scheme | 21 | 35 | 16 | 11 | 1 | 6 | 15 |
| Life assurance premium relief | 40 | 22 | 16 | 11 | 7 | 12 | 28 |
| Total | 1 409 | 1 478 | 1 387 | 1 771 | 918 | 1 792 | 1 322 |
| **Final income** | 8 138 | 6 173 | 5 031 | 4 886 | 3 829 | 5 088 | 6 616 |

[1] Together with water, etc, charges.
[2] During the year prior to interview.

## Households whose head is self-employed or an employee at work[1] for at least 9 months, 1982

TABLE 2

(a)

| Quintile group | Percentages of income for each quintile group of households ranked by original income | | | |
|---|---|---|---|---|
| | Original income | Gross income | Disposable income | Final income |
| Bottom | 8 | 9 | 10 | 11 |
| 2nd | 14 | 14 | 14 | 15 |
| 3rd | 18 | 18 | 18 | 18 |
| 4th | 23 | 23 | 23 | 22 |
| Top | 37 | 36 | 35 | 34 |
| Total | 100 | 100 | 100 | 100 |

(b)

| Quintile group | Percentages of income for each quintile group of households re-ranked at each stage | | | |
|---|---|---|---|---|
| | Original income | Gross income | Disposable income | Final income |
| Bottom | 8 | 9 | 9 | 9 |
| 2nd | 14 | 14 | 14 | 14 |
| 3rd | 18 | 18 | 18 | 18 |
| 4th | 23 | 23 | 23 | 23 |
| Top | 37 | 36 | 36 | 36 |
| Total | 100 | 100 | 100 | 100 |
| Gini coefficient (per cent) | 29.2 | 27.0 | 26.2 | 27.5 |

(c)

| Quintile group | Average number of economically active people per household in each quintile group of households re-ranked at each stage | | | |
|---|---|---|---|---|
| | Original income | Gross income | Disposable income | Final income |
| Bottom | 1.2 | 1.2 | 1.2 | 1.2 |
| 2nd | 1.5 | 1.5 | 1.5 | 1.6 |
| 3rd | 1.8 | 1.8 | 1.8 | 1.7 |
| 4th | 2.0 | 2.0 | 2.0 | 2.0 |
| Top | 2.4 | 2.4 | 2.4 | 2.3 |
| Overall average | 1.8 | 1.8 | 1.8 | 1.8 |

[1] During the year prior to interview.

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## General government expenditure in 1982

TABLE 1

| | £ million | *Percentage of total expenditure* |
|---|---|---|
| **Allocated expenditure** | | |
| Allocated cash benefits[1] | | |
| Social security benefits | | |
| National Insurance (contributory) | | |
| Retirement | 13 400 | *10.5* |
| Widows and guardians | 740 | *0.6* |
| Unemployment | 1 580 | *1.2* |
| Sickness | 580 | *0.5* |
| Invalidity | 1 640 | *1.3* |
| Maternity | 160 | *0.1* |
| Disablement | 350 | *0.3* |
| Other | 220 | *0.2* |
| Non-contributory | | |
| Child benefit | 3 580 | *2.8* |
| Supplementary benefit | 6 320 | *4.9* |
| War pension | 480 | *0.4* |
| Other | 1 200 | *0.9* |
| Student maintenance grants | 600 | *0.6* |
| Rent rebates and rent allowances | 750 | *0.6* |
| Allocated benefits in kind[1] | | |
| Health services | 13 120 | *10.2* |
| Education | 13 000 | *10.2* |
| School meals, milk, welfare foods | 530 | *0.4* |
| Option mortgage scheme | 310 | *0.2* |
| Housing subsidy | 1 750 | *1.4* |
| Rail travel subsidy | 590 | *0.5* |
| | 60 900 | *47.6* |
| **Unallocated expenditure** | | |
| Other current expenditure on social, environmental and protective services | | |
| Social services | | |
| Social security benefits administration | 1 400 | *1.1* |
| Personal social services | 2 700 | *2.1* |
| Other | 40 | — |
| Environmental services | | |
| Housing | 210 | *0.2* |
| Water, sewerage, land drainage and public health | 1 250 | *1.0* |
| Parks, etc | 740 | *0.6* |
| Miscellaneous local authority services | 900 | *0.7* |
| Libraries, museums, and arts | 620 | *0.5* |
| Protective services | | |
| Police | 2 790 | *2.2* |
| Parliament, courts and prisons | 1 450 | *1.1* |
| Fire services | 570 | *0.4* |
| | 12 660 | *9.9* |
| Capital expenditure on social, environmental and protective services | | |
| Social services | 1 630 | *1.3* |
| Environmental services | | |
| Housing | 2 470 | *1.9* |
| Other | 1 280 | *1.0* |
| Protective services | 270 | *0.2* |
| | 5,640 | *4.4* |
| Other current expenditure | | |
| Defence and external relations | 16 320 | *12.7* |
| Roads, transport and communications | 2 950 | *2.3* |
| Industry, trade, agriculture, research and employment | 6 160 | *4.8* |
| Other | 2 360 | *1.8* |
| | 27 780 | *21.7* |
| Other capital expenditure | 4 590 | *3.6* |
| Debt interest | 14 260 | *11.1* |
| Non-trading capital consumption | 2 210 | *1.7* |
| **Total expenditure** | 128 040 | *100.0* |

[1] Including benefits to people not living in private households.

Source: *National Income and Expenditure, 1983 edition,* Table 9.4

## Financing of general government expenditure in 1982

TABLE 2

| | £ million | *Percentage of total financing* |
|---|---|---|
| **Allocated financing** | | |
| Allocated taxes[1] | | |
| Direct taxes | | |
| Income tax | 30 270 | *23.6* |
| Employees' and self-employed NI contributions | 8 590 | *6.7* |
| Indirect taxes | | |
| Domestic rates (net of rebates) | 5 650 | *4.4* |
| Taxes on final goods and services | | |
| VAT | 11 540 | *9.0* |
| Duty on beer | 1 460 | *1.1* |
| Duty on wines and spirits | 1 690 | *1.3* |
| Duty on tobacco | 3 520 | *2.8* |
| Duty on hydrocarbon oils | 2 530 | *2.0* |
| Car tax, vehicle excise duty and driving licences | 1 290 | *1.0* |
| Other | 1 430 | *1.1* |
| Taxes on intermediate goods and services | | |
| Employers' NI contributions[2] | 3 030 | *2.4* |
| Commercial and industrial rates | 2 960 | *2.3* |
| Duty on hydrocarbon oils | 1 320 | *1.0* |
| National insurance surcharge | 900 | *0.7* |
| Motor vehicle duty and driving licences | 430 | *0.3* |
| Other | 450 | *0.4* |
| | 77 060 | *60.2* |
| **Unallocated financing** | | |
| Unallocated taxes | | |
| Direct taxes | | |
| Employers' NI contributions not allocated | 6 450 | *5.0* |
| Indirect taxes | | |
| Commercial and industrial rates not allocated | 3 580 | *2.8* |
| Taxes on final goods and services not allocated | | |
| VAT | 2 710 | *2.1* |
| Duty on hydrocarbon oils | 1 240 | *1.0* |
| National insurance surcharge | 1 890 | *1.5* |
| Other | 2 490 | *1.9* |
| Other taxes | | |
| Corporation tax | 4 990 | *3.9* |
| Petroleum revenue tax[3] | 5 040 | *3.9* |
| Taxes on capital | 1 640 | *1.3* |
| Other receipts[4] | 14 780 | *11.5* |
| Government borrowing requirement | 6 180 | *4.8* |
| **Total financing** | 128 040 | *100.0* |

[1] Including taxes paid by people not living in private households.
[2] Not allocated as a tax on consumers' expenditure in the National Accounts.
[3] Including supplementary petroleum duty.
[4] Receipts of rent, royalties and licence fees on oil and gas production, interest, dividends, trading income and miscellaneous transactions (net).

Source: *National Income and Expenditure, 1983 edition*, Table 9.1.

## Average incomes, taxes and benefits, 1982

**By decile groups of households ranked by original and disposable incomes**

TABLE 3

£ per year

| | Decile group | | | | | | | | | | Average over all decile groups |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1st | 2nd | 3rd | 4th | 5th | 6th | 7th | 8th | 9th | 10th | |
| **(i) Ranked by original income** | | | | | | | | | | | |
| **All households** | | | | | | | | | | | |
| Decile points (£) | *38* | *660* | *2 457* | *4 949* | *6 717* | *8 302* | *9 974* | *12 124* | *15 227* | | |
| Number of households in the sample | 743 | 743 | 742 | 743 | 743 | 743 | 743 | 742 | 743 | 743 | 7 428 |
| Original income | 4 | 288 | 1 416 | 3 819 | 5 874 | 7 511 | 9 122 | 10 950 | 13 511 | 21 260 | 7 376 |
| Direct benefits in cash | | | | | | | | | | | |
| Age-related | 1 084 | 1 605 | 1 485 | 740 | 348 | 216 | 183 | 134 | 139 | 85 | 602 |
| Child-related | 158 | 48 | 96 | 197 | 245 | 307 | 293 | 280 | 235 | 234 | 209 |
| Income-related | 1 362 | 619 | 523 | 430 | 225 | 169 | 167 | 117 | 160 | 102 | 388 |
| Other | 281 | 214 | 273 | 189 | 148 | 115 | 83 | 106 | 67 | 50 | 153 |
| Gross income | 2 890 | 2 774 | 3 793 | 5 375 | 6 840 | 8 317 | 9 849 | 11 587 | 14 111 | 21 730 | 8 727 |
| Direct taxes | — | 19 | 172 | 683 | 1 245 | 1 616 | 2 031 | 2 523 | 3 070 | 5 130 | 1 649 |
| Disposable income | 2 890 | 2 755 | 3 622 | 4 692 | 5 595 | 6 702 | 7 818 | 9 064 | 11 041 | 16 600 | 7 078 |
| Domestic rates (net of rebates)[1] | 219 | 192 | 239 | 264 | 280 | 301 | 322 | 342 | 355 | 455 | 297 |
| Taxes on final goods and services | 366 | 351 | 588 | 810 | 972 | 1 121 | 1 276 | 1 433 | 1 661 | 2 215 | 1 079 |
| Intermediate taxes | 176 | 171 | 241 | 308 | 347 | 407 | 466 | 534 | 607 | 813 | 407 |
| Benefits in kind | | | | | | | | | | | |
| Education | 397 | 190 | 304 | 572 | 593 | 651 | 672 | 752 | 718 | 742 | 559 |
| National health service | 652 | 705 | 666 | 562 | 577 | 573 | 559 | 530 | 553 | 553 | 593 |
| Welfare foods | 52 | 17 | 28 | 34 | 25 | 25 | 22 | 21 | 21 | 18 | 26 |
| Housing subsidy | 152 | 92 | 87 | 84 | 90 | 66 | 64 | 43 | 49 | 26 | 75 |
| Other allocated benefits | 12 | 10 | 20 | 43 | 45 | 75 | 78 | 98 | 103 | 197 | 68 |
| Final income | 3 394 | 3 054 | 3 659 | 4 605 | 5 325 | 6 261 | 7 149 | 8 199 | 9 862 | 14 653 | 6 616 |
| **(ii) Ranked by disposable income** | | | | | | | | | | | |
| **All households** | | | | | | | | | | | |
| Decile points (£) | *2 443* | *3 279* | *4 186* | *5 211* | *6 236* | *7 292* | *8 484* | *10 013* | *12 355* | | |
| Number of households in the sample | 743 | 743 | 742 | 743 | 743 | 743 | 742 | 743 | 743 | 743 | 7 428 |
| Original income | 353 | 825 | 1 872 | 3 819 | 5 610 | 7 313 | 8 997 | 10 764 | 13 356 | 20 843 | 7 376 |
| Direct benefits in cash | | | | | | | | | | | |
| Age-related | 1 163 | 1 294 | 1 181 | 752 | 455 | 340 | 240 | 212 | 194 | 188 | 602 |
| Child-related | 26 | 62 | 119 | 205 | 277 | 295 | 303 | 286 | 255 | 266 | 209 |
| Income-related | 470 | 683 | 679 | 508 | 374 | 290 | 216 | 225 | 220 | 211 | 388 |
| Other | 46 | 146 | 214 | 201 | 214 | 170 | 153 | 153 | 127 | 103 | 153 |
| Gross income | 2 059 | 3 009 | 4 065 | 5 485 | 6 930 | 8 407 | 9 909 | 11 640 | 14 152 | 21 610 | 8 727 |
| Direct taxes | 102 | 168 | 352 | 802 | 1 203 | 1 646 | 2 014 | 2 433 | 3 088 | 4 680 | 1 649 |
| Disposable income | 1 957 | 2 841 | 3 713 | 4 682 | 5 727 | 6 762 | 7 895 | 9 207 | 11 064 | 16 930 | 7 078 |
| Domestic rates (net of rebates)[1] | 179 | 219 | 244 | 260 | 285 | 302 | 323 | 345 | 360 | 452 | 297 |
| Taxes on final goods and services | 271 | 388 | 592 | 761 | 982 | 1 142 | 1 305 | 1 457 | 1 697 | 2 197 | 1 079 |
| Intermediate taxes | 142 | 184 | 238 | 285 | 358 | 420 | 472 | 539 | 624 | 809 | 407 |
| Benefits in kind | | | | | | | | | | | |
| Education | 149 | 173 | 276 | 489 | 640 | 704 | 716 | 795 | 794 | 855 | 559 |
| National health service | 540 | 609 | 639 | 612 | 591 | 589 | 583 | 570 | 575 | 621 | 593 |
| Welfare foods | 6 | 19 | 31 | 36 | 41 | 33 | 30 | 20 | 23 | 24 | 26 |
| Housing subsidy | 79 | 107 | 115 | 103 | 89 | 70 | 59 | 52 | 53 | 25 | 75 |
| Other allocated benefits | 11 | 14 | 25 | 33 | 61 | 70 | 76 | 93 | 104 | 192 | 68 |
| Final income | 2 150 | 2 972 | 3 725 | 4 650 | 5 525 | 6 364 | 7 259 | 8 397 | 9 931 | 15 188 | 6 616 |

[1] Together with water, etc, charges.

## Average incomes, taxes and benefits, 1982

**By quintile groups of original income within household type**

TABLE 4

| £ per year | Quintile group 1st | 2nd | 3rd | 4th | 5th | Average over all quintile groups |
|---|---|---|---|---|---|---|
| **(i) 1 adult retired** | | | | | | |
| Quintile points (£) | | *—* | *83* | *400* | *1 071* | |
| Number of households in the sample | | 376[2] | 187 | 188 | 188 | 939 |
| Original income | | 15 | 214 | 658 | 3 023 | 786 |
| Direct benefits in cash | | | | | | |
| Age-related | | 1 514 | 1 581 | 1 527 | 1 520 | 1 531 |
| Child-related | | — | — | — | — | — |
| Income-related | | 682 | 307 | 155 | 31 | 372 |
| Other | | 103 | 38 | 93 | 60 | 80 |
| Gross income | | 2 315 | 2 140 | 2 433 | 4 633 | 2 768 |
| Direct taxes | | 1 | 18 | 64 | 761 | 169 |
| Disposable income | | 2 314 | 2 122 | 2 369 | 3 872 | 2 599 |
| Domestic rates (net of rebates)[1] | | 206 | 171 | 191 | 294 | 214 |
| Taxes on final goods and services | | 171 | 201 | 252 | 472 | 253 |
| Intermediate taxes | | 122 | 124 | 141 | 218 | 145 |
| Benefits in kind | | | | | | |
| Education | | — | — | — | — | — |
| National health service | | 671 | 671 | 554 | 540 | 621 |
| Welfare foods | | — | — | — | — | — |
| Housing subsidy | | 137 | 83 | 84 | 51 | 98 |
| Other allocated benefits | | 3 | 4 | 9 | 8 | 6 |
| Final income | | 2 627 | 2 383 | 2 432 | 3 488 | 2 712 |
| **(ii) 2 adults retired** | | | | | | |
| Quintile points (£) | | *68* | *478* | *1 174* | *2 686* | |
| Number of households in the sample | 149 | 148 | 151 | 149 | 149 | 746 |
| Original income | 12 | 235 | 792 | 1 774 | 5 705 | 1 703 |
| Direct benefits in cash | | | | | | |
| Age-related | 2 329 | 2 469 | 2 435 | 2 449 | 2 285 | 2 394 |
| Child-related | — | — | — | — | — | — |
| Income-related | 564 | 350 | 198 | 112 | 22 | 249 |
| Other | 390 | 273 | 301 | 295 | 134 | 279 |
| Gross income | 3 295 | 3 327 | 3 726 | 4 630 | 8 146 | 4 624 |
| Direct taxes | 3 | 15 | 63 | 249 | 1 364 | 338 |
| Disposable income | 3 293 | 3 312 | 3 663 | 4 382 | 6 782 | 4 286 |
| Domestic rates (net of rebates)[1] | 219 | 201 | 207 | 284 | 391 | 260 |
| Taxes on final goods and services | 407 | 411 | 580 | 620 | 933 | 590 |
| Intermediate taxes | 194 | 198 | 236 | 255 | 384 | 253 |
| Benefits in kind | | | | | | |
| Education | — | 15 | — | — | 29 | 9 |
| National health service | 951 | 957 | 935 | 925 | 831 | 920 |
| Welfare foods | — | — | — | — | — | — |
| Housing subsidy | 139 | 88 | 91 | 93 | 29 | 88 |
| Other allocated benefits | 13 | 9 | 8 | 11 | 22 | 13 |
| Final income | 3 575 | 3 571 | 3 674 | 4 251 | 5 985 | 4 211 |

[1] Together with water, etc, charges.
[2] More than a fifth of these households had no original income, so the bottom group is undefined.

## Average incomes, taxes and benefits, 1982

**By quintile groups of original income within household type**

TABLE 4 (*continued*)

£ per year

| | Quintile group 1st | 2nd | 3rd | 4th | 5th | Average over all quintile groups |
|---|---|---|---|---|---|---|
| **(iii) 1 adult non-retired** | | | | | | |
| Quintile points (£) | | *901* | *3 629* | *5 746* | *8 126* | |
| Number of households in the sample | 140 | 140 | 141 | 140 | 140 | 701 |
| Original income | 171 | 2 297 | 4 733 | 6 842 | 11 382 | 5 084 |
| Direct benefits in cash | | | | | | |
| Age-related | 354 | 602 | 218 | 73 | 17 | 253 |
| Child-related | 2 | — | — | — | 3 | 1 |
| Income-related | 1 179 | 230 | 86 | 2 | 32 | 305 |
| Other | 339 | 74 | 39 | 28 | 36 | 103 |
| Gross income | 2 044 | 3 203 | 5 076 | 6 945 | 11 469 | 5 746 |
| Direct taxes | 14 | 409 | 1 114 | 1 793 | 2 995 | 1 265 |
| Disposable income | 2 030 | 2 794 | 3 962 | 5 152 | 8 474 | 4 482 |
| Domestic rates (net of rebates)[1] | 178 | 193 | 245 | 266 | 326 | 242 |
| Taxes on final goods and services | 352 | 489 | 677 | 848 | 1 215 | 716 |
| Intermediate taxes | 162 | 194 | 239 | 299 | 418 | 263 |
| Benefits in kind | | | | | | |
| Education | 456 | 221 | — | — | 31 | 141 |
| National health service | 194 | 210 | 175 | 156 | 151 | 177 |
| Welfare foods | 1 | — | — | — | — | — |
| Housing subsidy | 101 | 61 | 78 | 68 | 29 | 68 |
| Other allocated benefits | 18 | 21 | 33 | 48 | 103 | 45 |
| Final income | 2 107 | 2 429 | 3 087 | 4 010 | 6 829 | 3 692 |
| **(iv) 2 adults non-retired** | | | | | | |
| Quintile points (£) | | *4 867* | *7 775* | *10 269* | *13 472* | |
| Number of households in the sample | 299 | 300 | 299 | 300 | 299 | 1 497 |
| Original income | 2 322 | 6 337 | 8 918 | 11 802 | 17 799 | 9 435 |
| Direct benefits in cash | | | | | | |
| Age-related | 806 | 382 | 226 | 90 | 82 | 317 |
| Child-related | 7 | 3 | 2 | 3 | 4 | 4 |
| Income-related | 797 | 156 | 59 | 53 | 12 | 215 |
| Other | 428 | 152 | 87 | 58 | 35 | 152 |
| Gross income | 4 360 | 7 030 | 9 292 | 12 005 | 17 932 | 10 123 |
| Direct taxes | 341 | 1 351 | 2 020 | 2 809 | 4 328 | 2 170 |
| Disposable income | 4 019 | 5 679 | 7 272 | 9 196 | 13 603 | 7 953 |
| Domestic rates (net of rebates)[1] | 229 | 283 | 300 | 322 | 409 | 309 |
| Taxes on final goods and services | 783 | 1 005 | 1 178 | 1 386 | 1 743 | 1 219 |
| Intermediate taxes | 279 | 325 | 410 | 506 | 646 | 433 |
| Benefits in kind | | | | | | |
| Education | 241 | 81 | 8 | 27 | — | 71 |
| National health service | 496 | 446 | 385 | 335 | 336 | 400 |
| Welfare foods | 1 | — | — | — | — | — |
| Housing subsidy | 101 | 68 | 69 | 41 | 19 | 59 |
| Other allocated benefits | 34 | 51 | 71 | 105 | 173 | 87 |
| Final income | 3 599 | 4 713 | 5 917 | 7 490 | 11 333 | 6 610 |

[1] Together with water, etc, charges.

## Average incomes, taxes and benefits, 1982

**By quintile groups of original income within household type**

TABLE 4 (*continued*)

| | £ per year | | | | | |
|---|---|---|---|---|---|---|
| | Quintile group | | | | | Average over all quintile groups |
| | 1st | 2nd | 3rd | 4th | 5th | |
| **(v) 3 or more adults with no children** | | | | | | |
| Quintile points (£) | | *6,777* | *10 056* | *13 396* | *16 968* | |
| Number of households in the sample | 169 | 168 | 169 | 168 | 169 | 843 |
| Original income | 3 735 | 8 462 | 11 805 | 14 944 | 22 166 | 12 224 |
| Direct benefits in cash | | | | | | |
| Age-related | 1 334 | 543 | 369 | 107 | 181 | 507 |
| Child-related | 36 | 64 | 43 | 63 | 53 | 52 |
| Income-related | 1 080 | 553 | 335 | 304 | 205 | 496 |
| Other | 745 | 337 | 272 | 88 | 49 | 298 |
| Gross income | 6 931 | 9 959 | 12 824 | 15 506 | 22 653 | 13 576 |
| Direct taxes | 665 | 1 762 | 2 714 | 3 464 | 5 542 | 2 830 |
| Disposable income | 6 266 | 8 197 | 10 110 | 12 042 | 17 111 | 10 747 |
| Domestic rates (net of rebates)[1] | 259 | 311 | 318 | 358 | 461 | 341 |
| Taxes on final goods and services | 1 237 | 1 498 | 1 901 | 2 042 | 2 716 | 1 879 |
| Intermediate taxes | 421 | 495 | 610 | 688 | 953 | 633 |
| Benefits in kind | | | | | | |
| Education | 781 | 530 | 391 | 700 | 592 | 599 |
| National health service | 908 | 621 | 641 | 570 | 623 | 673 |
| Welfare foods | 4 | 5 | 2 | 2 | 3 | 3 |
| Housing subsidy | 74 | 88 | 101 | 53 | 37 | 71 |
| Other allocated benefits | 39 | 58 | 81 | 111 | 251 | 108 |
| Final income | 6 154 | 7 195 | 8 498 | 10 390 | 14 487 | 9 346 |
| **(vi) 1 adult with children** | | | | | | |
| Quintile points (£) | | *—* | *205* | *1 839* | *4 247* | |
| Number of households in the sample | 84[2] (1st and 2nd combined) | | 41 | 42 | 42 | 209 |
| Original income | 15 | | 867 | 2 998 | 7 017 | 2 189 |
| Direct benefits in cash | | | | | | |
| Age-related | 140 | | 210 | 145 | — | 127 |
| Child-related | 548 | | 557 | 614 | 542 | 562 |
| Income-related | 2 274 | | 1 645 | 787 | 155 | 1 426 |
| Other | 115 | | 10 | 19 | 16 | 55 |
| Gross income | 3 091 | | 3 288 | 4 564 | 7 730 | 4 358 |
| Direct taxes | — | | 11 | 279 | 1 297 | 319 |
| Disposable income | 3 091 | | 3 277 | 4 285 | 6 433 | 4 039 |
| Domestic rates (net of rebates)[1] | 278 | | 271 | 213 | 284 | 265 |
| Taxes on final goods and services | 387 | | 406 | 479 | 855 | 503 |
| Intermediate taxes | 208 | | 219 | 255 | 351 | 248 |
| Benefits in kind | | | | | | |
| Education | 1 077 | | 1 253 | 1 323 | 1 211 | 1 188 |
| National health service | 464 | | 418 | 422 | 318 | 417 |
| Welfare foods | 149 | | 210 | 173 | 84 | 153 |
| Housing subsidy | 238 | | 113 | 188 | 88 | 173 |
| Other allocated benefits | 14 | | 35 | 36 | 47 | 29 |
| Final income | 4 162 | | 4 411 | 5 478 | 6 691 | 4 984 |

[1] Together with water, etc, charges.
[2] More than a fifth of these households had no original income, so the bottom group is undefined.

## Average incomes, taxes and benefits, 1982

**By quintile groups of original income within household type**

TABLE 4 (*continued*)

| | £ per year | | | | | |
|---|---|---|---|---|---|---|
| | Quintile group | | | | | Average over all quintile groups |
| | 1st | 2nd | 3rd | 4th | 5th | |
| **(vii) 2 adults, 1 child** | | | | | | |
| Quintile points (£) | | *5 012* | *7 082* | *9 347* | *12 167* | |
| Number of households in the sample | 125 | 125 | 126 | 125 | 125 | 626 |
| Original income | 2 480 | 6 215 | 8 183 | 10 597 | 17 842 | 9 062 |
| Direct benefits in cash | | | | | | |
| Age-related | 65 | 80 | 34 | 24 | 16 | 44 |
| Child-related | 327 | 369 | 358 | 322 | 323 | 340 |
| Income-related | 1 385 | 198 | 89 | 55 | 18 | 349 |
| Other | 186 | 64 | 70 | 31 | 55 | 81 |
| Gross income | 4 443 | 6 926 | 8 735 | 11 028 | 18 255 | 9 876 |
| Direct taxes | 351 | 1 270 | 1 745 | 2 294 | 4 309 | 1 994 |
| Disposable income | 4 092 | 5 656 | 6 990 | 8 734 | 13 946 | 7 882 |
| Domestic rates (net of rebates)[1] | 243 | 272 | 312 | 344 | 423 | 319 |
| Taxes on final goods and services | 762 | 1 030 | 1 179 | 1 472 | 1 662 | 1 221 |
| Intermediate taxes | 292 | 366 | 430 | 575 | 652 | 463 |
| Benefits in kind | | | | | | |
| Education | 568 | 365 | 385 | 495 | 486 | 460 |
| National health service | 595 | 707 | 680 | 612 | 567 | 632 |
| Welfare foods | 43 | 17 | 14 | 13 | 18 | 21 |
| Housing subsidy | 112 | 76 | 52 | 21 | 10 | 54 |
| Other allocated benefits | 62 | 66 | 93 | 136 | 146 | 101 |
| Final income | 4 176 | 5 221 | 6 294 | 7 619 | 12 437 | 7 148 |
| **(viii) 2 adults, 2 children** | | | | | | |
| Quintile points (£) | | *5 827* | *7 754* | *9 631* | *11 981* | |
| Number of households in the sample | 179 | 180 | 179 | 180 | 179 | 897 |
| Original income | 3 164 | 6 864 | 8 656 | 10 646 | 16 251 | 9 115 |
| Direct benefits in cash | | | | | | |
| Age-related | 54 | — | — | — | — | 11 |
| Child-related | 563 | 579 | 575 | 567 | 557 | 568 |
| Income-related | 1 069 | 45 | 49 | 14 | 1 | 235 |
| Other | 160 | 51 | 26 | 35 | 15 | 57 |
| Gross income | 5 010 | 7 539 | 9 306 | 11 262 | 16 824 | 9 987 |
| Direct taxes | 492 | 1 478 | 1 802 | 2 384 | 3 849 | 2 001 |
| Disposable income | 4 518 | 6 061 | 7 504 | 8 877 | 12 976 | 7 986 |
| Domestic rates (net of rebates)[1] | 254 | 304 | 327 | 371 | 442 | 340 |
| Taxes on final goods and services | 816 | 1 004 | 1 151 | 1 296 | 1 579 | 1 169 |
| Intermediate taxes | 299 | 392 | 464 | 522 | 681 | 472 |
| Benefits in kind | | | | | | |
| Education | 1 082 | 951 | 984 | 1 227 | 1 147 | 1 078 |
| National health service | 698 | 700 | 672 | 598 | 598 | 653 |
| Welfare foods | 101 | 37 | 41 | 50 | 44 | 55 |
| Housing subsidy | 112 | 67 | 31 | 35 | 13 | 52 |
| Other allocated benefits | 51 | 76 | 75 | 99 | 150 | 90 |
| Final income | 5 193 | 6 192 | 7 367 | 8 698 | 12 225 | 7 934 |

[1] Together with water, etc, charges.

## Average incomes, taxes and benefits, 1982

**By quintile groups of original income within household type**

TABLE 4 (*continued*)

| | £ per year | | | | | |
|---|---|---|---|---|---|---|
| | Quintile group | | | | | Average over all quintile groups |
| | 1st | 2nd | 3rd | 4th | 5th | |
| **(ix) 2 adults, 3 or more children** | | | | | | |
| Quintile points (£) | | *3 570* | *6 711* | *8 702* | *11 115* | |
| Number of households in the sample | 75 | 75 | 75 | 75 | 75 | 375 |
| Original income | 791 | 5 255 | 7 718 | 9 816 | 17 598 | 8 236 |
| Direct benefits in cash | | | | | | |
| Age-related | 17 | — | — | — | — | 3 |
| Child-related | 1 021 | 926 | 896 | 884 | 916 | 929 |
| Income-related | 2 691 | 396 | 122 | 86 | 28 | 665 |
| Other | 448 | 201 | 52 | 33 | 44 | 156 |
| Gross income | 4 968 | 6 779 | 8 789 | 10 820 | 18 586 | 9 988 |
| Direct taxes | 51 | 1 088 | 1 602 | 2 218 | 4 296 | 1 851 |
| Disposable income | 4 917 | 5 691 | 7 186 | 8 602 | 14 290 | 8 137 |
| Domestic rates (net of rebates)[1] | 241 | 277 | 302 | 368 | 481 | 334 |
| Taxes on final goods and services | 797 | 951 | 1 290 | 1 214 | 1 556 | 1 162 |
| Intermediate taxes | 333 | 375 | 490 | 525 | 782 | 501 |
| Benefits in kind | | | | | | |
| Education | 2 417 | 2 154 | 2 147 | 1 965 | 2 153 | 2 167 |
| National health service | 864 | 965 | 865 | 833 | 760 | 857 |
| Welfare foods | 340 | 163 | 115 | 62 | 89 | 154 |
| Housing subsidy | 155 | 182 | 64 | 97 | 27 | 105 |
| Other allocated benefits | 38 | 68 | 89 | 76 | 173 | 89 |
| Final income | 7 359 | 7 620 | 8 385 | 9 528 | 14 674 | 9 513 |
| **(x) 3 or more adults, with children** | | | | | | |
| Quintile points (£) | | *6 721* | *9 756* | *12 547* | *16 027* | |
| Number of households in the sample | 119 | 119 | 119 | 119 | 119 | 595 |
| Original income | 3 539 | 8 365 | 11 085 | 14 172 | 24 951 | 12 422 |
| Direct benefits in cash | | | | | | |
| Age-related | 250 | 153 | 155 | 234 | 73 | 173 |
| Child-related | 605 | 530 | 522 | 498 | 507 | 532 |
| Income-related | 1 958 | 630 | 429 | 280 | 179 | 695 |
| Other | 576 | 151 | 150 | 78 | 116 | 214 |
| Gross income | 6 928 | 9 828 | 12 342 | 15 261 | 25 826 | 14 037 |
| Direct taxes | 497 | 1 633 | 2 351 | 3 219 | 5 018 | 2 544 |
| Disposable income | 6 431 | 8 195 | 9 991 | 12 042 | 20 808 | 11 494 |
| Domestic rates (net of rebates)[1] | 276 | 322 | 334 | 363 | 442 | 347 |
| Taxes on final goods and services | 1 219 | 1 558 | 1 554 | 2 095 | 2 600 | 1 805 |
| Intermediate taxes | 452 | 561 | 594 | 715 | 871 | 638 |
| Benefits in kind | | | | | | |
| Education | 2 201 | 1 846 | 1 931 | 1 685 | 1 750 | 1 882 |
| National health service | 815 | 722 | 752 | 779 | 756 | 765 |
| Welfare foods | 153 | 48 | 50 | 45 | 44 | 68 |
| Housing subsidy | 116 | 100 | 76 | 78 | 43 | 83 |
| Other allocated benefits | 51 | 55 | 97 | 82 | 169 | 91 |
| Final income | 7 820 | 8 526 | 10 415 | 11 538 | 19 658 | 11 591 |

[1] Together with water, etc, charges.

## Average incomes, taxes and benefits, 1982

**By decile groups of households ranked by original income**

TABLE 5

£ per year

| | Decile groups | | | | | | | | | | Average over all decile groups |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1st | 2nd | 3rd | 4th | 5th | 6th | 7th | 8th | 9th | 10th | |
| Decile points (£) | *38* | *660* | *2 457* | *4 949* | *6 717* | *8 302* | *9 974* | *12 124* | *15 227* | | |
| Number of households in the sample | 743 | 743 | 742 | 743 | 743 | 743 | 743 | 742 | 743 | 743 | 7 428 |
| **Original income** | | | | | | | | | | | |
| Earnings of main earner | — | 38 | 459 | 2 624 | 4 727 | 6 111 | 7 135 | 7 968 | 8 973 | 13 217 | 5 125 |
| Other earnings | — | 1 | 17 | 159 | 384 | 877 | 1 451 | 2 319 | 3 811 | 6 338 | 1 536 |
| Occupational pensions, annuities | — | 126 | 552 | 536 | 432 | 232 | 177 | 233 | 199 | 248 | 273 |
| Investment income | 3 | 103 | 294 | 343 | 264 | 224 | 280 | 363 | 412 | 1 321 | 361 |
| Other income | — | 19 | 95 | 157 | 67 | 67 | 79 | 68 | 116 | 136 | 80 |
| Total | 4 | 288 | 1 416 | 3 819 | 5 874 | 7 511 | 9 122 | 10 950 | 13 511 | 21 260 | 7 376 |
| **Cash benefits** | | | | | | | | | | | |
| Age-related | | | | | | | | | | | |
| Retirement and old persons' pension | 1 036 | 1 543 | 1 415 | 663 | 306 | 184 | 164 | 114 | 117 | 81 | 562 |
| Widows' pension | 41 | 51 | 60 | 72 | 39 | 31 | 18 | 18 | 21 | 4 | 35 |
| Christmas bonus for pensioners | 8 | 11 | 10 | 5 | 3 | 1 | 1 | 1 | 1 | 1 | 4 |
| Child-related | | | | | | | | | | | |
| Child benefit | 157 | 47 | 94 | 189 | 227 | 287 | 279 | 268 | 225 | 228 | 200 |
| Maternity allowance | 1 | — | 1 | 7 | 16 | 19 | 13 | 11 | 9 | 5 | 8 |
| Maternity grant | 1 | — | — | 1 | 2 | 2 | 2 | 1 | 1 | 1 | 1 |
| Income-related | | | | | | | | | | | |
| Supplementary benefit | 1 187 | 393 | 263 | 172 | 84 | 56 | 68 | 34 | 55 | 26 | 234 |
| Unemployment benefit/TOPS, etc, awards | 76 | 79 | 135 | 142 | 94 | 87 | 79 | 66 | 66 | 48 | 87 |
| Rent rebates and allowances | 60 | 107 | 82 | 58 | 29 | 12 | 5 | 4 | 3 | — | 36 |
| Student maintenance grants | 40 | 40 | 33 | 28 | 14 | 13 | 15 | 13 | 36 | 27 | 26 |
| Family income supplement | — | — | 10 | 30 | 4 | 1 | 2 | — | — | — | 5 |
| Other | | | | | | | | | | | |
| Invalidity pension and allowance | 157 | 117 | 145 | 97 | 50 | 51 | 22 | 26 | 9 | 1 | 68 |
| Sickness, industrial injury benefit | 9 | 17 | 18 | 35 | 40 | 29 | 26 | 22 | 26 | 26 | 25 |
| Attendance allowance | 27 | 23 | 23 | 5 | 14 | 4 | 5 | 15 | 9 | 6 | 13 |
| Disablement and war disability pension | 9 | 6 | 32 | 11 | 3 | 9 | 5 | 9 | 10 | 3 | 10 |
| Industrial injury disablement pension | 30 | 21 | 24 | 7 | 13 | 3 | 4 | 15 | 3 | 7 | 13 |
| Mobility allowance | 14 | 9 | 9 | 6 | 15 | 7 | 7 | 8 | 8 | 3 | 9 |
| Non-contributory invalidity pensions | 8 | 10 | 15 | 5 | 7 | 2 | 8 | 2 | 1 | 4 | 6 |
| Miscellaneous cash benefits | 28 | 11 | 9 | 23 | 5 | 8 | 7 | 9 | — | 1 | 10 |
| Total | 2 886 | 2 486 | 2 377 | 1 556 | 967 | 807 | 726 | 637 | 600 | 471 | 1 351 |
| **Gross income** | 2 890 | 2 774 | 3 793 | 5 375 | 6 840 | 8 317 | 9 849 | 11 587 | 14 111 | 21 730 | 8 727 |
| **Direct taxes** | | | | | | | | | | | |
| Income tax | — | 18 | 152 | 524 | 927 | 1 180 | 1 497 | 1 890 | 2 328 | 4 169 | 1 269 |
| National Insurance contributions | — | 1 | 20 | 159 | 318 | 436 | 534 | 632 | 742 | 961 | 380 |
| Total | — | 19 | 172 | 683 | 1 245 | 1 616 | 2 031 | 2 523 | 3 070 | 5 130 | 1 649 |
| **Disposable income** | 2 890 | 2 755 | 3 622 | 4 692 | 5 595 | 6 702 | 7 818 | 9 064 | 11 041 | 16 600 | 7 078 |
| **Indirect taxes** | | | | | | | | | | | |
| Domestic rates (net of rebates)[1] | 219 | 192 | 239 | 264 | 280 | 301 | 322 | 342 | 355 | 455 | 297 |
| Taxes on final goods and services | | | | | | | | | | | |
| VAT | 146 | 145 | 255 | 345 | 402 | 498 | 573 | 681 | 797 | 1 095 | 494 |
| Duty on tobacco | 121 | 79 | 125 | 163 | 194 | 188 | 200 | 183 | 201 | 222 | 168 |
| Duty on beer | 18 | 19 | 32 | 47 | 71 | 80 | 90 | 99 | 111 | 146 | 71 |
| Duty on wines | 3 | 5 | 8 | 17 | 14 | 19 | 24 | 29 | 35 | 67 | 22 |
| Duty on spirits | 10 | 20 | 36 | 42 | 51 | 56 | 57 | 66 | 80 | 136 | 55 |
| Duty on hydrocarbon oils | 15 | 19 | 40 | 79 | 102 | 118 | 147 | 162 | 200 | 245 | 113 |
| Car tax | 1 | 2 | 4 | 9 | 11 | 15 | 19 | 25 | 31 | 48 | 17 |
| Vehicle excise duty | 8 | 12 | 24 | 37 | 43 | 49 | 58 | 67 | 73 | 91 | 46 |
| Television licences | 19 | 26 | 30 | 30 | 33 | 34 | 35 | 37 | 37 | 38 | 32 |
| Stamp duty on house purchase | — | 1 | 2 | 3 | 4 | 6 | 9 | 13 | 14 | 29 | 8 |
| Customs' duties | 11 | 10 | 16 | 20 | 23 | 28 | 31 | 39 | 43 | 58 | 28 |
| Other | 12 | 13 | 17 | 19 | 26 | 30 | 33 | 33 | 38 | 39 | 26 |
| Intermediate taxes | | | | | | | | | | | |
| Commercial and industrial rates | 59 | 58 | 81 | 103 | 116 | 136 | 155 | 178 | 203 | 268 | 136 |
| Employers' NI contributions | 74 | 72 | 103 | 132 | 149 | 175 | 202 | 232 | 264 | 353 | 176 |
| Duty on hydrocarbon oils | 27 | 25 | 34 | 44 | 49 | 57 | 65 | 74 | 83 | 115 | 57 |
| Vehicle excise duty | 8 | 7 | 10 | 13 | 15 | 18 | 20 | 23 | 26 | 37 | 18 |
| Other | 9 | 9 | 12 | 16 | 18 | 21 | 24 | 27 | 31 | 40 | 21 |
| **Total indirect taxes** | 761 | 715 | 1 067 | 1 382 | 1 599 | 1 830 | 2 064 | 2 309 | 2 623 | 3 484 | 1 783 |
| **Benefits in kind** | | | | | | | | | | | |
| Education | 397 | 190 | 304 | 572 | 593 | 651 | 672 | 752 | 718 | 742 | 559 |
| Welfare foods | 52 | 17 | 28 | 34 | 25 | 25 | 22 | 21 | 21 | 18 | 26 |
| National health service | 652 | 705 | 666 | 562 | 577 | 573 | 559 | 530 | 553 | 553 | 593 |
| Housing subsidy | 152 | 92 | 87 | 84 | 90 | 66 | 64 | 43 | 49 | 26 | 75 |
| Rail travel subsidy | 5 | 4 | 8 | 12 | 10 | 22 | 21 | 33 | 41 | 96 | 25 |
| Option mortgage scheme | 2 | 1 | 5 | 15 | 13 | 27 | 23 | 28 | 18 | 19 | 15 |
| Life assurance premium relief | 4 | 5 | 7 | 16 | 22 | 25 | 33 | 37 | 45 | 82 | 28 |
| Total | 1 265 | 1 014 | 1 105 | 1 295 | 1 329 | 1 389 | 1 395 | 1 444 | 1 444 | 1 537 | 1 322 |
| **Final income** | 3 394 | 3 054 | 3 659 | 4 605 | 5 325 | 6 261 | 7 149 | 8 199 | 9 862 | 14 653 | 6 616 |

[1] Together with water, etc, charges.

## Average incomes, taxes and benefits, 1982

**By decile groups of households ranked by gross income**

TABLE 6

| | £ per year | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Decile group | | | | | | | | | | Average over all decile groups |
| | 1st | 2nd | 3rd | 4th | 5th | 6th | 7th | 8th | 9th | 10th | |
| Decile points (£) | 2 494 | 3 432 | 4 681 | 6 162 | 7 673 | 9 121 | 10 683 | 12 695 | 15 862 | | |
| Number of households in the sample | 743 | 743 | 742 | 743 | 743 | 743 | 743 | 742 | 743 | 743 | 7 428 |
| Original income | 264 | 564 | 1 587 | 3 682 | 5 789 | 7 372 | 9 026 | 10 865 | 13 455 | 21 152 | 7 376 |
| Cash benefits | | | | | | | | | | | |
| Age-related | 1 188 | 1 397 | 1 224 | 722 | 412 | 297 | 235 | 206 | 167 | 170 | 602 |
| Child-related | 23 | 68 | 135 | 229 | 267 | 295 | 292 | 286 | 240 | 257 | 209 |
| Income-related | 496 | 746 | 805 | 525 | 305 | 258 | 227 | 173 | 171 | 171 | 388 |
| Other | 56 | 172 | 244 | 277 | 160 | 166 | 126 | 124 | 125 | 77 | 153 |
| Total | 1 763 | 2 383 | 2 408 | 1 752 | 1 145 | 1 016 | 879 | 789 | 703 | 676 | 1 351 |
| Gross income | 2 027 | 2 946 | 3 995 | 5 434 | 6 934 | 8 387 | 9 905 | 11 653 | 14 158 | 21 828 | 8 727 |
| Direct taxes | | | | | | | | | | | |
| Income tax | 18 | 63 | 180 | 519 | 922 | 1 168 | 1 479 | 1 877 | 2 326 | 4 133 | 1 269 |
| National insurance contributions | 2 | 9 | 52 | 172 | 324 | 418 | 523 | 622 | 738 | 944 | 380 |
| Total | 20 | 72 | 232 | 691 | 1 246 | 1 585 | 2 002 | 2 500 | 3 064 | 5 078 | 1 649 |
| Disposable income | 2 006 | 2 875 | 3 763 | 4 743 | 5 688 | 6 802 | 7 903 | 9 153 | 11 095 | 16 751 | 7 078 |
| Indirect taxes | | | | | | | | | | | |
| Domestic rates (net of rebates)[1] | 181 | 214 | 246 | 261 | 286 | 299 | 325 | 342 | 362 | 452 | 297 |
| Taxes on final goods and services | | | | | | | | | | | |
| VAT | 110 | 159 | 239 | 345 | 398 | 500 | 599 | 685 | 810 | 1 090 | 494 |
| Duty on tobacco | 58 | 94 | 135 | 182 | 179 | 195 | 204 | 193 | 204 | 231 | 168 |
| Duty on beer | 16 | 19 | 32 | 49 | 63 | 81 | 92 | 98 | 112 | 151 | 71 |
| Duty on wines | 4 | 5 | 8 | 14 | 15 | 20 | 25 | 29 | 36 | 66 | 22 |
| Duty on spirits | 14 | 17 | 31 | 42 | 44 | 63 | 59 | 70 | 75 | 139 | 55 |
| Duty on hydrocarbon oils | 11 | 24 | 42 | 75 | 97 | 128 | 146 | 156 | 200 | 249 | 113 |
| Car tax | 1 | 3 | 4 | 8 | 9 | 17 | 20 | 25 | 31 | 46 | 17 |
| Vehicle excise duty | 6 | 15 | 24 | 34 | 43 | 51 | 60 | 62 | 75 | 90 | 46 |
| Television licences | 20 | 25 | 28 | 31 | 33 | 34 | 35 | 37 | 38 | 38 | 32 |
| Stamp duty on house purchase | 1 | 1 | 2 | 2 | 5 | 6 | 9 | 13 | 15 | 29 | 8 |
| Customs' duties | 7 | 11 | 16 | 20 | 23 | 28 | 32 | 39 | 44 | 58 | 28 |
| Other | 9 | 14 | 17 | 20 | 26 | 30 | 32 | 35 | 38 | 40 | 26 |
| Intermediate taxes | | | | | | | | | | | |
| Commercial and industrial rates | 47 | 62 | 80 | 102 | 117 | 139 | 158 | 180 | 206 | 269 | 136 |
| Employers' NI contributions | 58 | 78 | 101 | 130 | 150 | 179 | 205 | 234 | 267 | 354 | 176 |
| Duty on hydrocarbon oils | 20 | 27 | 34 | 43 | 50 | 59 | 66 | 75 | 84 | 115 | 57 |
| Vehicle excise duty | 6 | 8 | 10 | 13 | 15 | 18 | 21 | 23 | 26 | 37 | 18 |
| Other | 7 | 10 | 12 | 16 | 18 | 21 | 24 | 27 | 31 | 40 | 21 |
| Total indirect taxes | 576 | 785 | 1 061 | 1 386 | 1 574 | 1 869 | 2 111 | 2 323 | 2 654 | 3 495 | 1 783 |
| Benefits in kind | | | | | | | | | | | |
| Education | 140 | 190 | 323 | 615 | 590 | 713 | 697 | 768 | 723 | 831 | 559 |
| Welfare foods | 6 | 20 | 43 | 40 | 34 | 33 | 21 | 24 | 19 | 23 | 26 |
| National health service | 548 | 658 | 657 | 594 | 590 | 586 | 573 | 563 | 555 | 606 | 593 |
| Housing subsidy | 82 | 110 | 110 | 110 | 84 | 68 | 58 | 51 | 51 | 28 | 75 |
| Rail travel subsidy | 5 | 5 | 6 | 11 | 16 | 20 | 24 | 27 | 45 | 94 | 25 |
| Option mortgage scheme | 2 | 4 | 6 | 11 | 16 | 28 | 25 | 23 | 19 | 17 | 15 |
| Life assurance premium relief | 3 | 6 | 10 | 15 | 22 | 26 | 32 | 36 | 45 | 81 | 28 |
| Total | 785 | 993 | 1 155 | 1 396 | 1 353 | 1 474 | 1 431 | 1 492 | 1 458 | 1 680 | 1 322 |
| Final income | 2 216 | 3 082 | 3 857 | 4 753 | 5 468 | 6 407 | 7 223 | 8,322 | 9 899 | 14 936 | 6 616 |

[1] Together with water, etc, charges.

## Distribution of households co-operating in the Family Expenditure Survey, 1982

**By decile groups of households ranked by original, gross, disposable and final incomes**

TABLE 7

| | 1 adult retired | 2 adults retired | 1 adult non-retired | 2 adults non-retired | 3 or more adults | 1 adult with children | 2 adults 1 child | 2 adults 2 children | 2 adults 3 or more children | 3 or more adults with children | All house holds |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Decile groups of original income** | | | | | | | | | | | |
| Bottom | 303 | 129 | 84 | 36 | 6 | 75 | 30 | 27 | 38 | 15 | 743 |
| 2nd | 367 | 217 | 44 | 38 | 16 | 25 | 7 | 10 | 9 | 10 | 743 |
| 3rd | 184 | 242 | 93 | 80 | 26 | 37 | 17 | 30 | 18 | 15 | 742 |
| 4th | 55 | 88 | 140 | 150 | 65 | 43 | 65 | 65 | 37 | 35 | 743 |
| 5th | 19 | 33 | 129 | 185 | 53 | 11 | 104 | 117 | 49 | 43 | 743 |
| 6th | 6 | 16 | 75 | 174 | 79 | 5 | 102 | 172 | 59 | 55 | 743 |
| 7th | 2 | 5 | 66 | 209 | 83 | 8 | 86 | 151 | 61 | 72 | 743 |
| 8th | 2 | 10 | 44 | 206 | 105 | 3 | 87 | 151 | 44 | 90 | 742 |
| 9th | — | 4 | 16 | 228 | 176 | 2 | 74 | 95 | 30 | 118 | 743 |
| Top | 1 | 2 | 10 | 191 | 234 | — | 54 | 79 | 30 | 142 | 743 |
| Total | 939 | 746 | 701 | 1 497 | 843 | 209 | 626 | 897 | 375 | 595 | 7 428 |
| **Decile groups of gross income** | | | | | | | | | | | |
| Bottom | 537 | 11 | 142 | 16 | 1 | 27 | 6 | 2 | 1 | — | 743 |
| 2nd | 268 | 228 | 72 | 68 | 3 | 55 | 17 | 21 | 7 | 4 | 743 |
| 3rd | 70 | 278 | 100 | 95 | 16 | 59 | 47 | 46 | 25 | 6 | 742 |
| 4th | 30 | 115 | 129 | 158 | 43 | 39 | 63 | 79 | 54 | 33 | 743 |
| 5th | 17 | 45 | 95 | 191 | 50 | 13 | 108 | 132 | 54 | 38 | 743 |
| 6th | 10 | 33 | 52 | 195 | 83 | 4 | 96 | 150 | 59 | 61 | 743 |
| 7th | 4 | 12 | 57 | 186 | 103 | 6 | 85 | 155 | 57 | 78 | 743 |
| 8th | 2 | 10 | 33 | 213 | 115 | 3 | 83 | 136 | 54 | 93 | 742 |
| 9th | — | 9 | 13 | 207 | 193 | 3 | 67 | 98 | 32 | 121 | 743 |
| Top | 1 | 5 | 8 | 168 | 236 | — | 54 | 78 | 32 | 161 | 743 |
| Total | 939 | 746 | 701 | 1 497 | 843 | 209 | 626 | 897 | 375 | 595 | 7 428 |
| **Decile groups of disposable income** | | | | | | | | | | | |
| Bottom | 523 | 6 | 153 | 19 | 2 | 26 | 7 | 5 | 2 | — | 743 |
| 2nd | 294 | 186 | 107 | 59 | 5 | 51 | 16 | 15 | 6 | 4 | 743 |
| 3rd | 62 | 277 | 118 | 104 | 7 | 56 | 50 | 43 | 20 | 5 | 742 |
| 4th | 28 | 138 | 115 | 177 | 29 | 38 | 74 | 83 | 42 | 19 | 743 |
| 5th | 19 | 59 | 73 | 196 | 54 | 19 | 96 | 129 | 64 | 34 | 743 |
| 6th | 7 | 39 | 61 | 193 | 75 | 8 | 93 | 151 | 61 | 55 | 743 |
| 7th | 4 | 15 | 33 | 195 | 111 | 5 | 83 | 162 | 57 | 77 | 742 |
| 8th | 2 | 10 | 19 | 204 | 133 | 3 | 82 | 138 | 56 | 96 | 743 |
| 9th | — | 12 | 13 | 194 | 186 | 2 | 70 | 94 | 29 | 143 | 743 |
| Top | — | 4 | 9 | 156 | 241 | 1 | 55 | 77 | 38 | 162 | 743 |
| Total | 939 | 746 | 701 | 1 497 | 843 | 209 | 626 | 897 | 375 | 595 | 7 428 |
| **Decile groups of final income** | | | | | | | | | | | |
| Bottom | 382 | 37 | 208 | 70 | 9 | 11 | 15 | 8 | 2 | 1 | 743 |
| 2nd | 346 | 124 | 134 | 85 | 9 | 22 | 16 | 5 | 1 | 1 | 743 |
| 3rd | 144 | 216 | 108 | 128 | 19 | 41 | 52 | 28 | 3 | 3 | 742 |
| 4th | 36 | 195 | 87 | 205 | 27 | 44 | 70 | 54 | 13 | 12 | 743 |
| 5th | 19 | 101 | 78 | 206 | 68 | 29 | 104 | 109 | 17 | 12 | 743 |
| 6th | 8 | 32 | 46 | 209 | 97 | 26 | 99 | 148 | 34 | 44 | 743 |
| 7th | 4 | 16 | 13 | 183 | 118 | 21 | 89 | 173 | 64 | 62 | 743 |
| 8th | — | 11 | 13 | 173 | 145 | 7 | 65 | 148 | 87 | 93 | 742 |
| 9th | — | 12 | 7 | 134 | 154 | 4 | 58 | 128 | 90 | 156 | 743 |
| Top | — | 2 | 7 | 104 | 197 | 4 | 58 | 96 | 64 | 211 | 743 |
| Total | 939 | 746 | 701 | 1 497 | 843 | 209 | 626 | 897 | 375 | 595 | 7 428 |

Chancellor
Chief Secretary
Economic Secretary
Mr Middleton
Mr Bailey
Mr Cassell
Mr Monck

Mr Price
Mr Monger
Mr R I G Allen
Mr Hopkinson
Mr Stredder
Mr Portillo
Mr Corlett - IR
PS/IR

Treasury Chambers, Parliament Street, SW1P 3AG

Ian Gow Esq MP
Minister for Housing and Construction
Department of the Environment
2 Marsham Street
LONDON SW1

24 November 1983

Dear Ian.

Thank you for your letter of 31 October about capital allowances for shared ownership and the contribution from Ferdy Mount in his letter of 1 November.

Home ownership is one of our most important policies and I fully recognise the importance of doing as much as possible to encourage it. Its importance stems partly from a belief that people should be encouraged, as far as possible, to make their own provision in meeting their needs and also a belief that the market is better able to provide what the consumer wants. It is in this light that we must look at the impact of capital allowances for shared ownership on our overall housing policy both as it is now and how we hope to see it more.

Our aim, as in other areas of economic activity, should be to remove as far as possible the various distortions that prevent the proper operation of the housing market. I am glad to learn that you are already considering measures to remove the distortions which have all but eliminated the private rented sector and Peter Rees has written separately suggesting a review of the local authority rented sector. My hope is that in both cases these will lead to a freer housing market better able to meet the various housing needs. In particular I see no reason why the private sector should not develop forms of low cost home ownership to meet the evident demand. The starter homes to which you refer in your letter, and which are a relatively new phenomenon, are a case in point although they clearly do not meet every need. Building societies can now develop index-linked mortgages although they will understandably wish to tread carefully. But we cannot predict what other responses the market may make. Our main task must be to create the conditions in which it can come up with the right response.

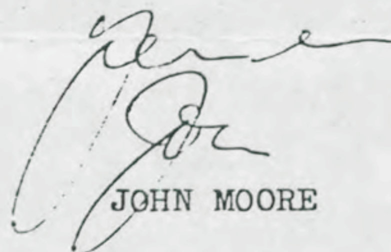
It is for that reason that I am not attracted by your proposal to add an additional distortion to the housing market by giving capital allowances for shared ownership schemes, although I accept that they are unlikely to prove attractive without such a subsidy. I accept that shared ownership has proved popular but would point out that this is not surprising in view of the substantial public sector subsidy that has been provided. I accept too, Ferdy Mount's point that there may be some offsets to the crude estimate of the cost scheme but the fact remains that it would represent a substantial further subsidy and hence distortion to the housing market.

By the same token, the general approach to taxation which Nigel Lawson and I are taking is to try to remove the distortions to the free flow of market forces which have developed over the years. The introduction at the same time of capital allowances for trading stock would be a novel concept going in precisely the opposite direction and carrying with it the prospect of substantial pressure for repercussions in other sectors. Alternatively, I am doubtful whether the terms referred to by Ferdy, under which shared ownership transactions would need to be drawn up if under existing law they were to be regarded as capital investment, would in practice be acceptable either to builders or to potential owners.

It is perhaps also worth making the point explicitly that a tax relief affects the PSBR just as directly as public expenditure. You mention in your letter that the tight public expenditure position in 1984-85 may make it difficult to maintain the existing shared ownership scheme. The same considerations apply with equal force to a tax subsidy.

I am sorry if my letter appears to be unconstructive. I would be only too ready to consider any scheme for low cost home ownership which was consistent with a move towards a more market orientated h housing policy particularly one which did not have significant PSBR consequences. But I am bound to say that the shared ownership proposal does not seem to fall into the category.

I am copying this letter to Ferdinand Mount at No 10.



JOHN MOORE

CONFIDENTIAL

Tref

b.c. N. Owen

10 DOWNING STREET

*From the Private Secretary* 1 August 1983

TAXATION OF HUSBAND AND WIFE

The Prime Minister has seen the Chancellor's minute of 26 July about the taxation of husband and wife as well as that of the Chancellor of the Duchy of Lancaster of 29 July. Mrs. Thatcher agrees with the Chancellor that the next step should be a further consultative document which would reject the cash benefit solution. She considers, however, that in addition to the options set out in the Chancellor's minute, that proposed by Lord Cockfield should also be added to the consultative document. She hopes that each option will be put in reasonable and unperjorative terms and that the disadvantages of all courses of action are made equally clear. Mrs. Thatcher has commented that she herself is very much against a change to Independent Taxation with Transferable Allowances (ITTA).

I am sending a copy of this to Steve Godber (DHSS), Jonathan Spencer (Department of Trade and Industry), John Ballard (Department of the Environment), Alex Galloway (Chancellor of the Duchy of Lancaster's Office) and Richard Hatfield (Cabinet Office).

TIMOTHY FLESHER

John Kerr, Esq.,
HM Treasury.

SH

CONFIDENTIAL

CHANCELLOR OF THE DUCHY OF LANCASTER

CONFIDENTIAL

Prime Minister ①

In view of this I have not passed on to the Chancellor your reluctant agreement to a two option consultative document (i.e ① status quo ② ITTA). Should we ask him to consider a three option document, including this one?

MCS 29/7

PRIME MINISTER

TAXATION OF HUSBAND AND WIFE

The transferable allowance scheme faces immense problems both of cost and of manpower. Experience in the United States suggests that the kind of equality it sets out to achieve is fragile and unlikely to last.

A much, much simpler, and cheaper solution is simply to leave the present system as it stands but allow people freedom of choice whether to be taxed jointly or singly. The freedom to choose is integral to our political philosophy. But the Inland Revenue do not like it because people change their minds. It is true that it attracted little support when the Green Paper was published. But it was presented in such an unattractive, if not pejorative, fashion that this is not surprising. It is also attacked on the ground that it benefits only wives with investment income. But this is the counterpart of the fact that the corresponding change for earned income was made in the 1970s. Nor as a party do we suffer from this prejudice about investment income. In any event, I would have thought it better to benefit a million or so people whose wives have investment income than to prejudice 5 million people who simply have wives - which is what ITTA does.

I would hope that, if a further consultative document is published, it could at least offer this option.

I am copying this minute to Nigel Lawson, Norman Fowler, Cecil Parkinson and Patrick Jenkin.

A.C.

A C

29 July 1983

Yes - the 3 option - but put the third in reasonable terms. And make the disadvantages of all courses of action equally clear. MT

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10 DOWNING STREET

*From the Private Secretary* 29 July 1983

Not sent in view of CDL's minute of 29/7

Taxation of Husband and Wife

The Chancellor minuted the Prime Minister on 26 July about the taxation of husband and wife.

The Prime Minister agrees with the Chancellor that the next step should be a further consultative document, which would reject the cash benefit solution, and narrow the options to retaining the status quo or to introducing Independent Taxation with Transferable Allowances (ITTA). The Prime Minister has minuted that she is herself very much against a change to ITTA. But she is prepared to agree to these options being presented in an open and impartial way, bringing out the disadvantages of a change to ITTA as well as the advantages.

I am sending copies of this letter to Steve Godber (DHSS), Jonathan Spencer (Department of Trade & Industry), John Ballard (Department of the Environment), Alex Galloway (Chancellor of the Duchy of Lancaster's Office) and Richard Hatfield (Cabinet Office).

John Kerr, Esq.,
HM Treasury.

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Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

Prime Minister
Agree to X?
MCS 27/7

Yes - but I am very much against the proposed change

PRIME MINISTER

**TAXATION OF HUSBAND AND WIFE**

You will recall that before the Election you agreed that during the campaign our line on the taxation of husband and wife should be as proposed in Geoffrey Howe's minute of 11 May. This was, in brief, to recognise that the question is a subject of understandable public interest; that it was in response to that interest that we published the original Green Paper in December 1980; and that in the new Parliament we would, through further consultation, seek to establish whether or not there was sufficient support to justify a move to Independent Taxation with Transferable Allowances (ITTA) when that became possible. The Manifesto gave no undertakings, and the topic did not in fact attract much comment during the campaign - though there have been references since, both in the House and in the media.

2. I have now been thinking further about this issue.

3. For exactly the same reasons that led to Geoffrey's proposals and your agreement to them, I am sure that the Government must make some response to the representations it has received on the 1980 Green Paper. Given that each option has some pretty unattractive features, I agree also that the next step should be a further consultative document. This would reject the cash benefit solution and narrow the options to either retaining the status quo or introducing ITTA. The two options would be presented in an absolutely open and impartial way, bringing out the disadvantages of a change to ITTA as well as the advantages. This would leave open the possibility of introducing it, if it attracted widespread support, but would also enable us to reject radical reform, and look for much more modest changes.

4. If you agree that this remains the best course, I will set in hand the drafting of a consultative document. The aim might be to publish around the end of the year. I would of course want to look at a draft, and discuss it with you and other colleagues, before making any public announcement.

5. I am sending copies of this minute to Norman Fowler, Cecil Parkinson, Patrick Jenkin, and Arthur Cockfield.

(N.L.)

26 July 1983

ECON POL: Taxation of husband and wife : March 1980

JUL 1985

CONFIDENTIAL FILE

Hz

bc Mr. Mount

10 DOWNING STREET

*From the Private Secretary*

12 May 1983

Dear John,

Taxation of husband and wife

The Prime Minister agrees to the line on taxation of husband and wife set out in paragraph 7 of the Chancellor's minute of 11 May.

I am sending copies of this letter to Steve Godber (Department of Health and Social Security), Jonathan Spencer (Department of Industry), Mary Brown (Lord Privy Seal's Office), and John Sparrow.

Yours sincerely,

Michael Scholar

John Kerr, Esq.,
H.M. Treasury.

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3.33 CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Prime Minister

Agree to the proposal in para 7 at X?

MCS 11/5

PRIME MINISTER

**TAXATION OF HUSBAND AND WIFE**

I have been thinking further about this issue, following our talk at Chequers.

2. It will not of course be possible to issue a Green Paper until after the Election, but I think we need to be clear as to the best way forward not least because we shall be asked during the campaign what our intentions are. As I see it, there are really three main points.

3. First, our first Green Paper on this subject was published in 1980. For better or worse, all the main representative bodies have responded to it, as have the other political parties. Sooner or later we have to give our response.

4. Second, we are all agreed that, if there is to be any question of changing the present system, the only possibly acceptable alternative would be something on the lines of ITTA. This would be a major change in the present tax system, from which most people would benefit, but from which some 5 million married men would be worse off in relative terms - though, as previously explained, transitional arrangements could prevent them being actually worse off in cash terms. There would also be administrative costs. Before a Conservative Government committed itself to a change of this kind, we should need to be sure that not only the representative bodies, but also ordinary people in the country at large, understood the reason for it, and were indeed keen that we should bring it in. These conditions do not yet exist.

5. Third, the fact remains that the Green Paper itself acknowledged that in a number of important respects the tax treatment of husband and wife in this country is not really logical, or fair, or paralleled in any other western country. The response has shown that, for better or worse, this is the virtually unanimous view of the representative bodies - including representatives of our own Party and of professional and other working women. (The Party's Advisory Committee

on Policy (which I am due to see today) has expressed the hope that the manifesto will deal with the subject.) This means that in deciding on our attitude, we have to recognise that, for those who responded to the Green Paper, the question was not whether it is right to change the system, but how to change it: in favour of MIT/cash benefits - which we all agree is quite unacceptable - or in favour of ITTA, which we see (although many others do not) as a more open question.

6. This leads me to the following conclusions. We need to be ready to respond to the representations we have received on the Green Paper. We need to demonstrate why MIT/cash benefits is wrong, and to persuade its genuinely open minded supporters (people like Sam Brittan) why that is so. To keep their support, and the support of the others of our natural supporters who responded to the Green paper, we need to explain the implications of ITTA, both its advantages and its disadvantages, much more fully and clearly than has been done yet. For this purpose, the presentation of the case should be absolutely fair and impartial, either for maintaining the present system, or for changing to ITTA.

7. In the light of all this, I believe that the line we should take during the Election campaign is that there will need to be a further consultative document. The Government is neither committed to change, nor shutting the door in the face of change. We have, however, recognised that this is a subject of understandable public interest. That is why we published the original Green Paper. The next Conservative Government will, along the same lines, seek to establish whether or not there is the kind of genuine and widespread public support that would justify the introduction of ITTA when computerisation of the personal tax system makes that possible.

8. I believe that unless we go as far as this our position is in danger of being misrepresented as unsympathetic to those who are genuinely concerned about this topic. But this, I think, is as far as we need go at this stage.

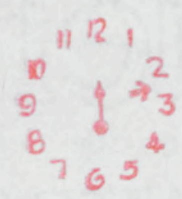
9. I am sending copies of this minute to Norman Fowler, Patrick Jenkin, Janet Young, Ferdinand Mount and John Sparrow.

(G.H.)

11 May 1983

Pol, March '80,
Econ, 8
Taxation, 8
Husband & Wife,

1 MAY 1983



CONFIDENTIAL

MJ

FILE

10 DOWNING STREET

*From the Private Secretary*

26 April 1983

Dear John,

Taxation of Husband and Wife

The Prime Minister was grateful for the Chancellor's minute of 22 April about the proposal for independent taxation with transferable allowances (ITTA). The Chancellor and the Prime Minister had a word about this at Chequers on Sunday.

The Prime Minister believes that public reaction to this proposal would be hostile, and justifiably so. She also considers that these changes would wholly alter the part-time labour market for married women, and that professional women (teachers, doctors, nurses and so on) would strongly object; so, too, would married women factory staff and the large number of married women working in shops, catering, hotels and so on. The Prime Minister suspects that the response to the Green Paper which showed that virtually everyone was united in rejecting the present system was not a truly representative response. On the assertion (in paragraph 14a) that the great majority of families with young children would not lose, the Prime Minister has commented that many mothers go out to work part-time, up to the married women's earned income relief. On the claim, in paragraph 20, that this change would bring the UK's tax treatment of husband and wife more into line with the best treatment in North America and the rest of Europe, the Prime Minister has asked whether we are planning to halve the joint income and treat it as two single incomes.

I am sending copies of this letter to Steve Godber (DHSS), Jonathan Spencer (Department of Industry), Mary Brown (Lord Privy Seal's Office), Gerry Spence (CPRS) and Ferdinand Mount.

Yours sincerely,

Michael Scholar

John Kerr Esq
HM Treasury.

CONFIDENTIAL

RM

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Prime Minister

Discuss at the next regular meeting with the Chancellor?

MLS 22/4

PRIME MINISTER

TAXATION OF HUSBAND AND WIFE

1. When we last discussed this subject I think we were all agreed that the present system had serious weaknesses and that all the options for change had their difficulties, but if a change were to be made at all, the best choice would be independent taxation with transferable allowances (ITTA). A number of us felt, however, that before we took this further forward a more detailed paper was needed setting out the effects of ITTA on families; and this is now attached.

2. Of the other options, we saw strong objections to a system of mandatory independent taxation (MIT) which would direct the extra tax savings from cutting the tax threshold for all married couples into more and bigger cash benefits. This is the system favoured for obvious reasons by the Poverty Lobby and, as we thought at the time of our previous discussion, by the Labour Party. In their latest campaign document published last month, however, the Labour Party recognising the large number of "losers" under MIT appear to be drawing back from their earlier commitment and may themselves be shifting towards some form of ITTA.

3. None of this lessens my conviction that we must say something before the Election in response to the Green Paper and the reactions to it - indeed the contrary. The issue is a live one and will not go away - the other political Parties have given their views and will firm them up once an Election is announced. It would, I believe, be indefensible for us alone to remain silent, particularly with the risk that otherwise our position can be misrepresented as the Guardian leak

at the end of last month illustrated. At the same time our response need not and should not be more than indicative of the direction of our thinking - a final decision on any change cannot be taken until 1984 at the earliest.

4. This, as I see it, leaves open two questions. What should the Government's response be and how can it best be presented?

5. On presentation I suggest there are three options (though obviously they are not mutually exclusive):-

i. a piece in the Party Manifesto;

ii. a Green Paper to be published ahead of the Manifesto (depending, of course, on the timing of the Election;

iii. a major speech - perhaps by myself to the Conservative Women's Conference next month - which could then serve as the basis of the policy adopted during the Election campaign.

6. Because the subject needs delicate and careful handling, I incline towards option ii. or iii, but first we need to decide how best the substance of our response can:-

i. respond to the criticism of the present system;

ii. mount an effective attack upon MIT with cash benefits; and

iii. prepare our answer to the crucial question, which I asked in my earlier paper - "Do the advantages of ITTA outweigh the cost?".

Present System

7. We ourselves recognised the faults of the present system when we published the Green Paper:

- by any standard of equity (or international comparisons) it gives too much relief to the husband, when both husband and wife are earning;

- in other cases (mainly in the case of investment income) it imposes a penalty on marriage;

- more generally, it does not recognise women's reasonable demands for independence and equality within a marriage.

8. As I said in my earlier paper, the response to the Green Paper shows virtually everyone united in rejecting the present system. This covers (at one extreme) our political opponents, the Poverty Lobby and the Equal Opportunities Lobby and (at the other extreme) our National Women's Committee, the Chartered Accountants and the Law Society.

Not typical

9. Before adopting an alternative system we have to satisfy ourselves that the alternative is not only better, but sufficiently better to justify the change. But we cannot argue that the present system is, or is generally accepted as, satisfactory in itself.

Countering MIT

10. The apparent shift in Labour Party thinking does not lessen the need for us to mount our arguments against MIT - it still commands strong and widespread support from some powerful pressure groups.

11. But we should be inviting battle on pretty unfavourable ground, if we mount our counter-attack on MIT simply by comparison with the present system; and if we offer no other alternative. MIT addresses all the

three criticisms in paragraph 4, though in a way we find unacceptable. We cannot hope to win over all those who criticise the present system, because some of them have a view of society which we do not share. Others however include many of our own natural supporters, and at present they are advocating ITTA. Whatever decision we finally make, we need to win their support.

12. As I have said, I see this as the purpose of any public document we issue. We need to demonstrate why MIT is wrong. We need to bring out the full facts about ITTA - its advantages and disadvantages. And we need to establish whether, in the light of this fuller analysis, there would be sufficient public support to justify the Government committing itself either to the change to ITTA, or, though less likely, to a defence of something very close to the present system.

ITTA - the costs

13. The attached factual paper provides further material on the distributional and other implications of ITTA. It might be helpful to pick out the main points.

14. Losers Any serious reform of the present system must end the present anomaly under which a married couple, where both work, can get more than the total of two single allowances. This means that some 5 million or so married couples must under the new tax system get less relief than they would have got under the existing tax system. However, the paper brings out three facts very clearly:

a. Most of the losers would be couples without young children - ie young couples who had not yet started a family, or those whose children were teenagers or had left home. The great majority of families with young children would not lose, and on a revenue neutral basis would actually gain (see paragraph 15 below).

Many of the mothers go out to work part-time. i.e. up to the married woman's earned income relief.

b. All but a few of elderly couples over 65 would gain (by contrast with MIT, under which most elderly married couples would lose). A number of couples could lose, when the husband is over 65 but the wife is under 65 (or vice versa). But the transitional arrangements (c. below) would protect them initially, and by the end of the period most of these couples should have become "gainers" because the younger partner would have reached the age of 65.

c. Transitional arrangements could ensure that no individual taxpayer suffers a withdrawal of tax relief in cash terms, and that a married couple (both working) could actually get increased tax relief in cash terms. This could be done by modifying the normal Rooker-Wise increases in allowances. (The lower the rate of inflation of course, the longer the transitional period would be, on a revenue neutral basis. If it were wished to shorten the period, the alternatives would be either to put in additional resources or to make some cash reduction in allowances. The pattern of transition and the length of transitional period are questions that - as the paper explains - will need to be decided much nearer the time.) Leaving aside the mechanical details, however, the essential point is that we can hope to avoid the sharp impact on the take home pay of married men of the kind which accompanied the shift from child tax allowances to child benefit, and which affected wage negotiations at the time.

15. By the same token, the savings from ending the present anomaly rising to perhaps £900m on present day values, could on a revenue neutral basis finance higher tax thresholds for taxpayers generally, including the majority of families with young children. Alternatively

the savings could be used to finance improvements especifically for families with children or a combination of both. These savings would first begin to emerge at the beginning of the 1990s and, depending on how the transitional arrangements work out, the full amount could be achieved some time around the middle of that decade.

16. Incentive for wives to work The note of our previous meeting recorded scepticism

> "about the desirability of altering the tax system to encourage wives to stay at home".

Certainly, I would be against any system that discriminates against wives. (This is the critical objection to ideas of reducing the present allowance for working wives - it would widen the gap between the allowances given to a married man and those received by wives, and would mean that the wife had a smaller tax allowance than anybody else.) The point at issue here, however, is very different. The proposal is to withdraw a selective tax incentive for married women to go out to work, which is given to the husband, not to the wife. This incentive is not available in the case of any single man or woman (and has no precedent in any overseas country). It was universally criticised in the response to the Green Paper.

17. Under ITTA the tax system would neither encourage nor discourage the married woman from going out to work. It would leave the matter to her choice.

18. Effect on husbands and administrative implications

As the factual note explains, we are exploring the possibility of transferring allowances by a system of end-year (not in-year) adjustment. This could have two main advantages. First, it could avoid the situation arising in which a man had his take-home pay cut,

at the point when his wife went out to work. Second, it is already clear that it would significantly simplify the administrative arrangements and cut something like 1,000 off the staff requirements which could - on present estimates - otherwise be of the order of 4,000-4,500 with partial transferability. It is too soon yet to say whether it could open up the possibility of more radical staff saving.

19. Additional requirements on taxpayers As I said in my earlier paper, there is no escaping the fact that there must be some cost, for the Revenue and for taxpayers, in taking on their books up to 12 million married women (though end-year adjustment could minimise this). But "taking on their books" would not mean subjecting them to anything like the "full treatment". For the 5 or 6 million married couples where the wife is at work, there could be little or no change in the present arrangements. For the remainder, we envisage that there might be just one piece of paper, signed by both husband and wife, giving the information which the Revenue would need to transfer the allowance. This would be an additional chore for the majority of men and women, who do not now complete any tax return. But it would be a good deal less formidable and complex than existing tax returns.

ITTA - the advantages

20. As I see it, the advantages of ITTA remain:

- a more coherent and acceptable tax structure No
- independence where the wife goes out to work or otherwise has her own income
- fair support where she stays at home to look after the family
- the recognition that this is her choice, for her to make ?
- bringing the UK's tax treatment of husband and wife more into line with the best treatment in North America and the rest of Europe.

Are we planning to take the joint income - or treat them as 2 single incomes?

## Conclusion

21. I believe that we should now make a further public statement in response to the 1980 Green Paper on the taxation of Husband and Wife. This would reject MIT with cash benefits and develop fully and sympathetically the implications of ITTA.

22. As I suggested in my earlier paper, any statement of our position should have broad "green edges". I have in mind a very open approach, recognising the attractive features of ITTA, but at the same time emphasising that the Government would not wish to change the system unless there was broad public support for the change, and for the consequent redistribution of the tax burden.

23. As I said at the end of my earlier note, the timetable needs

> "to give ample time to assess the response to this further consultative document, before we finally commit ourselves to go ahead."

This means that a decision would not need to be, indeed could not be, taken until 1984 at the earliest. But a substantive response in the form of either a consultative document or major speech before the Election might well give us the most defensible basis on which to stand during the campaign.

24. You may wish to discuss.

25. I am copying this minute to Norman Fowler, Patrick Jenkin, Janet Young, Ferdinand Mount and John Sparrow.

GH.

(G.H.)

22 April 1983

12 APR 1983

# DISTRIBUTIONAL AND PRACTICAL IMPLICATIONS OF ITTA WITH PARTIALLY TRANSFERABLE ALLOWANCES

1. This note answers the factual questions about the consequences of ITTA raised by colleagues at our 30 November meeting.

## DISTRIBUTIONAL CONSEQUENCES

### Methods of Analysis

2. There are two broad approaches to analysing the distributional effects of change from the present structure of tax allowances to a system of independent taxation with partially transferable allowances.

3. First, we could assume that the structural change was to be made in one step at the existing level of allowances. On this basis the two-earner married couple would lose. One-income couples and single people would have the same allowances as now. A change on this basis would yield a revenue gain of about £m900.

4. Alternatively, the effects can be analysed on the basis of a revenue neutral change. This was the approach adopted in the December 1980 Green Paper and the explanatory material published with it. The assumption made then, and in the analysis that follows in this note and its annex, are that the £m900 revenue savings from the structural change are used to increase the basic single allowance - with the one-income couple continuing to get 1.56 times the single allowance. On this basis, two-earner couples would lose less than they would otherwise; one-income couples and

single people would gain.

5. I should emphasise that these assumptions are made solely for illustration. In principle, the revenue yield from the structural change in the tax system could be used in many different ways. For example, the savings could be used partly or wholly to increase the transferable proportion of allowances for the one-income married couple: this would reduce or eliminate the increase in the basic single allowance, so that single people would either not gain at all, or not gain so much. Or the savings could be used in other ways, for example to direct extra benefits specifically to families with children eg by child-benefit or to reduce the PSBR.

6. Ways of introducing the change over time are also examined in this note. The transitional patterns chosen to illustrate the possibilities show at the end of the day the same savings of around £m900 in constant price terms as a one-step change at existing allowance levels. The same range of options for using the savings is also available here.

... 7. Against this background the attached note by officials analyses the distributional consequences of ITTA, compared with the present system. It shows:-

i. the numbers who would gain and lose _if_ ITTA was introduced in one step on a revenue neutral basis, but (for simplicity) disregarding the effect of transitional measures;

ii. the types of families who would gain and lose, on the same illustrative basis as;

iii. how transitional arrangements could ensure that the "losers" were not worse off from the change in cash terms.

8. The main points are as follows:-

a. Numbers of gainers and losers

For illustrative purposes it is assumed that a

change to ITTA with partially transferable allowances were made in one step and on a revenue neutral basis, and that the £m900 or so revenue yield from reducing the allowances available to two-earner married couples would be used to increase the basic single allowance (under the new system this basic allowance would be available to everyone regardless of sex or marital status). An increase in the basic single allowance also automatically increases the amount that can be transferred to the working spouse by a wife (or husband) who stays at home - so one income couples would also get bigger allowances than they get now. As a result about three-quarters of the tax paying population would gain and a quarter would lose. In broad terms:-

- all the 4½ million couples where the wife stays at home would gain (with people below average earnings and the fairly well-paid gaining rather more than those in between).

- most two-earner married couples would lose (some 5 million out of the 6 million in the group). The loss would fall on the husband because he would lose the present lead of the married man's allowance over the single allowance; the working wife herself would usually gain because of the increase in the basic single allowance. The losses would generally be smaller for those with high joint incomes.

- the majority of elderly couples would gain, and would usually gain substantially. They would get a bigger age allowance each, or a bigger transferable allowance. And they would gain more, as a group, from the disaggregation of investment income than younger people. The minority of losers - some 400,000 out of the 1.3 million total - would usually be couples where one partner is under 65 (and most of these 'loser' couples would have become 'gainers' by the end of the transitional period - see c. below). This

analysis assumes that the increase in the basic single allowance would be carried through into an increase in the age allowance. If this was thought excessive - and it is arguable that it would be too generous - a smaller increase in age allowance would reduce the amount of the gain, though without (probably) much of a reduction in the numbers of elderly couples who would gain.

- all single people would gain - 8 million under 65, 1.3 million elderly.

As I have said, this revenue-neutral illustration assumes that all the £m900 or so saving was spent on increasing the basic single allowance. The pattern of gainers and losers would change if it were spent in different ways - eg if it were spent specifically on families with children. This alternative is dealt with in para 2.12 of the note by officials.

b. Types of family who gain and lose: gains and losses over the life cycle.

Families with children. Section 3 of the note by officials brings out the fact that the main reason why wives stay at home is to look after children - particularly young children. Wives are most likely to be at work if they have not yet started a family or if their children are teenagers or have left home. The broad effects of ITTA on families with children would therefore be:-

- the majority of families with dependent children would gain (because the wife is not working at all, or has only small part-time earnings);

- 40% of families with children have a child under 5. In three-quarters of them the wife is not working; all these couples would gain. Some of the rest would also gain, because the mother would have only small part-time earnings;

- 60% of families with three or more children are one-earner couples who would gain from ITTA. (Again, some of the rest would also gain because the mother had only small part-time earnings.)

Other Families. While looking after children is the main reason why the wife stays at home, there are of course other reasons why the wife stays at home rather than working - eg

- older wives who cannot get back into the labour market after having children

  (Only 60% of childless women between 50 and 60 have a job, compared with 85% of childless women under 30.)

- younger wives who would like a job and cannot find one

- some wives have to stay at home to look after an elderly relative or because they have a sick husband (this is most likely to be the case if the wife is in her late 40s or 50s than if she is older).

These important - and sensitive - families where the wife is not working would gain from ITTA.

The life cycle. The vast majority of wives work at some stage in their lives. The effect of ITTA will be to redistribute income from the stages in the life cycle at which the wife is working to those where she is not. For most couples this means that they will be worse off as a result of a change to ITTA in their early, childless, married years and in later life when the children become less dependent, but better off than they are now:

- when they have a young family

- when they retire

- and in intervening periods where there are other reasons

(elderly dependants etc) which prevent the wife from going out to work.

Regional Variations. The information on this is limited. In general, the proportions of one-earner and two-earner couples are fairly evenly spread, which implies that the gainers and losers would also be fairly evenly spread. There is a tendency for the proportion of one-income couples to be slightly higher than average in Scotland, Wales and the North (also in East Anglia and the South West) than in the rest of the UK. On the other hand, the regions where the proportions of two-earner couples are higher are also, generally, those (like the South East and Midlands) where incomes are higher and where the losses to two income couples will, on average, be rather lower than in the rest of the UK.

c. Transitional Arrangements

A transitional period would be necessary to mitigate the impact of ITTA on two-earner couples. By definition, of course, the change involves a real reduction in tax allowances for them. So long as inflation persists this can be masked by modifying the Rooker Wise cash increase in allowances that would otherwise be necessary. Perversely, the greater our success against inflation the more plainly the change will be perceived unless (as is possible) that success itself enables us to raise thresholds in real terms. Section 4 of the note by officials shows how it would be possible to manage the transition so that, while these couples would get less tax relief than they would have done if the present system was maintained, nevertheless:

a. working married couples could get increased tax reliefs between them in cash terms;

b. no married man would be worse off in cash terms;

and

c. one-income couples and single people would get the

same in tax reliefs as they would have had under the present system.

The - purely illustrative - examples in the Annex show how this might be done if the annual inflation rate was 10% or 5% (with a transition period of five and nine years respectively). On these particular examples there would be a revenue saving over most of the transition period, with a saving in the last year of around £m900. If this was used to increase tax thresholds generally, one-income couples (and single people) would gain to about the same extent as they would in the - revenue neutral - analysis set out above. Or it could be used in other ways. The precise details of the transition would be a matter of decision at the time, and would depend on the availability of resources, the current level of inflation and the view on how long a transition period would be desirable. In general, the lower the rate of inflation, the longer the transition period at a given revenue yield.

Transitional Arrangements for the elderly. The transitional arrangements for the elderly would be on the same lines as the general transitional arrangements. They would phase in the benefit for those who would gain from ITTA (the majority) and cushion the impact for the minority who did not gain. In practice, the number of elderly couples who would be worse off than under the present system would be very small indeed by the end of the transition period. Most of those who would be 'losers' if the charge to ITTA was made in one step would b couples where only one partner was over 65 (see a. above). By the end of the transition period, most of these under 65 will have reached the age of 65 (and be entitled to age allowance). These couples will therefore gain from ITTA in the same way as other elderly couples.

PRACTICAL EFFECTS OF INTRODUCTION OF ITTA

9. My colleagues may find it useful to have some more detailed information on points about the administrative implications of ITTA - and its impact on the public - which were raised at the 30 November FPG meeting, or are relevant to them.

The effect of bringing 12 million wives into the tax system

10. ITTA would bring some 12 million wives into the tax system, in the sense that they would all formally be responsible for their own tax affairs, instead of being treated as adjuncts of their husbands. This will inevitably involve extra work, and extra staff, for the Revenue. In practice, however, this should not constitute much of an extra burden for the great majority of these 12 million women.

(i) For the majority of working wives (5 million odd in total) there would be no change of substance. Tax is already deducted from their earnings under PAYE and the tax office already writes to them direct about this if correspondence is necessary. In this respect ITTA would make no noticeable difference for most of them. Some of these wives would get annual returns. But the majority would not, because their financial affairs would be pretty straightforward. (And some of their husbands would stop getting annual returns, because once the wife's income was separately taxed his affairs would become straightforward enough for him not to need one.) If the wife received a return, she would have to be given the right to complete it independently if she so wished - many wives would complain if they were not allowed this degree of independence. But there would be no need to insist that the wife should send in a separate return if she does not want to. The wife and husband could be allowed to send in what would in effect be a joint return if they wanted, which would in essence be what happens now.

(ii) Non-working wives, or those with small incomes (7 million or so). Where the wife's income is below the level of the single allowance* (now £1,565), the Revenue would need to know:

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* The income level would be higher where the wife is over 65 and gets single age allowance

- whether the husband is claiming the transfer of his wife's allowance

- whether the wife is willing to surrender it

- the amount of the wife's income, so that the Revenue know how much to transfer.

For many taxpayers this will be a new requirement, but it can (and should) be on one piece of paper, and would be much simpler than a normal tax return.

How the Transfer of Allowances would work

11. If one starts from the existing allowance level, partial transferability would mean: £1,565 single allowance; £880 "partially transferable" element (representing the difference between the single and the married man's allowance); £685 the basic or non-transferable element.

The basic or non-transferable element (£685) would be used first. Thus:

- if the wife has an income of £685 or less, she can transfer the whole £880 to her husband; and the husband has total allowances of £2,445 (£1,565 plus £880), equal to the present married man's allowance;

- if the wife has an income of more than £685 but less than £1,565, she can transfer the balance of her personal allowance to her husband: so that, for example, if her income is £1,000, she can transfer £565 to her husband;

- if her income is £1,565 or more, she herself uses the whole of her personal allowance, and she has nothing left to transfer to her husband.

It follows that the wife can go out and earn up to £685 a year (or less if she has investment income) without affecting her husband's take-home pay. To the extent that she earns more

than £685 a year, she uses more of her own tax allowances against her own income, and has correspondingly less (or nothing) to transfer to her husband.

The impact of this on the husband's tax position when the wife went back to work (or stopped) would depend on the administrative arrangements for handling transferability.

12. The Revenue are considering the possibility of dealing with transferable allowances by way of end-year adjustment, instead of an in-year adjustment on the present PAYE pattern. There are various ways in which this could be done. Basically it would mean that transferable allowances would be given at the end of the year, instead of at the beginning, and any transferable allowance due would be given to the husband - as a tax repayment - at the end of the year. Something on these lines would have two big advantages:-

a. it would greatly simplify the administration of ITTA and could reduce the staff requirement (4,000 - 4,500 on present estimates) by 1,000 or more;

b. it would make the operation of transferable allowances considerably easier for taxpayers to understand particularly for those who find the amount of the transfer varying from year to year (and this is the area of ITTA which the public will find most difficult).

c. it would reduce any disincentive to the wife going back to work (because the husband's allowances would not be changed till the end of the year, instead of changing as soon as she went back to work).

The Revenue are studying all this as part of their work on minimising the staff costs of ITTA, and taking the maximum advantage of the opportunities offered by computerisation of PAYE to simplify the administration of the system.

INDEPENDENT TAXATION WITH TRANSFERABLE ALLOWANCES

NOTE BY OFFICIALS

Introduction

1. This note discusses:

   i. The distributional effects of a change to a system of independent taxation with transferable allowance (ITTA), concentrating on the variant with partial transferabilit This analysis is in terms of a revenue neutral change made in one step: that is, one that maintains the same overall yield of tax before and after the change.

   ii. The characteristics of the groups of one-earner and two-earner married couples who would be chiefly affectec by such a revenue neutral change.

   iii. A possible method of transition to ITTA starting from existing levels of allowances, which avoids reducing the allowance available to a married man in cash terms.

Distributional effects of ITTA

2.1 For the purposes of illustration we have analysed the distributional effects of a move to independent taxation with transferable allowances (ITTA) on the basis of a revenue neutral change made in one step - though in practice the transition would almost certainly be made over a number of years in a way that avoided (or went some way towards avoiding) reducing allowances in cash terms - see para 4.1 below.

2.2 Because ITTA with partial transferability at existing allowance levels would produce tax savings from cutting the allowances available to the two-earner couple, the assumptio of revenue neutrality means that the £m900 or so tax savings could be used to finance an increase in the level of the single allowance which would become the basic allowance for everybody. This would benefit both single taxpayers and one-income couples and reduce the loss for two-earner couples, thus mitigating the adverse effect of the change-over This is illustrated in the following table:-

| | Existing Regime | ITTA with existing allowance levels | Revenue-neutral ITTA |
|---|---|---|---|
| Singles | 1565 | 1565 | 1655 |
| One-income couples | 2445 | 2445 | 2585 |
| Two-earner couples | 4010 | 3130 | 3310 |

2.3 An alternative approach would be to direct part or all of the £m900 saving specifically to families with children, instead of using it to raise the basic tax allowance for everybody. The effects of this alternative are dealt with in paragraph 2.12 below. For simplicity, the rest of this analysis assumes that all the saving is used to increase the basic allowance.

2.4 The distributional effects of a revenue-neutral change to ITTA with partially transferable allowances are shown in detail in the table following this section. The numbers of gainers and losers, and the percentage change in income after tax, compared with the existing regime (at 1982-83 levels of income, tax allowances etc), are shown for the following groups:

Under 65: Single
One-earner married couples, by level of total income

Two-earner married couples, by level of total income

Over 65: Single
Married couples, by level of total income

2.5 Overall, about three-quarters of the current taxpaying population gain from the change. The effect on each of the above groups is summarised in the following paragraphs.

2.6 Single people (elderly and non-elderly) are affected only because of the adjustment in the level of the basic allowanc required to maintain revenue-neutrality. Under the partiall transferable system, the allowance would rise by £90 (£110 f the elderly), so all single taxpayers would benefit. The ga for a basic rate payer would be £27 a year (or £33 for an elderly person).

2.7 One-earner married couples all gain; most of the gain (an overall 1% in net income) stems from the general increase in allowance levels, and this is proportionately more importan at lower income levels. Couples with wife's investment inco will additionally benefit from disaggregation, particularly those at higher income levels. The increase in net income therefore falls from about 1½% at the bottom income range to ¾%, then rises to just over 1% for those on incomes of £12,000 or more.

2.8 Two-earner married couples: the majority of couples in this category (and all 'breadwinner wives', who are included in this group) lose; only 0.9 million out of 6.2 million gain. The fall in net income for the group as a whole is 1.7%. The loss generally falls as income rises, both because the cash decrease in the husband's allowance becomes less significant and because couples at higher levels of income are more likely to have offsetting gains from the disaggregation of investment income.

2.9 Elderly married couples: 0.9 million of the 1.3 million couples currently paying tax would gain, and 0.4 million (mostly couples where one spouse is under 65) would lose. The net increase in income after tax for the whole group i some 3½%; the gain is fairly constant at just under 3% at income levels up to £12,000, and rather higher, over 5%, for the few couples with incomes above this level, probably because they benefit from the disaggregation of investment income.

2.10 Elderly couples both over 65 would gain more as a group than younger people for a variety of reasons. They would often get more age allowance between them than now (because they would each be entitled to single age allowance, with a separate income limit). They would benefit more from the disaggregation of investment income than younger people: partly because more of the elderly have investment income and it is a bigger proportion of their income; partly because the wife's own tax allowance would be available against the category B pension (paid in respect of the husband's contributions) instead of being aggregated with the husband's income as it is now. Couples where one partn is under 65 would be more likely to lose because the partne under 65 would not get age allowance, whereas married age allowance now goes to couples where only one partner is ove 65 (though by the end of the transitional period many of these under 65s would have reached 65, so that the couple would ultimately gain in the same way as other elderly couples).

2.11 Leaving aside single people. The effect of partial transferability on married couples can be summarised as follows:

| | Existing married couple taxpayers | of whom: gainers | losers | Couples brought into tax | Total married couple losers |
|---|---|---|---|---|---|
| Partial transferability | 12.0 | 6.3 | 5.7 | 0.1 | 5.8 |

Millions

| e, f ily atus, nd nge of tal income | Number of taxpayers under current scheme (1) | Of those numbers - gaining (2) | losing (3) | Percentage gain or loss (-) in income net of tax for whole group |
|---|---|---|---|---|
| DER 65:- | | | | |
| ngle | 8.0 | 8.0 | - | +0.6 |
| rried, wife ot working: | | | | |
| ,000 - £4,999 | 0.8 | 0.8 | - | +1.6 |
| ,000 - £7,999 | 1.8 | 1.8 | - | +1.0 |
| ,000 - £11,999 | 1.3 | 1.3 | - | +0.7 |
| 2,000 and over | 0.7 | 0.7 | - | +1.1 |
| tal | 4.6 | 4.6 | - | +1.0 |
| rried, wife orking: | | | | |
| ,000 - £4,999 | 0.3 | 0.1 | 0.2 | -2.3 |
| ,000 - £7,999 | 1.2 | 0.3 | 0.9 | -2.3 |
| ,000 - £11,999 | 2.6 | 0.2 | 2.4 | -2.1 |
| 2,000 and over | 2.1 | 0.3 | 1.8 | -1.1 |
| tal | 6.2 | 0.9 | 5.3 | -1.7 |
| ER 65:- | | | | |
| ngle | 1.3 | 1.3 | - | +0.7 |
| rried: | | | | |
| ,000 - £4,999 | 0.5 | 0.3 | 0.2 | +2.7 |
| ,000 - £7,999 | 0.4 | 0.2 | 0.2 | +2.8 |
| 3,000 - £11,999 | 0.2 | 0.2 | neg | +2.9 |
| 2,000 and over | 0.2 | 0.2 | neg | +5.2 |
| otal | 1.3 | 0.9 | 0.4 | +3.4 |
| LL TAXPAYERS | 21.4 | 15.7 | 5.7 | - |

1) Counting married couples as one

2) Included in these numbers are 0.5m cases taken out of tax

3) In addition, some 0.1m cases are brought into tax

eg : negligible

\- : zero

umbers have been rounded independently and may not add to totals.

●.12 As we have said, this analysis assumes that all the £m900 saving from cutting the allowances for two-earner couples would be channelled into an increase in the basic tax allowance. There are other ways in which the money could be used. Part or all of it could for example be channelled into child benefit. If part of the £m900 saving were channelled into child benefit, one-income couples with children would gain more, and two-earner couples with children would lose less, but other one-income couples, and childless single people, would have a smaller gain and childless two earner couples would have a greater loss. If all the £m900 saving were spent on increasing child benefit, this would give an extra £1.65 for each child. On this basis:

- one income couples with children would gain more than if the saving was channelled into an increase in the basic tax allowance. (A two-child family, for example, would gain about £170 a year instead of £42, and a three-child family would gain about £260 instead of £42).

- two-earner couples with children would lose a smaller amount than if the saving was channelled into an increase in the basic allowance. A two child family would lose about £90 a year instead of £210. A three child family would lose £ 7, instead of £210, and a four child family would be better off.

  This improvement would be at the expense of single people and childless couples (including the elderly)

- childless single people would be in the same position as now, instead of gaining (because their tax allowances would be unchanged instead of increasing

- childless one-income couples would be in the same position as now instead of gaining (for the same reason)

- childless two-income couples would experience a greater loss (because they would lose the full value of the married man's allowance, without any compensating increase in the value of the basic allowance)

## Characteristics of one-earner and two-earner couples

3.1 This section examines the characteristics of the groups of non-elderly one-earner couples (who would all gain from a revenue-neutral change to independent taxation with partially transferable allowances (if the basic allowance was increased)) and non-elderly two-earner couples (who mostly lose). The information comes from a variety of sources (General Household Survey 1981; Labour Force Survey 1981; and Women and Employment Survey 1980), and cannot be linked very closely to the data on which the effects of the taxation change are calculated. In particular, some women who are classified as working in these surveys may have part time earnings so low that they are not reported for tax purposes; a couple in this position would be classified as 'one-earner' in our tax calculations. An instance where this may have an effect on the overall picture is pointed out in paragraph 3.5.

### Age and children

3.2 Non-working wives (and presumably their husbands too) tend to be younger than two-earner couples:

| Age of wife | Percentage of one-earner couples | Percentage of two-earner couples |
|---|---|---|
| 16-34 | 47 | 31 |
| 35-59 | 53 | 69 |
| | 100 | 100 |

However, this is largely if not wholly accounted for by the presence of dependent children; younger women tend to be at home because they are more likely to be looking after children. The presence of dependent children is the single most important determinant of whether a wife is working, and in particular the age of the youngest child:

| | Percentage of one-earner couples | Percentage of two-earner couples |
|---|---|---|
| Wife 16-34, dependent children | 43 | 18 |
| Wife 16-34, no dependent children | 4 | 13 |
| Wife 35-59, dependent children | 28 | 35 |
| Wife 35-59, no dependent children | 25 | 34 |
| | 100 | 100 |
| All wives without dependent children | 29 | 47 |
| All wives with dependent children | 71 | 53 |
| of which, youngest child age: 0-4 | 41 | 10 |
| 5-9 | 16 | 16 |
| 10 or more | 14 | 27 |
| All wives with dependent children | 71 | 53 |
| of which, number of children: 1 | 24 | 21 |
| 2 | 31 | 24 |
| 3 | 11 | 6 |
| 4 or more | 5 | 2 |

3.3 The main conclusions to be drawn from this table are:

Of one-earner couples, who all gain from ITTA:

- around 70% have dependent children
- around 40% have at least one child under 5
- just under half have two or more children.

Of two-earner couples, who mostly lose:

- just over half have dependent children
- only 10% have a child under 5
- about a third have two or more children.

3.4 The data can also be analysed in another way to assess the probability of sensitive groups gaining or losing. The results can be summarised as follows:

- half of all families with dependent children have mothers who work, half are one-earner

- three-quarters of families with at least one child under 5 have non-earning wives, and must therefore gain from ITTA

- 60% of families with three or more children are one-earner couples.

3.5 A gloss on these results is that some 70% of working mothers with dependent children work only part-time (and the greater the number of children, and the younger their ages, the greater the incidence of part-time work). Some of these, with very low part-time earnings, will be amongst the minority of two-earner couples who gain from ITTA. Hence families, and particularly larger families with young children, are even more likely to be amongst those gaining.

3.6 There are also suggestions that, for a variety of possible reasons, there is a stronger than average likelihood that, if the husband is unemployed, the wife will also not be economically active. Couples in this position would be kept out of tax by ITTA, whilst under a scheme of independent taxation with child benefits, the husband would be liable to tax if he had only a small amount of income in addition to his unemployment benefit.

Regional variation

3.7 Unpublished figures from the 1981 Labour Force Survey, covering married women of all ages, show some, but by no means large, regional variation in the proportion in employment:

| | Number of married females, all ages,+ in the region (millions) | Percentage in employment |
|---|---|---|
| Great Britain | 13.5 | 46.0% |
| Scotland | 1.2 | 45.2 |
| Wales | 0.7 | 41.3 |
| Northern | 0.8 | 43.6 |
| Yorkshire & Humberside | 1.2 | 46.3 |
| North West | 1.6 | 48.4 |
| West Midlands | 1.3 | 46.1 |
| East Midlands | 1.0 | 47.4 |
| South East | 4.2 | 47.0 |
| East Anglia | 0.5 | 44.1 |
| South West | 1.1 | 43.2 |

It is difficult to assess the extent to which these variations are associated with regional differences in (eg) demographic characteristics; for instance, a lower than average proportion of the total population is of working age in East Anglia and the South West, and this may account for the lower than average percentage of two-earner couples in those two regions. Differential unemployment rates would clearly be another important factor. It has not been possible within the time and resources available to explore all the causes that could underlie these regional differences, even to the extent that the information to do so exists.

Changes in the position of couples over the life-cycle

3.8 The results discussed above are all based on cross-sectional data, which shows the proportion of women who are working or not working at any one point in time. A different perspective is afforded by the use of longitudinal data which has recently become available from a survey on Women and Employment carried out in 1980. (These results are preliminary, and the report will not be published until mid-1983).

+ ie some 12m of these are members of married couples who pay tax; 1½m are not.

3.9 The results of this survey confirm that the presence of children, and particularly the age of the youngest child are the most important determinants of whether a wife is working. Those two variables, together with age, have been combined into a complete life cycle variable, and the following table shows how the proportion of married women working varies at different life cycle stages.

| Life stage | Proportion of wives in employment |
|---|---|
| | Per Cent |
| Under 30, childless | 84 |
| 30 and over, childless | 77 |
| Youngest child aged 0-4 | 25 |
| Youngest child aged 5-10 | 64 |
| Youngest child aged 11-15 | 77 |
| Children 16 + aged 30-49 | 78 |
| No child under 16, aged 50-59 | 59 |
| All married women aged 16-59 excluding students | 60 |

3.10 As looking after children is the primary reason for not working it follows that most women are absent from the labour market only temporarily, and the longitudinal data confirms this. It is difficult to give concise information about this because the proportion of her potential working life a woman has spent at work will depend not only on the stage of the life cycle reached but also on her date of birth. The earlier the generation, the longer spent away from the labour market; nevertheless, even the oldest women in the survey, those aged 55-59, had on average spent 60 per cent of their total possible working lives in work. An indication that this proportion is likely to rise for successive generations is that women aged 35-39 had already spent a similar proportion of their possible working life to date in work; as most of this group will be reaching the end of the child-rearing and caring stage and tending to return to work, this cohort will by the end of their working lives have spent substantially more than 60 per cent of their time in employment.

3.11 However, the survey also suggests that older, non-working women are more likely than their younger counterparts to be affected by ill-health, to be caring for elderly or disabled dependants or to face difficulties in returning to work after a long absence from the labour market. This effect is obviously connected with age rather than the cohort the women belong to, and so is likely to be a persisten factor in depressing the activity rate of older women. ITTA (in contrast to MIT) will preserve the position of couples where the wife is not working for reasons such as these.

3.12 The conclusion to be drawn from this is that the vast majority of couples will at some stage of their lives be one-earners, and at others two-earners. The redistribution from the latter to the former that would result from ITTA should therefore not be viewed as benefitting one fixed group of couples at the expense of another. Rather, it redistributes income from one stage of the life cycle to another for nearly all couples - making them better off during the child-rearing period (when the family income tends to be lowest) at the expense of their early, childless, married life and later life when children become less dependent. (However, it may be difficult for couples already part of the way through their married life at the time of the changeover to view the impact in this way.)

Transitional arrangements

4.1 It is of the essence of the change to independent taxation with partially transferable allowances that the two-earner couple - specifically the husband - will get smaller allowances than they would have enjoyed (other things being equal) under the present system.[1] This is the necessary consequence of abolishing the married man's allowance, as such. There is no escaping that effect, and merely transitional arrangements cannot reverse it. However, they can phase in the changes relatively gradually - and therefore less painfully - over a period of years. For example, they offer the possibility of using the effects of revalorisation (in line with inflation) to "float off" the present married man's allowance - so that, though the total tax reliefs available to a married man are lower in real terms than they would have been otherwise, they are never actually reduced in cash terms.

4.2 One basic possibility might be to

a. revalorise the single person's allowance in line with inflation in the usual way;

b. "freeze" the married man's allowance at its present cash level, until it is overtaken by the revalorised single person's allowance - at which point it is subsumed in the single person's allowance and the transition is complete;

c. phase in the transferable allowance year by year - representing the difference (under a scheme of partially transferable allowances) between 1.56 of the single person's allowance at a. above and the present

---

(1) With fully transferable allowances the basic allowance would, on a revenue neutral basis, be lower than the current single allowance; so wives of two-earner couples would also lose, as would single people.



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4.3 This can be illustrated as follows, starting from existing, 1982/83, levels of allowances assuming inflation rates of 10% and 5% per annum with transitional periods of 5 and 9 years respectively.

Transition over 5 years with 10% inflation

| | Present rates | Year Y | Y+1 | Y+2 | Y+3 | Y+4 | Y+4 under current system* |
|---|---|---|---|---|---|---|---|
| ingle person | 1565 | 1720 | 1890 | 2080 | 2290 | 2520 | 2520 |
| rried man (ife not rning). | | | | | | | |
| "frozen MAA | 2445 | 2445 | 2445 | 2445 | 2445 | 2520 | |
| . additional transfer-able allowance | – | 245 | 515 | 810 | 1135 | 1420 | |
| tal of i. d ii. ove | 2445 | 2690 | 2960 | 3255 | 3580 | 3940 | 3940 |
| o-earner uple | | | | | | | |
| husband | 2445 | 2445 | 2445 | 2445 | 2445 | 2520 | |
| . wife | 1565 | 1720 | 1890 | 2080 | 2290 | 2520 | |
| tal of i. d ii. ove | 4010 | 4165 | 4335 | 4525 | 4735 | 5040 | 6460 |

*For comparison with the preceding column, this column shows the level of allowances which would prevail at the end of the transition period if the existing tax régime continued with revalorisation of allowances by the appropriate percentage each year. The figures shown represent, respectively, the single person's allowance; the married man's plus wife's earned income allowance; and the married man's allowance.

4.4 On the assumption of 5% inflation the pattern would be basically the same, with smaller changes in the allowance levels each year:-

Transition over 9 years with 5% inflation

| | Present rates | Year Y | Y+1 | Y+2 | ......... | Y+8 | Y+8 under current system* |
|---|---|---|---|---|---|---|---|
| ingle erson | 1565 | 1645 | 1725 | 1815 | | 2445 | 2445 |
| arried man wife not arning) | | | | | | | |
| . "frozen" MMA | 2445 | 2445 | 2445 | 2445 | | 2445 | |
| i. additio-nal transfer-able allow-ance | - | 120 | 245 | 385 | | 1370 | |
| otal of i. nd ii bove | 2445 | 2565 | 2690 | 2830 | | 3815 | 3815 |
| wo-earner ouple | | | | | | | |
| . husband | 2445 | 2445 | 2445 | 2445 | | 2445 | |
| i. wife | 1565 | 1645 | 1725 | 1815 | | 2445 | |
| otal of i. nd ii. bove | 4010 | 4090 | 4170 | 4260 | | 4890 | 6260 |

(The slightly lower allowance levels in the final year here than appear in the previous table arise simply because for consistency a 10% inflation increase was assumed for the final year even though this took the single allowance above the level of the "frozen" MMA.)

* See footnote on previous page.

4.5 It will be seen that

- the single person's allowance increases in line with inflation

- the total allowances available to the one-earner couple - that is the "frozen" MMA plus the transferable allowance - increase in line with inflation, and remain at 1.56 times the single person's allowance

- the total allowances available to the two-earner couple increase every year in cash terms - though by less than enough to compensate for the full effect of inflation

- at no point is there any reduction in the cash value of the allowances given to the married man - either in the one-earner couple or in the two-earner couple.

4.6 The transitional arrangements would be broadly similar for elderly couples (though the amounts would be different, to take account of age allowance). Special arrangements would also be needed to avoid a loss in cash terms for the relatively few "bread winner wives".

4.7 Because of the real reduction in allowances for the two-earne couple, a scheme of this kind, would begin to throw up a net saving (after the second year) and this would rise to approximately £m900 per annum by the final year. This saving would be available, if desired, to finance an increase in the basic personal allowance - and therefore a somewhat more generous transition. Alternatively part or all of it could be used to finance (eg) higher child benefit.

4.8 These two tables are purely illustrative. Similar schemes would be possible for different levels of inflation, and different lengths of transitional period. Generally

speaking, the lower the rate of inflation the longer the period of transition, and the less the revenue savings (or the greater the cost). The precise path and speed of the transition would be for the Chancellor of the day to determine in the light of circumstances at that time. Budgetary considerations might make it possible to put in additional resources to speed the transition or make it more generous. Alternatively it might be impossible to afford full revalorisation, in which case a slower or perhaps a more painful transition would be necessary.

4.9 For present purposes it is sufficient to note that there is scope for transitional arrangements which neither cut the cash value of any taxpayer's allowances nor necessarily involve a net cost to the Exchequer.

INLAND REVENUE

CONFIDENTIAL

10 DOWNING STREET

*From the Private Secretary*

30 November, 1981.

Dear John,

Administration of Mortgage Interest Relief

The Prime Minister was grateful for the Chancellor's minute of 25 November.

The Prime Minister is content with the course of action proposed by the Chancellor. She has commented that much care will be needed in the presentation of these changes.

I am sending copies of this letter to David Edmonds (Department of the Environment), Muir Russell (Scottish Office), Stephen Boys-Smith (Northern Ireland Office), John Craig (Welsh Office), and to the Private Secretaries to the other Members of E. A copy also goes to David Wright (Cabinet Office).

Yours sincerely,

Michael Scholar

John Kerr, Esq.,
HM Treasury.

CONFIDENTIAL

(4)

Prime Minister

Content in principle for the Chancellor to introduce deduction at source?

MCS 26/11

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

Provided he can present it all right!

ADMINISTRATION OF MORTGAGE INTEREST RELIEF

You agreed last December that the Inland Revenue should study with the main lending institutions a scheme for giving mortgage interest relief at source. I can now let you know the outcome of this review.

2. The study has confirmed that a switch to deducting basic rate tax from most mortgage interest payments is feasible and offers a substantial manpower saving in the Revenue - around 2,000. This is a much bigger saving than was contemplated a year ago. The main reason is that a reappraisal has revealed the cost of operating the present system with the more frequently changing interest rates we must now expect. Moreover provided deduction at source could start in April 1983 the change could contribute over 1,000 to the manpower targets for 1 April 1984. It would also mean a major simplification of the tax system for a great many ordinary PAYE taxpayers. Lenders too accept that there is a very strong case for it, although it will give them some extra work.

3. Of course there is nothing new about deducting tax; it used to be the normal rule. Allowing interest to be paid gross to building societies was a departure for reasons which were good in the 1920s when it was done. Circumstances have changed greatly since then and the balance of advantage is now clearly the other way. You will recall too that since 1979 we have been successfully giving tax relief for life assurance premiums by a deduction mechanism.

4. Changing over to a basic rate deduction scheme would not affect the final amount of relief or the borrower's ultimate tax

liability, although his tax payments would go up to balance the reduction in mortgage payments. Those liable at higher rates would continue to get the higher rate part of the relief through codings and assessments.

5. There is an awkwardness in changing over to deduction at source for the ordinary 'repayment' (or annuity) kind of mortgage, under which the borrower repays a constant monthly sum with an interest component reducing each year. The tax relief naturally goes down as the interest reduces. A straight conversion to deduction at source would therefore mean increasing the level of repayment every year. The building societies and local authorities could not handle this. To get round the problem they propose rescheduling the borrower's capital repayments to keep the new, lower, monthly payments constant. This would make it easier for borrowers to plan their family budgets but initially it would mean that net outgoings after tax would increase a little in the early years because they would be paying off their capital debt more quickly. The increases would not be large (typically, around 5 per cent) and would not affect the RPI. In the later years - and overall - they would pay rather less than they would have done. The lenders have said they will be sympathetic to those borrowers who do not wish to increase their mortgage outgoings (an extension of the term is one possibility).

6. There is also a money cost to consider. There is a first year PSBR cost of £m225-250 mainly due to a once for all bringing forward of the cost to the Exchequer of the relief. In later years the PSBR effect is neutral, or possibly a small saving. I judge this to be a price worth paying.

7. Giving relief at source opens up the possibility of winding up (with a further small staff saving in DOE) the option mortgage scheme which nowadays overlaps with the tax relief arrangements to a considerable extent. A lot of people who take an option mortgage

could equally well take a tax relief mortgage. We can protect the others by allowing them to keep the benefit of a basic rate deduction even though they may not be liable to tax. The lenders would want the option mortgage scheme absorbed within any new arrangements - they do not want to have to operate two similar but slightly different schemes.

8. In the run up to the General Election we must obviously approach any change on the mortgage front with caution. The view I have come to, however, is that we ought to make this change and also wind up the option mortgage scheme. The staff saving the scheme offers is a very attractive prize indeed, particularly given the scale of the reductions still required before I can meet the 1 April 1984 manpwoer target for my Departments. Also the opportunity to simplify the tax system for so many ordinary PAYE taxpayers at relatively little cost is not something we should lightly reject. In announcing our intentions we should of course make it absolutely clear that it is merely a change of method and not a cutting down of relief.

9. I have shown the detailed report to Michael Heseltine and also invited George Younger, James Prior and Nicholas Edwards to give their views. Michael has said that he fully agrees with my proposal to introduce the scheme in April 1983 and to absorb option mortgages into it. (The others are of the same mind.) Michael has raised some points of detail which I will pursue with him. I need only mention that he would like to see further assurances from lenders that they will not impose the rescheduling referred to above o unwilling borrowers. This is clearly a sensitive point - and there will be further discussions with the lenders' associations about it. At the same time we have to recognise that it is probably not in their power to give an assurance binding on every member.

10. The timetable for a 1983 start is already tight. But putting the starting date back to 1984 would mean that we lost the contribution the scheme can make to the 1984 manpower target.

Also it will be better to get the change over well before the next election. A 1983 start requires legislation in next year's Finance Bill. To give time for further discussion with lenders (who are waiting to hear the result of the review) we need to make an announcement very shortly. If therefore you are content that we should go ahead I propose asking the Financial Secretary to make our intentions known in the House as soon as I have settled the terms of the statement with Michael.

11. I am copying this minute to Michael Heseltine and to George Younger, James Prior and Nicholas Edwards in view of their housing responsibilities and I am also sending copies to other members of E Committee.

G.H.

(G.H.)
25 November 1981

25 NOV 1981

10 DOWNING STREET

*From the Private Secretary*

16 March, 1981

Report of the Working Group on Tax and Savings

The Prime Minister was grateful for the Chancellor's minute of 27 February and for the two reports enclosed - the conclusions of which she has noted.

I am sending a copy of this letter to David Wright (Cabinet Office).

A J Wiggins, Esq
H M Treasury

cc MR. IBBS
MR. LANKESTER

MR. CRAWLEY (HMT)

REPORT OF THE WORKING GROUP ON TAX AND SAVINGS

Your paras:

3. Agree. I do not see why contractual savings should get special tax relief (p.22). Similarly the pension arrangements discourage labour mobility which is so important today (p.18).

4. One option which is important is to amend capital gains tax and investment income tax to take account of the erosion of the asset value due to inflation. At present capital gains tax is confiscatory and it is very much resented and evaded or avoided. Marginal real tax rates usually exceed 100 per cent on investment income and so have a similar confiscatory effect.

Many countries have both capital gains and investment income taxes that exclude the increase in the general level of prices (eg Brazil and Chile). From my direct observation and research they appear to be very successful.

I am also reminded that the recent reduction (in 1977 I think) in the USA of capital gains tax has been associated with very large - perhaps unprecedented - supply of risk capital (reported in the Wall Street Journal).

I can see no case for the investment income surcharge. It is best - perhaps in stages - to abolish it rather than create more special cases such as higher thresholds etc. It is a double tax on savings.

5. Agree.

6. Agree.

7. The only tax that the owner-occupier bears is local rates - and this is less than the cost (but not value) of the services he receives on the average because of the support grant and because of the super-rating of industry and commerce. I think there is a strong argument in equity and efficiency for taxing implied income from owner-occupiers - but politically it seems a non-starter.

CONFIDENTIAL

Qa 05284

To: MR LANKESTER

From: J R IBBS

13 March 1981

REPORT OF THE WORKING GROUP ON TAX AND SAVINGS

1. In your minute of 3 March you asked for our comments on this report.

2. As you say, we were represented on the Group that produced the Report. We endorse the Chancellor's view (in his minute of 27 February) that the involvement of outsiders in the Group was useful. We also generally endorse the Report's conclusions.

3. We think the Report is right to see some cause for concern in the large and steadily increasing proportion of UK equity held by the institutions, notably the larger pension funds and insurance companies, even though some of the evidence of possible damage is inclusive or unconvincing. But there are at least two points which emerge fairly clearly. First, wider share ownership, for which the arguments are as much social as economic, does not appear to be taking place. Second, there is evidence that the institutions play relatively little part in investment in smaller companies, and that for the smallest companies at least there are still serious deficiencies in the supply of outside equity finance.

4. On the first point, we think the most promising options identified in the Report are:

(a) to consider a significant further reduction of life assurance relief;

(b) further alleviation of the investment income surcharge, eg through a higher threshold for retired people, or a new approach to the taxation of married couples' investment income in the context of the recent Green Paper;

(c) an increase in the annual examption for capital gains tax.

There is much to be said, as the outsiders on the Group argued, for linking (a) above with changes under (b) and (c). In this way one of the more anomalous

biases towards institutional investment would be reduced at the same time as tax penalites on direct investment were alleviated.

5. We think the Group is right to conclude against any tax changes affecting superannuation (despite the somewhat anomalous treatment of lump sums), and against any new special tax incentive either for contractual saving generally or for equity investment on the lines of the French Loi Monory. The latter, while superficially attractive, would introduce a new bias into the system without removing any of the existing ones; would be expensive without necessarily generating much new investment; and would be complex to administer.

6. On the second point (additional finance for smaller companies), we think the right way forward is that which has now been taken in the Budget through the new business start-up scheme and the loan guarantee scheme. The wider measures discussed in the Report would have little if any direct effect on the specific problem of inadequate finance for the smallest companies, whereas the Budget measures are aimed directly at this problem and should have a substantial effect.

7. Finally, we think it is important to bear in mind, as pointed out in paragraph 6 of the Report, that the Report does not deal with existing reliefs for owner occupation (which were outside its terms of reference). The revenue cost of these reliefs (estimated at some £3680 million in 1979-80 including £1450 million mortgage tax relief) means that there is a very powerful fiscal bias towards this form of saving in addition to its other attraction. There are clearly great difficulties in altering or reducing this bias, particularly while interest rates remain at relatively high levels. But, as a matter of housing policy, it may be necessary some time to look further at the position, if the movement towards full economic pricing in public sector housing is to be successfully sustained. Undoubtedly, so long as special reliefs for owner-occupation

remain at their present level, the competitive attractions of housing rather than equities as a medium for personal investment will continue to be very strong.

8. I am sending a copy of this minute to Sir Robert Armstrong.

JR

13 MAR 1981

CONFIDENTIAL

ECON POL

file cc: CO
(+ copy of report)

10 DOWNING STREET

*From the Private Secretary*

MR. IBBS

REPORT OF THE WORKING GROUP ON TAX AND SAVINGS

You have received a copy of the Chancellor's minute of 27 February.

I understand that the CPRS were represented on the above Working Group, and your predecessor made recommendations on how the work should be done. I should be glad to know if you have any comments on the Report.

I am sending a copy of this minute, and also a copy of the Chancellor's minute to David Wright (Cabinet Office).

T. P. LANKESTER

3 March 1981

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

REPORT OF THE WORKING GROUP ON TAX AND SAVINGS

You may recall that you agreed early last year to the setting up of a mixed group of officials and outside experts to look again at some of the main tax reliefs for institutional saving through life assurance and superannuation, along with a case for introducing new reliefs to encourage direct personal investment in equities. You suggested (your Private Secretary's letter of 31 March) that a parallel official group, without the outsiders, should consider the more sensitive issue of whether the taxation system biased saving away from investment in productive assets towards gilts and chattels.

2. You may be interested to see the final reports of both groups, which I now attach. The idea of involving outsiders in exercises of this sort has proved to be successful. The reports, taken together, raise a number of issues which I intend to give further consideration after the Budget.

3. The existence of the mixed group was announced last summer in answer to a Written PQ, but in a very low-key way which does not appear to have attracted any attention. I do not intend to publish their report in any way. The outside members were assured that it was intended to be confidential to me, and, since they acted as individuals and not in a representative capacity, some of them would almost certainly be gravely embarrassed if its contents were made public.

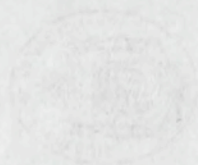
/I am

4. I am sending copies of this letter to Sir Keith Joseph and John Biffen, both of whose Departments were represented on the working groups, and to Robin Ibbs.

(G.H.)

27 February 1981

27 FEB 1981



WGTS(81)2 COPY NO

16 February 1981

HER MAJESTY'S TREASURY

WORKING GROUP ON TAX AND SAVINGS

Supplementary Report

I attach, for those who have not already got it, the final version of the Supplementary report, which has now been submitted to the Chancellor. The annex was added at the last moment, at his request.

C W KELLY
Secretary

H M Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

## SUPPLEMENTARY REPORT OF THE WORKING GROUP ON TAX AND SAVINGS

In addition to the areas covered by the main WGTS(E) report, the Prime Minister asked that a parallel official group, without the outsiders, should consider the more sensitive issue of whether the taxation system biassed saving away from investment in productive assets towards investment in gilts and chattels.

2. This supplementary report therefore considers the present reliefs related to gilts and chattels. There are two of the former - an exemption from capital gains tax for gilts held for more than 12 months and an exemption from stamp duty on transfers - which are dealt with in turn.

### CAPITAL GAINS TAX EXEMPTION FOR GILTS HELD FOR MORE THAN 12 MONTHS

3. Since 1969, gains on disposals of gilts held for more than 12 months have been exempt from capital gains tax. Conversely, any losses on gilts held for more than this period have not been allowable for capital gains tax purposes. Gains on disposals within the 12 month period are chargeable to the tax at 30 per cent (subject to the £3,000 exempt allowance for individuals or £1,500 for most trustees), and any losses are allowable. There are a number of provisions intended to counter abuse, for example by restricting the use of losses on a re-acquisition of the same stock within one month before or after disposal. In addition, there is a special provision under Section 27 of the Finance Act 1973 whereby gains on the limited number of special issues of deep-discounted stock (which would normally be treated as income) are exempt from income tax.

4. It is not possible to give any sensible estimate of the revenue cost of the gilts exemption. The figures to estimate the potential gross yield at current levels of activity are not available; nor is there any way of estimating the extent to which the gross yield would be reduced by the use of off-setting losses. Furthermore, there can be little doubt that the imposition of a tax charge would have a significant effect on market behaviour, so that the actual yield would be very different from any current potential liability.

5. The exemption is of no value to those who are already otherwise exempt from capital gains tax, including gross funds, non-resident investors and, following the 1980 Finance Act, authorised unit trusts and investment trusts. Modest investors are also unlikely to benefit from it because the first £3,000 of capital gains in a year are exempt from tax in any case. Finally, the gains of banks and stock-jobbers trading in gilts are taxed as income as part of trading profits and are not therefore subject to capital gains tax either. The exemption is therefore an attraction mainly to the insurance companies, building societies and more

substantial private investors and trusts. An approximate breakdown of the total Treasury stock outstanding at 31 March 1980 indicates the following division of ownership:

| | £ billion |
|---|---|
| Exempt | 30 |
| Non-exempt | 35 |

6. The Wilson Committee examined the exemption in paragraphs 710-712 of their report. They suggested that it created anomalies and had potentially undesirable effects in concealing the true cost of public sector borrowing. Subsequently they made a general recommendation that the tax arrangements for Government borrowing should be brought into line with those which apply to other borrowers.

Justification for the relief

7. The exemption was introduced originally as a way of improving the marketability of gilts and, at the margin, of reducing the direct cost of Government borrowing. This remains its justification. It has the effect of removing an impediment to investors' freedom to manage their portfolios, for which they are prepared to pay by accepting a lower yield. Very roughly, the exemption is thought to confer a redemption yield advantage on gilts of about ¼ per cent over comparable local authority stocks. The consequent reduction in borrowing costs can in principle be offset against the revenue foregone as a result of it. The Bank of England believe that the improvement engendered in the secondary marketability of gilts, which helps to make it possible for investors to deal in large amounts at any time without turning the market against themselves, brings important benefits in terms of the volume of new issues that investors are willing to absorb. They also consider that the exemption improves market structure, the ability of holders to switch without incurring a tax penalty making it easier for the Bank to influence the structure of yields across the board through open market operations which affect only a few stocks directly.

8. On the other hand, the exemption is an undoubted distortion to the tax system, and one which is open to potential abuse by way of holders realising losses within the 12 month period (and setting these against other gains), but hanging on to gains until these become exempt. It would, however, in practice be very difficult to withdraw it from existing securities (or at least from the existing holders). This is because, while not actually mentioned in the prospectus, the exemption has since 1969 been part of the general environment in which new issues of gilts have been made. It is, for example, invariably mentioned in the accompanying official press notices. It has therefore constructively become part of the terms of issue. Of course, investors must always face the possibility that a fiscal concession of any kind might be withdrawn, or a rate of tax increased. But there seems to be a difference in kind between general changes in taxation, such as, for

example, increases in the rate of capital gains tax which affects all instruments and all holders, and a change specific to the Government's own debt.

A matching rule

9. The same argument also applies, but probably with rather less force, to changes intended to narrow the exemption,but falling short of outright abolition.

10. One possibility of this kind is to allow short-term losses on gilts to be set only against taxable (and therefore also short-term) gains on gilts. A matching rule of this kind would ensure that an investor making overall gains in the exempt field could not at the same time arrange for allowable losses on gilts to be used against gains on other investments.

11. Such a change would inevitably have some adverse impact on the attractiveness and thus the cost of issue, of gilts. But this effect would probably be relatively small; and the Bank would be prepared to live with it if there were strong enough revenue or other arguments in favour of the change - though they would equally prefer not to have to make it at a time when the Government's funding requirements are as heavy as they are at present.

12. Such evidence as there is does not, however, suggest that the case for making the change on revenue grounds is sufficiently strong to offset its disadvantages. It is certainly the case that, other things being equal, holders of gilts can be expected to take advantage of the rules. But market pressures may often over-ride purely tax considerations. An analysis by the Revenue of the holdings of a number of the larger insurance companies and building societies does show a clear pattern of realised losses exceeding realised gains during 1972-75. But this was a period during which gilt prices were more or less continuously declining. The excess of losses over gains may therefore merely reflect the fact that there were more losses than gains in most portfolios by virtue of the performance of the market. In 1975 this pattern was suddenly ended, and gains began to exceed losses at precisely the time when market prices began to rise again. Since then there has been a much more evenly-balanced pattern of gains and losses, which is exactly what might have been expected given the fact that price movements have fluctuated in both directions.

Extension of the exemption to industrial debentures

13. An alternative way of tackling the distortion resulting from the exemption would be to extend it to other borrowers, in particular to industrial debentures.

14. This would constitute a subsidy by the Government to the private sector, unlike the exemption for gilts where the cost (in revenue foregone) and the benefit (in lower borrowing costs) both accrue to the Government and in principle offset each other. It would also have

the effect of extending the anomalous area, in that these financial assets would then also be treated more favourably than other chargeable assets, including, most importantly, equities.

15. It would, moreover, be unlikely to make much difference to the cost of finance to companies. Where the issue price of the debt was about the same as the amount due on redemption, the advantage is unlikely to be more than the ¼ per cent presently enjoyed by gilts. It would be reduced still further if, as seems likely, it proved impractical to limit the extension of the exemption to industrial debentures. Apart from the difficult problems of definition which would arise, Ministers would almost certainly find themselves under considerable pressure to extend the exemption to other forms of loan stock, including that of local authorities who have been arguing strongly for it for some time. It is difficult to tell where this might lead. At present, the Revenue feel that they have a line which is defensible.

16. Different considerations would arise in the case of industrial debentures issued at a substantial discount, or redeemed at a substantial premium. Under present law, such discounts or premiums would be regarded as income and taxed accordingly. But the Finance Act 1973 expressly removed the income tax charge from low coupon gilts. The annex attached discusses the possibility of extending the same treatment, as well as the capital gains tax exemption, to low coupon debentures. It concludes that, despite the superficial attraction of providing neutrality of treatment between gilts and debentures, the prospect of doing so by extending the special gilts rules is not appealing. It would potentially involve substantial revenue and administrative costs. In practice there might prove to be few takers, and the further bending of the basic tax rules, with the risk of abuse and troublesome line drawing, would have been largely in vain.

**STAMP DUTY AND GILTS**

17. Stamp duty is ordinarily chargeable at a flat rate of 2 per cent on transfers of property. But since at least 1804 transfers of Government stocks have been exempt. Following a series of relaxations in recent years (most recently in the 1980 Finance Act), this privilege is now shared by industrial debentures, local authority stock and most other classes of loan capital, with the exception of convertibles. Transfers of equities are chargeable at the full rate, except in the case of overseas residents who pay at a reduced rate of 1 per cent.

18. The apparent revenue cost of the exemption is considerable. The estimated turnover of gilts and local authority stock in 1979-80 was in excess of £60 billion (separate figures for gilts alone are not available); and the present expectation is that the 1980-81 figure will be substantially higher. But, as with the capital gains tax exemption, the apparent cost could

be misleading. The imposition of a charge to duty would undoubtedly lead to considerable changes in market behaviour, including a substantial reduction in turnover.

Justification for the stamp duty relief

19. The main arguments for the stamp duty relief as it affects gilts are similar to those for the capital gains tax exemption - that it improves the marketability of gilts and, by increasing their attractiveness, reduces slightly their cost of issue. Unlike capital gains tax, stamp duty is normally payable by all investors, without exception.

20. Taking duty from transfers of gilts would imply a greater borrowing cost for the Government in the form of higher interest rates or a reduction in the issue price. It is also possible that it could lead to a switch of gilts into the hands of foreign depositories, with dealings thereafter occurring abroad (with little or no stamp duty liability), to the detriment of markets here. That possibility already exists, of course, as regards dealing in equities. The chairman of the Stock Exchange expressed some apprehension about it last year in the wake of the dismantling of exchange controls.

21. Whatever the balance of advantage, however, the same problem about withdrawing the relief from existing securities arises as with the capital gains tax exemption, if anything in a more acute form. The prospectuses of all Government stocks currently outstanding have consistently included what is in effect a promise that transfers of that stock would be free of stamp duty. In practice, therefore, a different rule could only be applied to new issues.

22. This objection does not, of course, apply to the possibility of re-imposing a charge to duty on other forms of fixed interest stock. But it would be perverse to re-introduce stamp duty on corporate stocks at a time when considerable thought is being given to ways of stimulating the corporate bond market in order to take pressure off bank lending. To single out other issuers such as the local authorities might be difficult, particularly since the extension of the exemption last year to the sterling-denominated loan stock of foreign issuers (which was aimed at attracting foreign issuers to the London market) might reasonably have given rise to an assumption that freedom from stamp duty in this area was now settled policy.

23. The alternative possibility is to extend the scope of the exemption still further to take in equities, or at least to make a substantial cut in the duty on equities. This is discussed in paragraphs 101-105 of the main WGTS(E) report.

Conclusion about gilts

24. The capital gains tax exemption for gilts constitutes an undoubted bias in the fiscal

system in favour of investment in Government debt, though on a smaller scale than the biases in favour of, for example, owner-occupation or superannuation. The stamp duty exemption is now shared with most other forms of fixed-interest stock, including corporate stock, but still involves discrimination against equities. The gross revenue cost of both is probably substantial, but unquantifiable because of lack of data and the greater than usual need to take account of the substantial changes in behaviour which would result from their withdrawal. On the other hand, the cost in both cases is offset by the considerable advantages for debt management, which might be regarded as particularly important at a time when the funding requirement is as heavy as it is at present, and by a reduction in the cost of Government borrowing. Moreover, there is a particular difficulty in withdrawing the exemptions from existing gilts arising from undertakings effectively given in the documents associated with their issue. Any changes would therefore have to apply only to future issues of gilts, which could lead to a number of complications.

25. It is arguable that, had the exemptions not already existed, we would not want to introduce them at the present time. But, given the difficulty mentioned above, it now seems preferable to aim eventually to reduce any bias in the fiscal system in favour of gilts not by withdrawing the exemptions but by reducing the general burden of capital gains tax and stamp duty on other forms of investment, particularly equities, along the lines discussed in the main WGTS(E) report.

## THE TAX TREATMENT OF CHATTELS

26. The second area which the Prime Minister asked the group to consider is the tax treatment of chattels - that is tangible moveable property such as consumer durables, antiques or works of art - by comparison with productive assets. There are three aspects to this - capital gains tax, capital transfer tax and income tax.

### Capital gains tax

27. In general, and subject to the exempt allowances, capital gains are chargeable to tax at 30 per cent. There are, however, special rules for chattels. First, with certain exceptions, gains on disposals of chattels where the disposal proceeds are less than £2,000 are exempt, with the exemption being tapered off by a marginal relief over £2,000. There is a corresponding restriction on the calculation of losses on chattels sold for less than £2,000. For these purposes, chattels owned by one person and forming part of a set are regarded as a single asset if they are disposed of to the same person.

28. Secondly, gains arising on the disposal of "wasting" assets are entirely exempt from capital gains tax, even if the disposal proceeds exceed £2,000, and correspondingly any losses

are not allowable. Wasting assets are defined as those with a predictable life of less than 50 years, the main examples being race horses and yachts. The object of this exemption, which was introduced in 1968, is not to favour chattels of this type but to prevent losses, particularly on race horses, from getting tax relief. It does not apply where the assets are used for the purposes of a trade and capital allowances have been, or could have been, claimed for them.

29. The chattels exemption is an administrative convenience which saves work both for taxpayers and for the Revenue. It also recognises the virtual impossibility of enforcing a charge on relatively small gains on chattels. The revenue cost is impossible to estimate but, given the fact that gains by indviduals of less than £3,000 are exempt anyway, is probably small. It may even be negative if the potential loss of tax from allowable losses is taken into account.

30. If it does have the effect of imparting a bias into the tax system, and even this is debateable given the extent of the exempt allowance, this is mainly by comparison with the acquisition of shares. Direct investment in productive assets is also given favoured treatment through the capital gains tax system, in that gains arising on their disposal can be deferred by being rolled over into newly acquired productive assets. This is particularly valuable at present when inflation is throwing up large nominal gains. It would in principle be possible to add to this concession by allowing the £2,000 exemption to run against productive chattels (that is wasting assets which do not at present qualify for the £2,000 exemption because they are used for trade purposes). But this is unlikely to stimulate fresh investment. It would merely be a bonus to traders on final disposal, with a revenue cost of perhaps up to £25m.

31. It is also relevant that there is a capital gains tax retirement relief which exempts up to £50,000 on disposal of a business, which is also available for shares in a family trading company.

Capital transfer tax

32. In general, chattels are liable to capital transfer tax in the normal way, subject to the usual lifetime exemption for the first £50,000 transferred and the annual and other exemptions.

33. There is, however, a special exemption for national heritage chattels - that is, "pictures, prints, books, manuscripts, works of art, scientific collections or other things not yielding income which appear to the Treasury to be of national scientific, historic or artistic interest". Chattels which qualify for this relief are exempt from capital transfer tax

provided the recipient gives an undertaking to preserve them and to allow public access. The relief is withdrawn if the undertakings are subsequently broken or if the chattels are sold on the open market.

34. This exemption might make chattels of this kind an attractive investment for the wealthy. But against it must be set the fact that in order to qualify the owner of the chattels must make appropriate arrangements for public access, and this is seen in some quarters as imposing an onerous burden. In any event, it would be difficult to withdraw the relief (which also used to apply for estate duty) in view of the Government's policy of preserving the heritage.

35. Elsewhere in the capital transfer tax system there is something of a bias in favour of some forms of investment in productive assets, in that the transfer of a sole proprietor's business or interest in a business, or of a holding of shares which gives control of a company attracts business relief of 50 per cent - that is the value of the business property is reduced by that amount - and there is a 20 per cent relief for transfers of minority holdings in unquoted companies.

Income tax

36. There is no tax charge on possession of chattels, even though it could be argued that the owner of, for example, a work of art derives a "psychic income" from it. By comparison, an investment in productive assets will usually produce taxable income either directly or, in the case of shares which yield dividends, indirectly on which income tax and, in the latter case, potentially also the investment income surcharge will be paid.

37. The Chancellor has, however, already concluded that it would be impossible to turn back the clock and reintroduce the old Schedue A tax on housing (which could be said to generate an analogous imputed income to some forms of chattels). Taxing the psychic income of a work of art would be even more difficult. In practice it is hard to see how such imputed income could be measured other than by reference to the capital value of the object itself, which would imply something akin to a wealth tax.

38. An alternative way of achieving greater parity of treatment between the real income of a productive asset and the imputed income of a chattel is to make the cost of investment in the former deductible from income. In practice, the availability of 100 per cent initial capital allowances already has this effect in the case of most direct investment. A similar result can arise from the purchase of new issues of shares (but not from the purchase of shares bought in the secondary market) where the money raised from shareholders is spent on productive assets which qualify for the 100 per cent allowances. The provision in last

year's Finance Act for a capital loss on disposal of unquoted shares in trading companies to be set against income also provides a limited relief, as would an Aunt Agatha scheme if one were to be introduced.

Conclusion about chattels

39. The main area where investment in productive assets might be at a disadvantage by comparison with chattels would seem to be the acquisition of shares, though the disadvantage is by no means a substantial one. The owner of a chattel pays no tax on any "psychic" income he may derive from it, and is able to benefit from the special £2,000 exemption from capital gains tax when he disposes of it in addition to the normal annual allowance. By contrast, the owner of a share is subject to income tax on the income from it including, if his total investment income exceeds £5,500, the investment income surcharge. Moreover he may incur a capital gains tax charge if he sells it during a year in which his total gains are greater than £3,000.

40. However, there would seem to be little scope for pushing people out of investment in chattels (or even out of investment in unproductive chattels into productive chattels) by adjusting the existing capital taxation rules; and there are great practical difficulties in taxing imputed income. In practice, therefore, reduction of any bias is likely to depend on the scope for general reductions in capital gains tax and the investment income surcharge of the kind discussed in the main WGTS(E) report.

HM Treasury
February 1981

ANNEX

**DEEP-DISCOUNT LOW-COUPON STOCKS**

Paragraph 16 notes that a different set of considerations would be involved if debentures carrying a low coupon were to be issued at a substantial discount or redeemed at a substantial premium, comparable to the special low-coupon gilts issued since 1973.

2. Under present law, as interpreted in the Courts, a discount (or premium on redemption) on an issue carrying no interest, or a rate of interest plainly below a commercial rate, is likely to be taxable as income. The Finance Act 1973 expressly removed the income tax charge from low-coupon gilts. Taken together with the exemption from capital gains tax if the gilts were held for more than one year, this makes such gilts very attractive to high rate taxpayers (but not to the exempt institutions).

3. It has been suggested that, if both these tax rules were extended to debentures, then companies wishing to issue deep-discount stocks might find ready takers in the personal sector. The yields on such stocks could be expected to be much the same as on low-coupon gilts of similar maturity, apart from a higher risk premium, and could therefore be as much as 2 per cent less than on corresponding high-coupon stocks. From the issuing company's point of view, it would mean exchanging a high rate of (tax-deductible) interest for a lump sum payable on redemption. This would have to be made non-tax-deductible for the company in order to preserve symmetry with its treatment in the lender's hands. But it is argued that tax-exhausted companies would be no worse off since they could not effectively use the deduction anayway.

4. On the other hand, the Bank have expressed doubts whether there would be much of a market for such issues, unless perhaps issues of gilts were restricted. They have not issued many deep-discount gilts, nor have they issued one for a period greater than five years, and they believe that they have already tapped the market fairly thoroughly.

5. It may also be doubtful whether even companies which are at present tax-exhausted would find the prospect very attractive, since it involves assuming that they:

(a) would have funds to meet the large sum due on redemption but

(b) would remain tax-exhausted.

6. The potential cost to the Exchequer cannot be foreseen. The cost would consist of the loss of tax on exempt lump sums which might otherwise have taken the form of taxable

income - to the extent that these issues replaced what might otherwise have been ordinary loan stock or equity. There would be no countervailing increase of revenue at the company end, on the assumption that only the tax-exhausted would take part.

7. There would be intense pressure from the local authorities to be allowed similar privileges. They would say, with some justice, that they were being discriminated against. To concede this would, of course, add to the cost.

8. Finally, there could be some awkward administrative problems. It would be necessary to define closely the stocks that would be allowed this treatment, otherwise all kinds of short-term borrowing would find their way in. The length of the loan, the coupon and the discount would be factors. In practice a clearance procedure would be inevitable. Companies would want to submit a draft prospectus and be assured that it qualified. There would be marginal cases and argument. This would be a costly process - it could not be done at a junior level and the Revenue, Treasury and Bank would all have an interest.

9. The gilt exemptions from capital gains tax is protected by fairly complicated anti-avoidance provisions which would need to be adapted and applied if the exemption were to be extended to company stocks.

Conclusion

10. There is a superficial attraction in restoring equality of treatment between gilts and corporate stocks; and, if it could be done by withdrawing the tax advantages of the former, this would be appealing. But the prospect of doing so by extending the special gilts rules is not an appealing one. It would potentially involve substantial revenue and administrative costs. The more successful it was, the greater these costs would be. In practice there might prove to be few takers and the further bending of the basic tax rules, with the risk of abuse and troublesome line drawing, would have been largely in vain.

CONFIDENTIAL

**REPORT OF THE WORKING GROUP ON TAX AND SAVINGS**

**INTRODUCTION**

Over the years, and for a variety of historical reasons, a complex pattern of tax reliefs for different types of savings has been built up. Some methods of saving receive different forms of very favourable tax treatment. Others benefit from no special relief at all. These differences in treatment, and the distortions which result, have in recent years become increasingly questioned from a variety of standpoints.

2. This report considers the present fiscal treatment of the two main institutional forms of saving (life assurance and superannuation), the case for reducing or modifying the existing reliefs in these areas, and the possibility of introducing new specific or general reliefs intended to redress the balance in favour of direct personal investment. It has been prepared by a group of officials from the Treasury, Inland Revenue, CPRS, Bank of England, Department of Industry and Department of Trade together with a number of outside experts appointed in an individual capacity. A list of the outside members and the terms of reference, as set out in a letter to them from the Chancellor of the Exchequer, are attached as Annexes 1 and 2. A list of papers circulated to the group is at Annex 3.

Background and scope of the report

3. There are a number of factors which have to be taken into account in any consideration of the existing structure of tax reliefs for savings. Three are particularly important in the present context:

(i) the desirability, other things being equal, of achieving neutrality of fiscal treatment for different forms of saving so as to minimise potential distortions to saving flows. Planned divergences from neutrality might, however, be justified for a number of reasons;

(ii) the possibly unintended effects on the capital markets of past decisions to encourage some, generally institutional, forms of saving at the expense of others, in particular direct personal investment;

(iii) the Government's desire to encourage a wider degree of direct share ownership as seen, for example, in the provisions on SAYE-linked share option schemes in the 1980 Finance Act.

4. Unfortunately, of course, changes which might seem desirable in one context might have unwelcome implications in another. The introduction of a new tax relief for direct personal investment as an offset to the incentives already offered to institutional

investment might, for example, impart a greater degree of neutrality to the savings market. But it would conflict with the Government's other objectives of simplifying the tax system and widening the tax base.

5. Because of the group's terms of reference, and the need to restrict our task to manageable proportions, this report is subject to a number of limitations.

6. First, it does not consider the reliefs given to owner-occupation nor, on a much less substantial scale, to investment in government debt. Many, however, believe these to be among the most important reasons for the decline of private equity investment. This is particularly true in the case of owner-occupation, where the reliefs are afforded to a form of saving which by its very nature already enjoys intrinsic advantages. A house purchaser acquires an asset which is essential to his very existence and which historically has proved a much better and more certain store of value than most others. To put this in context, the estimated revenue cost in 1979-80 of mortgage interest relief is £1450 million, that of the capital gains tax exemption for principal private residences £2000 million and that of the exemption or reduced rates of stamp duty on transfers of houses a further £230 million. By comparison, the cost of the tax relief on life assurance premiums is only £430 million, with a further £90 million arising from the exemption from capital gains tax when life policies mature.

7. Secondly, this report is concerned only with fiscal questions. Full consideration of the implications of the growing institutional dominance of the capital markets in the context of stimulating more direct holding of equities would also need to take account of other factors, some of which are possibly more important. The justification for the explicitly funded nature of the nationalised industry and local authority schemes is the most obvious example.

8. Finally, we have not attempted to gauge the social or political consequences of any changes which might be considered. But the taxation of savings is an area which affects many millions of taxpayers. It has been estimated, for example, that 4 out of every 5 households have at least one life assurance policy. A large number of financial transactions have been undertaken, and plans for the future made, in the expectation that something like the present pattern of institutional reliefs would persist. Of course, governments can and do change rates of taxation; and there can never be any guarantee that a particular fiscal arrangement will survive a change of government or economic circumstance. But a number of the existing reliefs have been a feature of the tax system for a very long time indeed and any substantial change in the more important ones would be likely to be strongly resented.

9. The next section of the report discusses the extent to which present savings flows have

become institutionalised and considers some of the claims which have been made about the effect of this on the capital market. Sections III and IV are concerned with the fiscal treatment of life assurance and superannuation respectively. Sections V and VI considers the case for new forms of relief, including one on analogous lines to the French Loi Monory, and alternative ways of encouraging savings. The final section contains the group's conclusions.

## II THE INSTITUTIONALISATION OF SAVING AND ITS EFFECT ON THE CAPITAL MARKETS

10. One of the main financial developments over the last 20 years has undoubtedly been the steady increase in the proportion of British equity capital held by the institutions. It was estimated by the Wilson Committee that at the end of 1978 the financial institutions as a whole held 50 per cent of listed UK ordinary shares, compared with only 21 per cent in 1957, and that this proportion had probably risen to about 52 per cent in early 1980. The Stock Exchange believe the proportion to be even higher. According to the Wilson Committee estimates, at the end of 1978 the institutions also held just under half of listed UK company loan capital, three-quarters of listed UK preference shares and about two-thirds of listed public sector securities.

11. The most substantial holders of equity within the institutional group are the life assurance and pension funds. In 1975, the latest date for which comprehensive figures are available, the life assurance funds held 16 per cent and the self-administered pension funds 17 per cent of listed UK ordinary shares by market value respectively. Since then these proportions have almost certainly increased further.

12. The increase in institutional ownership has primarily been at the expense of direct ownership of shares by private individuals, who have been consistent net sellers for at least the last 20 years. As Table 1 shows, the proportion of UK listed ordinary shares beneficially owned by persons fell from 66 per cent in 1957 to 38 per cent at the end of 1975 and, according to the Wilson Committee, was probably as low as 32 per cent by the end of 1978. These figures almost certainly overstate the extent to which portfolios are actively managed by individuals themselves, since a proportion are managed on their behalf by professional trustees or others on a discretionary basis.

13. Alongside the increase in institutionalisation there has been some increase in concentration among the institutions. Figures for earlier years are not easily available. But by the end of 1978 there were already 13 pension funds each with assets in excess of £500 million (including 7 nationalised industry funds). Between them these accounted for 41 per cent of the total assets of non-insured self-administered pension funds. At that time there were also 23 insurance groups each with long-term funds in excess of £500 million, accounting

**TABLE 1: BENEFICIAL OWNERSHIP OF LISTED UK ORDINARY SHARES 1957-75**
At end-December*; per cent of total shareholdings at market value

| Category of beneficial shareholder | 1957 | 1963 | 1960 | 1975 |
|---|---|---|---|---|
| Persons | 65.8 | 54.0 | 47.4 | 37.5 |
| Charities and other non-profit making bodies serving persons | 1.9 | 2.1 | 2.1 | 2.3 |
| Insurance companies | 8.8 | 10.0 | 12.2 | 15.9 |
| Pension funds | 3.4 | 6.4 | 9.0 | 16.8 |
| Stockbrokers and jobbers | 0.9 | 1.4 | 7.4 | 0.4 |
| Banks | 0.9 | 1.3 | 1.7 | 0.7 |
| Investment trust companies | 5.2 | 7.4 | 7.6 | 6.1 |
| Unit trusts | 0.5 | 1.3 | 2.9 | 4.1 |
| Other financial companies | 1.6 | 2.6 | 1.1 | 4.0 |
| Industrial and commercial companies | 2.7 | 5.1 | 5.4 | 3.0 |
| Public sector | 3.9 | 1.5 | 2.6 | 3.6 |
| Overseas sector | 4.4 | 7.0 | 6.6 | 5.6 |
| TOTAL | 100.0 | 10.0 | 100.0 | 100.0 |
| £ billion | 11.6 | 27.5 | 37.9 | 44.6 |

*Except 1957, which is at 1 July

Source: Wilson Committee report

between them for almost three-quarters of the total UK business assets of the long-term funds as a whole. Four of these had assets of more than £1500 million, accounting for 31 per cent of the total.

14. This has implications for the concentration of ownership of industrial companies. Most long-term institutions generally like to have a reasonable spread of assets; and their individual shareholdings in any one company tend in consequence to be fairly small. But this is not always feasible for the larger institutions, even though they also try to limit their holdings in any one company to five per cent or less, and preferably to no more than two or three per cent. By 1975 there were already 23 holdings by insurance companies of more than 5 per cent in the 165 UK companies which then had equity capital with a market value of more than £40 million. The implications for the relationship between the institutions and the managements of the companies in which they invest have recently been the subject of some debate.

15. The UK is unique among major developed countries in the extent to which its capital markets have become dominated by the institutions. There has also been an increasing institutional presence in the USA, and a corresponding reduction in the proportion of shares held directly by individuals. But this has so far been on a smaller scale than in this country. According to a recent Securities and Exchange Commission estimate, institutional holdings of equity amounted to around 41 per cent of the total in 1980, compared with around 23 per cent in 1965. As Table 2 shows, in Japan, France, Germany and Italy, the household sectors have all been modest net purchasers of shares in recent years.

Causes of institutionalisation

16. There are a number of explanations of the trend towards greater institutionalisation and the associated decline in direct private investment. Taxation has obviously been an important factor. The availability of tax relief has been a major influence in channelling funds into tax-efficient forms of saving such as life assurance and superannuation rather than into direct holdings of equities, and into owner-occupied housing and government borrowing rather than either. It has also been argued that the combination of high and progressive direct taxation and a system of capital taxation which does not discriminate between real and monetary gains has discouraged the private investor generally and, in some cases, encouraged him to acquire assets in the form of small, movable objects which cannot be traced rather than a portfolio of shares. Evidence about the extent of this is, however, by its nature hard to find. To the extent that the level of taxation has been important, the recent reduction in the higher rates of tax can only be helpful.

17. But taxation has not been the only influence. Equally, if not more, important have

**TABLE 2: NET ADDITIONS TO FINANCIAL ASSETS BY THE HOUSEHOLD SECTOR' IN MAJOR DEVELOPED COUNTRIES**
(1973-77 averages expressed as per cent of GDP at market prices)

| | Equity in life assurance and pension funds | Shares | Bonds | Short-term deposits and securities | Other | Total |
|---|---|---|---|---|---|---|
| UK | 4.4 | -1.1 | 0.7 | 6.1 | 0.4 | 10.4 |
| USA | 2.9 | -0.3 | 0.9 | 6.6 | 0.2 | 10.4 |
| Japan | 2.2 | 0.2 | 1.5 | 12.7 | 0.4 | 17.0 |
| France | 0.4 | 0.3 | 0.5 | 8.2 | 1.1 | 10.4 |
| Germany | 1.5 | 0.1 | 1.1 | 5.6 | 0.6 | 8.9 |
| Italy | .. | 0.2 | 0.4 | 14.7 | 1.2 | 16.6 |

'Households and private non-profit institutions serving households; also includes unincorporated enterprises in UK, Japan, and France. In Germany all the housing sector is included.

Source: OECD Financial Statistics 1978

been the growth in occupational pension schemes and the benefits offered by them (resulting from social security legislation as well as from collective bargaining), and improvements in the state pension scheme and social security system which have reduced the need for individuals to make their own provision for retirement. A related factor is the wider distribution of savings through the population and the potentially greater importance to modest holders of wealth of the spread of risk achieved by holding their securities indirectly.

The effects of institutionalisation

18. The consequences of growing institutionalisation for the capital market are not entirely straightforward.

19. On the one hand, the institutional presence has brought with it some undoubted advantages. It is generally believed to have improved the efficiency of the market in a technical sense - that is in quickly reflecting in prices all currently available information as to the future returns expected from each security and their relative degrees of riskiness; and in the right economic conditions it makes it possible for companies to raise new equity capital through rights issues in amounts which are by no means always available in other, less institutionalised, European capital markets.

20. Against this, it is often argued that the institutions are more averse to risk-taking than private individuals, that for this and other reasons they tend to concentrate their holdings in larger and established companies, thus adding to the difficulty of financing smaller and newer ones, that their activities have added to price fluctuations in both equity and gilt markets, thus increasing general market uncertainty, and that in general increasing institutionalisation has put considerable strain on existing market mechanisms.

21. The validity of these assertions is difficult to evaluate. Most are usually based on a priori argument and anecdotal evidence rather than empirical analysis.

22. For example, the suggestion that institutions are naturally more risk-averse than individual share-holders normally stems from the view that the nature of their responsibilities towards their customers obliges them to place their funds in a more prudent way than might the same individuals acting on their own, despite their greater inherent ability to reduce their risks through diversification. There may be some truth in this. But there is also a danger of taking an over-romantic view of private investors in the past, the great majority of whom were likely to take above-average risks, if at all, with only a small proportion of their total assets. Moreover, there has been a growing tendency over the last few years for institutional investors to show greater awareness of the need to encourage risk-taking and of their capacity to support it without being in breach of fiduciary obligations. The successful financing of North Sea exploration and development shows that,

in the right circumstances, the institutions are not always averse to considerable risk, provided that the expected returns are sufficiently high. This may, however, be something of a special case.

23. Again, on a priori grounds, it would not be all that surprising if institutional investors favoured larger quoted companies at the expense of smaller ones. Assessing the prospects for a company, and monitoring its subsequent performance, involve costs which do not fall proportionately as the value of the holding falls. Larger companies offer institutions the opportunity to acquire more substantial blocks of equity while still holding a relatively small proportion of the total outstanding. Moreover, portfolio theory suggests that most of the benefits from diversification can be obtained with as few as 20 stocks.

24. However, if the institutions did favour larger companies, a fairly substantial yield differential would be expected between listed companies of different sizes. In practice, as Table 3 shows, the differential is relatively small and not out of line with what might be expected given the greater relative costs and potential risk of investing in small companies. It also appears to have been narrowing in recent years. This is not, however, a conclusive argument. Inadequate demand for small company shares would not lead to depressed share prices if it was matched by an inadequate supply of shares, that is by a relative scarcity of equity issues by small companies. There is some evidence that small quoted companies obtain a lesser proportion of their funds from the market than do large quoted companies, and that the position has deteriorated in recent years.

25. An alternative approach is to look at the Department of Industry's Share Register Survey for 1975. This showed no particular tendency for institutional holdings to be concentrated on the very largest "blue chip" companies. But it did suggest that at that time they were considerably under-represented in companies with market values of £4 million or less (see Table 4). This may be partly explained by the prevalence among companies of this size of strongly entrenched family-controlled shareholdings which rarely come onto the market; and these figures date from before the increased interest shown by the institutions in investing in smaller companies, many of them having recently set up specialised subsidiaries for this purpose. But few as yet invest in unlisted companies to any significant extent, and the general belief, voiced among others by the Wilson Committee, is that there are still serious deficiencies in the supply of outside equity finance for very small companies.

26. A third criticism is that the institutions have added to the volatility of the market. It has been argued that the greater professionalism of institutional fund managers, their tendency to use common sources of information and methods of analysis and their close contacts with each other have led them increasingly to form identical or similar views about

**TABLE 3: AVERAGE PRICE/EARNINGS RATIOS OF A SAMPLE OF 327 COMPANIES**
September 1978

| Range of pre-tax profits | Number of companies | Average price/earnings ratio |
|---|---|---|
| £ million | | |
| 50+ | 37 | 9.1 |
| 15 - 25 | 46 | 8.6* |
| 5 - 6.5 | 46 | 8.9 |
| 3 - 4 | 76 | 8.6 |
| 1 - 1.5 | 62 | 8.1 |
| 0.45 - 0.55 | 60 | 7.6 |

*Excludes the Thomson Organisation which had a P/E of 50.2 which would raise the average for this band to 9.5

Source: Submission to the Wilson Committee by the Prudential.

**TABLE 4: INSTITUTIONAL SHAREHOLDINGS BY SIZE OF SHARE ISSUE AT END 1975**
(per cent of total in issue)

| Category of beneficial shareholder | Market value of share issue (£ million) | | | | |
|---|---|---|---|---|---|
| | Over 130 | 40-130 | 4-40 | 0-4 | All |
| Insurance companies | 15.9 | 17.0 | 19.3 | 5.5 | 15.9 |
| Pension funds | 17.9 | 20.1 | 14.2 | 6.4 | 16.8 |
| Investment trust companies | 5.8 | 6.2 | 7.5 | 2.4 | 6.1 |
| Unit trusts | 3.4 | 4.0 | 5.6 | 5.0 | 4.1 |
| Total including institutions | 42.3 | 47.3 | 46.6 | 19.3 | 42.9 |
| Other sectors | 57.7 | 52.7 | 53.4 | 80.7 | 57.1 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| £ billion | 21.6 | 10.0 | 9.9 | 2.6 | 44.6 |

Source: The Ownership of Company Shares: A Survey for 1975

the prospects for particular securities. On a priori grounds this might be expected to lead to increasingly one-way markets in which institutions showing similar views were unable to trade until large price adjustments occurred. On the other hand, volatility might be expected to be reduced by the ability of the institutions to take a longer-term view about the companies in which they hold shares than the average private investor.

27. In fact, the volatility of the UK market has considerably increased over the last decade, as indeed it has also in the US (see Table 5). But this is not necessarily related to the increase in institutionalisation over the same period. The 1970s were a decade in which the capital markets were subjected to a series of large unexpected shocks - including, for example, the increases in oil prices, the associated bouts of very high rates of inflation and substantial fluctuations in interest and exchange rates. All of these have undoubtedly added to uncertainty and could be expected to have made expectations more volatile irrespective of any effects that the institutions might be having. A study done for the Wilson Committee found no evidence of a general upward trend in volatility over a longer period. Instead there have been three distinct periods when price volatility has been much higher than average - 1931-32, 1939-40 and 1974-76 - the common feature of each being that they coincided with conditions of more than usual uncertainty.

**TABLE 5: PRICE FLUCTUATIONS OF EQUITIES IN THE UK AND US**

Annualised average standard deviations of percentage changes in capital values

| | 1959-68 | 1969-78 |
|---|---|---|
| UK equities | 14.7 | 28.7 |
| US equities | 11.6 | 15.7 |

Source: Rowe Rudd

28. A final point is that increasing institutionalisation, together with other factors such as the cost of financing the taking of positions at a time of high interest rates, has put considerable strain on the present system of market organisation in the Stock Exchange - that is the separation of capacity between jobbers and brokers and the principle of competitive market-making by the jobbers. Paralleling the increase in institutionalisation, and undoubtedly closely connected with it, has been an increase in the average size of bargain (which has nearly doubled in real terms since 1966). This has been associated with a decline in the numbers of both brokers and jobbers, an increase in the "spreads" of those jobbing firms which remain, and an increase in the proportion of "put-throughs" (where a broker finds both buyer and seller himself and only puts the transaction through a jobber in a nominal fashion). In 1959 there were 104 jobbing firms in the London market. There are currently only 13 - of whom 5 account for about 90 per cent of total turnover -with a further six operating outside London on the country floors. The result is that markets in many

stocks are now made by only one, or at the most two, jobbers. This process has now gone so far that many observers believe that the viability of the present organisation of the Stock Exchange is in doubt irrespective of the outcome of the current reference to the Restrictive Practices Court.

29. There is no conclusive evidence that the present level of institutionalisation has damaged the effectiveness of the capital markets. But some causes for concern undoubtedly exist, notably about the efficacy of the mechanisms of raising capital for small companies. Moreover, the shift of ownership away from individuals towards institutions, which is presently proceeding at a rate of about 2 per cent a year, has clearly not yet ended. The group do not necessarily subscribe to some of the more extreme forecasts suggesting that by the end of the century ownership of ordinary shares by individuals will account for only an insignificant proportion of the total. But some considerable further growth in institutionalisation is clearly in prospect as existing funds continue to mature, irrespective of any changes of the taxation arrangements. A further factor is the possibility of developments in occupational provision following from recommendations which the Occupational Pensions Board may make when they report on pensions transferability and the initiatives on equal treatment for men and women which are being encouraged by the Equal Opportunities Commission and by the EC Commission. Both of these could lead to fairly substantial additions to pension liabilities.

30. Apart from this, there are often thought to be other reasons for encouraging more extensive direct holding of shares by individuals.

31. In these circumstances the case for retaining the present tax reliefs for institutionalised saving clearly needs to be scrutinised very carefully.

## III TAXATION OF LIFE ASSURANCE

32. There are two special tax reliefs relating to life assurance - life assurance premium relief to the individual and relief to life offices on the income received by them.

### Life assurance premium relief

33. The conditions for premium relief are laid down in Section 10 ICTA 1970 as amended by the 1976 Finance Act. Relief is given up to the greater of £1500 or one sixth of total income in respect of the aggregate premiums paid by an individual on qualifying life assurance policies taken out by him or his spouse on his own life or on that of his spouse. In order to qualify, a policy must generally be intended to run for a term of at least 10 years and the premiums must be paid not less than annually and evenly spread over the life of the

policy. The proceeds of a qualifying policy on death or maturity are generally exempt from income and capital gains tax.

34. Life assurance premium relief has been given for many years - almost as long, indeed, as income tax has existed. From 1973-74, when income tax and surtax were unified, it was given at half the basic rate of income tax. When the new system of relief by deduction was introduced, with effect from 1979-80, the rate of relief was set at 17½ per cent. In the 1980 Finance Act this was reduced to 15 per cent with effect from 6 April 1981.

35. The cost of the relief is expected to be around £540 million in 1980-81 and £530 million in 1981-82 in current prices. The fall in the real revenue cost results from the reduction in the rate of relief.

36. Neither the US nor Canada give life assurance premium relief. Japan and most European countries do give some form of relief, but the upper limit is generally much lower (see Annex 4).

Justification for life assurance premium relief

37. The historical justification for life assurance premium relief was that it encouraged the individual to save and thereby to make proper provision for his dependants in the event of his death. The Royal Commission on Income Tax observed in 1920:

> "The distinguishing feature of life insurance, which probably accounts for what would otherwise seem to be an unfair preference (in the allowance of tax relief), is that by no other means can the less wealthy taxpayer, who has not accumulated capital in his earlier years of productive effort, secure a proper provision for his dependants" (paragraph 296).

38. The principle was upheld by the Royal Commission on the Taxation of Profits and Income in 1955. It has, however, been considerably weakened over the years by the growth of state and occupational pension schemes and by the social security system. There now exists a number of other ways in which dependants can be protected against the death of the family bread-winner.

39. At the same time, the investment aspects of life assurance have become more dominant. The industry has developed policies with a large savings element designed to take advantage of the tax relief. This has boosted the return for a given net premium so as to make life assurance attractive as an investment in its own right, as well as a means of provision for dependents. Today there is a wide variety of policies concentrating on savings rather than life cover and with part of the yield coming from the premium relief itself.

40. The existence of the relief has undoubtedly had the effect over the years of mobilising a large volume of contractual saving for investment in private and public sector assets. To

some extent, especially in recent years, this might represent saving diverted from other intermediaries (or which might have flowed into other intermediaries if the revenue foregone had been used to encourage saving in some other way). But a large part has probably been additional saving which would not otherwise have taken place.

41. This is particularly likely to be the case with industrial life assurance, the distinguishing feature of which is that the premiums are collected house to house at frequent intervals. Though collection expenses are inevitably high, industrial insurance is widely believed to tap the savings of lower income groups in a way that has not successfully been done by other media. Industrial assurance accounts for about one quarter of the total new annual premiums of ordinary branch and industrial life assurance business combined, but a rather smaller proportion of the total accumulated funds.

Possible changes and their effects

42. The fiscal encouragement given to saving via life assurance now looks anomalous by comparison with the position of most other forms of saving, including savings invested directly in the equity markets (though not, of course, by comparison with the treatment of housing or additional voluntary contributions to pension schemes). A reduction in the relief, if that was thought to be justified, could be achieved in a number of ways:

(i) reducing, or withdrawing altogether, the relief on all policies;

(ii) reducing, or removing altogether, the rate of relief on new policies only;

(iii) restricting the relief solely to the genuine insurance element in existing and/or new policies. For a wide variety of life offices this would in practice be virtually equivalent to removing it altogether.

There is, of course, no reason why new and existing policies should be treated in exactly the same way. It would, for example, be possible to withdraw the relief completely on all new policies, while retaining that on existing policies or phasing it out gradually over a period of years.

43. None of these options would be without problems, the extent and nature of which would vary with which were adopted and the speed with which they were implemented. The Department of Trade believe that once confidence in the continuation of the relief was lost it might not be possible to influence the time at which the difficulties appear. But other members of the group, while not underestimating the potential problems, consider that they can be exaggerated, particularly if any changes are phased in over a sufficently long period of time and announced in full at the start.

44. First, there is the effect on the policy-holders. A large number of policies have been taken out in the past in the expectation that tax relief would be available on premium payments until the end of the contract. Of course, as has already been pointed out, governments must always retain the right to make changes in the rates or structure of taxation. But life assurance premium relief has been a feature of the income tax system for a very long time indeed. Any substantial change would be likely to be resented, particularly by those using the endowment method of house purchase. Though premium relief is a comparatively small proportion of the total tax relief afforded the average purchaser using this method, without it the balance of advantage in choosing this rather than some other form of house purchase would be altered.

45. This objection would not, of course, apply if any change in the relief only affected contracts made after some future date. But the result could be a very long transitional period, possibly as long as 40 or 50 years. (It has only recently been possible to get rid of special provisions for pre-1916 assurance contracts.) The revenue saving and the effect on capital markets would correspondingly take longer to come through. A distinction of this sort could also have some unpredictable side-effects because it would effectively lock policy-holders into their existing contracts.

46. Secondly, there is the effect on the insurance industry. There is something of a precedent in Australia where, over a period of years from 1973 to 1976, the taxation of life companies and the treatment of premiums were both made substantially less favourable. Since then there has been a steady decline in the total share of savings going to life insurance at a time when total household saving has been increasing. There has also been an increase in the number of policies forfeited or surrendered before maturity and a marked swing away from traditional life policies involving a substantial savings element towards contracts with a greater emphasis on protection, in particular towards term assurance.

47. It would be reasonable to expect something similar to happen in the UK. Complete withdrawal of the relief would raise the annual cost of a given return to the policy-holder by 21 per cent compared with its cost in 1980-81 (17½ per cent compared with 1981-82). The Department of Trade have sought to analyse the probable effect of this in the note attached at Annex 5. In brief, if the withdrawal of the relief was limited to new policies, they would expect a decline in the inflow of funds into endowment policies taken out for savings purposes only and a marked reduction in those policies issued in conjunction with house purchase. Sales of regular premium linked policies would also be made much less attractive. But these effects might in practice be mitigated by successful marketing. This would not, of course apply to those policies whose sole marketing appeal was the existence of the relief. Term insurance, whole life policies and single premium policies would be little affected. The implications for particular companies would depend upon the extent to which they

specialised in the most vulnerable areas. The worst affected are those likely to be the relatively young companies set up to develop linked policies. In principle all of these should be able to meet their liabilities, but a number could be forced into mergers and take-overs. The long established traditional companies should be in a stronger position. But their expense ratios could be expected to rise, at least initially, without a growing volume of new business to share the cost of fixed overheads and this is likely to be reflected in lower bonus rates affecting both old and new policies.

48. If abolition of the relief applied to existing as well as new contracts, there could be expected to be an increase in the number of surrenders of endowment and linked policies and a substantial conversion to paid-up policies. The impact on the companies would be correspondingly increased, and, depending upon how quickly the change was phased in, the Department believe there would be a risk that the industry could not be restructured quickly enough to avoid some failures.

49. Finally, there is the potential effect on the capital markets. A rapid fall in new business, accompanied by an increase in the number of surrenders, would put some life offices in a position in which their cash flow became negative and they consequently had to sell off some of their existing assets in order to meet their obligations.

## The taxation of life assurance companies

50. A secondary aspect of the taxation of life assurance is the treatment of the income received by life offices on invested premiums. Since 1940 a distinction has been made in the rate of tax charged on policyholders' and shareholders' profits. Shareholders' profits are charged at the normal corporation tax rate; but income reserved for policyholders or annuitants is charged at a special "pegged" rate of 37½ per cent. This does not affect dividends from UK companies (franked investment income) which are outside the charge to corporation tax.

51. The pegged rate of tax was originally introduced in response to claims from the life offices that they had made many long-term contracts on the assumption that the rate of tax on their investment income would be unlikely to exceed pre-war rates, and that the burden of war-time tax rates could consequently seriously embarrass them and might put some in danger of insolvency. An offsetting reduction in the amount of premium relief was made at the same time.

52. There are arguments both for increasing the pegged rate to the ordinary corporation tax rate (presently 52 per cent) and reducing it to, say, 30 per cent, which is the rate which would be applicable to the majority of policyholders had they received the same income directly.

53. The main argument for increasing the pegged rate to bring the tax treatment of life assurance funds into line with that of company profits in general is that it was intended originally to be a temporary device. The pattern of post-war rates is now well established, and there is no obvious reason why life companies should be permanently shielded from them. They managed to live with fluctuating rates of taxation before 1940 and have subsequently had to contend with other uncertainties of a similar order of magnitude arising from, for example, changes in interest rates.

54. Moreover, policyholders have choosen to place their savings with an institution rather than investing them directly. There is, therefore, no obvious reason for "looking through" the institution to take account of the tax rates that would have been charged had the policy holders invested directly, anymore than with tax payers who choose to invest with unit and investment trusts. The investment income of the latter is taxed under the normal company taxation rules (with the exception, since last year, of those investing solely in gilts or other fixed-interest stock). Increasing the pegged rate of tax to the normal corporation tax rate would, if the pattern of life funds' income remained unchanged, probably yield additional revenue of the order of £10 to £20 million a year.

55. Against this, it can be argued that there is a fundamental distinction between profits accruing to shareholders and those belonging to policyholders. It is the former, which are already taxed as 52 per cent, which are equivalent to the profits of other companies. The latter can never be distributed as dividends. There is also a lower rate of charge (at present 40 per cent) for other non-dividend bodies liable to corporation tax, such as building societies and industrial and provident societies. The unfranked investment income of unit trust holders and investment trust share holders, which is charged at the full rate of corporation tax, is different in that it actually reaches the investor as a dividend. The revenue cost of reducing the pegged rate to 30 per cent would be of the order of £10m a year.

56. These arguments do not seem to point conclusively in either direction. The effects of any change in the pegged rate on life assurance business and the size of life assurance funds would be likely to be very small and, bearing in mind the small amount of revenue involved, the group see no good reason to disturb the present status quo.

## IV THE TAXATION OF SUPERANNUATION

57. The second main area of institutional saving considered by the group is superannuation.

58. Saving through an occupational pension scheme is favoured in a number of ways, provided the scheme is approved by the Inland Revenue. First, employees' contributions are

tax-deductible in their hands and no assessment is made on them in respect of the employers' contributions. (For employers themselves the latter are an allowable deduction from taxable profits in the normal way as part of labour costs.) Secondly, the investment income and chargeable gains of an approved fund are exempt from income tax and from capital gains tax; and there is also an exemption for underwriting commissions. Trading profits, which are generally negligible for pension funds, are not exempted from tax, nor is there any relief from a development land tax charge should one arise. Thirdly, regular pensions are taxed as earned income at the time they are received, but up to 1½ times final pay may be taken at the time of retirement as a tax-free lump sum. There are comparable reliefs for approved retirement annuity contracts.

59. The current cost of the special reliefs for superannuation schemes is estimated at around £700 million (made up as shown in Annex 6). This figure reflects the additional yield from withdrawing the deduction for employee contributions and from taxing the funds' investment income (but not the funds' capital gains, about which data are not available). It also assumes that the element of pensions coming into payment representing income earned by the fund (but not that representing the return of contributions) would be taxable, with credit being given in respect of the tax already paid by the fund on its investment income. It does not assume that the employee is taxed directly on his share of the employer's contribution, since special provision - beyond the withdrawal of existing reliefs - would be needed for this. The yield from a new charge on the employee in support of this element of the contribution would depend on the form the arrangements took: it could be up to £500 million.

60. There are also special arrangements for the tax treatment of superannuatuion arrangements in most other industrial countries, though the details vary (see Annex 7).

61. There are a number of points at which the tax treatment of superannuation requires consideration:

(i) the treatment of the employer's contributions in his hands;

(ii) the treatment of the employer's contributions in the employee's hands;

(iii) the treatment of the employee's contributions;

(iv) the treatment of benefits - lump sum and pension - payable;

(iv) the treatment of the investment income of the scheme.

The most difficult areas are (iv) and (v).

Employer's and employee's contributions

62. The treatment of the employer's contributions in his own hands is not contentious. The annual contributions paid by an employer to an occupational pension scheme are clearly part of his labour costs and properly allowable under the normal rules in computing his profits for tax purposes. Additional payments, for example to augment benefits or to make good an actuarial deficiency, might in principle be regarded as being of a capital nature and therefore not strictly allowable. But the legislation makes special provision for them to be deductible (possibly over a number of years) if the scheme is approved.

63. The treatment of the employer's contributions in the employee's hands, and of the employee's contributions in his own hands, is more debatable. In essence, the arrangements treat pensions as deferred remuneration which is taxed as earned income at the time it is paid and not at the time it is earned. To tax remuneration gross of pension contributions (whether made by the employer or by the employee) and then also to tax the capital element of the pension when it is subsequently paid would constitute a form of double taxation.

64. It could be argued that the contributions are a form of fringe benefit on which the employee ought to be taxed. There are other forms of spreading income to provide for retirement, in particular direct investment in equities, which are not relieved of tax and on which a measure of double taxation could consequently be said to result.

65. But there is some justification for treating pensions as a special case. The employee has no entitlement to benefit from the employer's contributions if he leaves before qualifying for preservation rights. In circumstances where social security legislation and pension scheme rules permit a refund to be taken, he may not receive benefit from any employer's contributions to the scheme. To qualify for preservation rights he must have reached the age of 26 and he must have completed 5 years qualifying service. Even then, the actual enjoyment of the rights would normally be deferred until he reaches retirement age. Statutory preserved benefits are calculated as the appropriate proportion of the benefit which would have become payable had the employee remained in service - without regard to inflation or future salary increases. There is no set formula by which a transfer of contributions to another scheme is calculated except where the guaranteed minimum pension which has accumulated in a contracted-out scheme is transferred to another contracted-out scheme. Administratively it would be most unsatisfactory to have to base a tax charge on the value of an individual's rights. The calculation of rights attributable to the employer's contributions at any one time would, in particular, be extremely complicated: employers generally contribute on the basis of a flat rate percentage of the overall salary bill. The employee's interest in the employer's contribution is, therefore, very much a contigent one from which unlike other fringe benefits, he derives no immediate and certain advantage. As

regards his own contributions, they are also distinguished from discretionary savings in that he may, in practice have no choice whether or not he should make them since membership of the relevant scheme is often a condition of employment. Finally, he never actually sees his contributions in his hand, since they are deducted at source.

66. It is sometimes suggested that these arguments do not apply with anything like the same force to additional voluntary contributions (AVCs) made by employees to increase their pension entitlements. Such contributions are allowable for tax purposes up to a limit of 15 per cent of pay for voluntary and compulsory contributions combined. Until recently, relatively little use was made of them. But in the last few years they have become more popular, apparently partly because of greater realisation of the effects of inflation and partly because of publicity about their tax advantages. Since few pension schemes currently require full use of the 15 per cent limit in compulsory contributions, for many individuals AVCs are an attractive alternative use of savings by comparison with endowment life assurance or direct involvement in the equity market. It would, however, be difficult to justify a reduction in the rate of tax relief for AVCs while maintaining full relief on compulsory contributions. This would penalise employees in pension schemes offering only modest benefits and those who join a pension scheme well into their working life, having had no previous opportunity to participate in pension arrangements. It would be relatively easy to circumvent and would be seen as throwing more of the burden on employers, It would also be difficult to justify presentationally, since it would provide different tax treatment to employees paying the same total contributions for the same total benefit, depending on whether or not the whole of their contributions were being paid compulsorily or not.

Pensions in payment and lump sums

67. The treatment of pensions in payment as earned income follows logically from the treatment of the contributions which fund them. There is, however, a major departure from philosophical purity in the freedom from taxation of lump sums. The Wilson Committee drew attention to this as the chief anomaly in the present arrangements.

68. It might be argued that, unlike the pension, the lump sum should not be taxable because it is of a capital nature and therefore not properly subject to an income tax. But in this case the double taxation argument falls to the ground. Logically, either the lump sum should be taxed, or the deduction for the employee's contributions attributable to it should be disallowed, and the employer's contributions taxed in the employee's hands.

69. The main argument against making the lump sum taxable is the same as that for making any reduction in life assurance premium relief gradually. As the Wilson Committee recognised, the tax-free nature of the lump sum has become such an accepted part of the

present arrangements, and one on which so many individuals currently base their future financial plans, that its removal would be likely to be deeply resented. It would, moreover, in itself have no immediate effect on the balance between institutional and direct investment. Indeed, it is possible that the effect could be perverse, given that receipt of the lump sum on retirement is the first occasion on which many individuals acquire a capital sum large enough to make direct investment worthwhile. There is no evidence, however, about the extent to which lump sums are in practice made use of in this way rather than, for example, used to pay off mortgages, deposited in a building society or invested through other institutional media.

70. If the lump sum were to be made taxable, there are a number of ways in which this could be done. One possibility would be to impose a cash limit (and to provide that the remainder be taken in pension form) or to impose a threshold above which the lump sum would be taxable. A different approach would be to tax the entire lump sum at a flat rate somewhat lower than the basic rate, in order to overcome the problems arising from taxing the whole of the sum as income in one year and in recognition of the uncertainties about the tax that would be received on an equivalent pension. It would then be necessary to consider the interaction of these possible solutions with the method of taxing terminal payments such as redundancy payments and 'golden handshakes'. Any move to reduce the present limit on lump sums (broadly speaking, 1½ times final salary) would also have implications for those schemes (mainly in the public sector) where the lump sum is compulsory and those where, though a lump sum is usually taken, there is an option between the lump sum and a higher pension. Other alternatives would be to regard the lump sum as akin to repayments of contributions, or to disallow that part of the employee's contributions attributable to the provision of the lump sum and to tax the corresponding part of the employer's contribution in the employee's hands. The latter would avoid the problems of retrospection, but could be complicated administratively.

71. The additional revenue from taxing lump sums might be fairly small (since many pensioners would simply not exercise the option). In view of this, of the administrative difficulties outlined above and of the potentially unhelpful effect on the balance between personal and institutional investment, we do not recommend that they should be made taxable. The possibility of imposing a flat-rate cash limit, in addition to the existing proportional limit, on the amount of pension which can be taken tax-free in the form of a lump sum could, however, be given further consideration.

Investment income

72. The second possibly contentious part of the present arrangements is the treatment of investment income. It might be reasonable to allow superannuation contributions as a

deduction as a counterpart to the taxation of the subsequently emerging pension. But the freedom from tax of the investment income of the funds may appear to be excessive and unnecessary by comparison with the position of an individual providing for his retirement by investing directly himself. No corresponding reliefs are available to the latter (although he does have direct access to his capital).

73. There are, however, a number of important practical considerations which need to be taken into account.

74. First, taxing the income of the funds would, of itself, not affect their liabilities. But it would affect the way in which they were financed. Some employers might find that the change shifted the balance of advantage in favour of contracting into the earnings-related part of the State scheme (which is on a pay-as-you-go basis) or react by conceding less generous benefits to their employees than they might otherwise. In addition, at the margin, some funds at present flowing into annuity contracts or pension schemes in the form, for example, of AVC payments might be diverted to other uses. But these effects would be offset by the fund's need to acquire and hold a larger stock of financial assets in order to provide the same flow of benefits as before out of post-tax income. The effect of introducing a tax charge is therefore as likely to be to increase the size and rate of growth of pension funds as to reduce them.

75. Secondly, the tax charge would have to be financed in some way. The presumption must be that the major part would be borne by employers rather than employees. Companies with taxable profits would be able to claim their increased contributions as a deduction against any corporation tax liability. But even so the change would result in a considerable further call on their liquidity.

76. Thirdly, a change of this kind would disrupt the whole basis on which most employers have provided for their future pension obligations. The pension industry has only recently begun to settle down after a period of considerable uncertainty during the 1970s. A further upset would be most unwelcome unless the case for it was very clear indeed. The change would also add to the present imbalance between (unfunded) public sector schemes and (funded) private sector ones.

77. The group do not therefore favour any change in the present tax treatment of pension funds' investment income.

## V NEW FORMS OF SPECIFIC RELIEF

78. The two previous sections considered the case for withdrawing or modifying existing reliefs. Suggestions are also made from time to time which would have the effect of

extending them. We have looked at two such suggestions. The first involves turning the life assurance premium relief into a more general relief equally available to all forms of contractual saving. The second involves a new form of relief for direct investment in the equity market. Both would, of course, introduce yet further distortions into the system, but might nevertheless be held to be justified for other reasons.

A general relief for contractual saving

79. The first suggestion came from the Wilson Committee. Paragraph 708 of their report recommends that:

> "the tax relief given to life assurance premiums should be extended to any other form of contractual medium or long-term savings plan subject to similar safeguards against early withdrawal and to the same overall limit of £1500 or one-sixth of total income."

80. The main justification for such a change, as they saw it, was that it would provide greater fiscal neutrality without at the same time reducing the incentive to save in a contractual form (which they regarded as important to the institutions' ability to advance medium and long-term finance to industry) They expected the main beneficiaries to be the building societies, the unit trusts and the banks. At present both building societies and unit trust management groups are already able to take advantage of life assurance premium relief, but only through the intermediation of an insurance company.

81. It is certainly true that a modified relief of this kind would introduce greater fiscal neutrality to different forms of institutional saving. But it would do nothing about the balance between institutional and direct investment. Indeed it could well add to the overall incentive to invest through institutions. It could also be difficult and costly to administer.

82. There is also the question of whether it would in practice be possible to make the change on a revenue-neutral basis. In 1981-82 terms, the cost of life assurance premium relief at a rate of 15 per cent is of the order of £530 million. We have no means of making a proper estimate of the amount of saving which would qualify for a wider relief. But, as a broad indication, gross annual deposits in building societies, national savings, savings banks and unit trusts totalled around £32 billion in 1979. If, say, 10 per cent of this qualified for the new relief the rate would have to be set at around 8 per cent to keep within the same revenue cost. But much would depend on the extent to which existing deposits could be made to qualify, which could add substantially to the cost.

A new relief for direct investment in equities

83. The second suggestion is a new relief for the direct acquisition of company securities. This idea has been put forward by, among others, the Stock Exchange drawing on a scheme introduced in France in 1978 by the Loi Monory.

84. The Loi Monory was introduced for a limited period with the intention that it would apply until 1981. It provides relief for new investment in the equities of French quoted companies, French unquoted companies as part of a capital increase, or in the French equivalent of unit trusts (SICAVs) by way of a deduction against taxable income. The deduction is subject to an upper limit of F5000 per household (equivalent to around £450 at current exchange rates) with modest additions where the taxpayer has dependent children. It is given for net new investment, that is the difference between amounts expended on the purchase of shares and the amount realised on any sales of shares. There are clawback provisions where sales exceed purchases in any of the four subsequent years. To make this practical, all qualifying investments (including those held before the relief was introduced) must be lodged with a bank or other intermediary before the first acquisition in respect of which relief is to be claimed is made. All sales and purchases of qualifying assets have also to be made through the same intermediary.

85. The value of the Loi Monory as a precedent for the UK is limited. The encouragement of wider shareholding was one of its objectives (the others being to reduce the gearing of French companies and to lengthen the maturity structure of the financial assets held by the personal sector). But the French authorities appear to be indifferent as to whether this is achieved directly or through intermediaries, which are much less important than in this country. Consequently the proponderant part of qualifying investment has in fact taken place through institutional channels, which would hardly be the desired objective here. There are also a number of other important differences between the French financial and taxation systems and their counterparts here which would make a scheme in this country more difficult to administer and police.

86. We have nevertheless considered whether an analogous scheme to the Loi Monory, adapted to UK circumstances, would be helpful and cost-effective in relation to encouraging individuals to acquire company securities directly.

87. There can be little dispute that the introduction of such a relief would help to stimulate Stock Exchange activity. Investors would undoubtedly be attracted by a relief which, in effect, enabled them to buy shares at a discount. But the extent to which genuine additionality would be achieved is questionable. It would be difficult to limit the relief to new saving without complex legal and administrative arrangements. The Loi Monory deals with this problem by requiring all qualifying assets to be lodged with banks or other approved intermediaries. A similar arrangement seems unlikely to be feasible in the UK.

88. The revenue cost, on the other hand, could be substantial. It is difficult to put a figure to this, since it would depend both upon the amount of relief given and on how many people made use of it. But if, by way of example, a limit of about £500 was used, and 1 million

basic rate taxpayers took advantage of it, the annual cost could be £150 million. The cost would be higher to the extent that the relief would be particularly attractive to higher rate taxpayers.

89. A relief along these lines is subject to a number of other objections in addition to its possible high cost and limited effectiveness:

(i) It would require complex legislation and a large number of staff to administer. In practice there could be considerable difficulties in excluding all forms of intermediaries.

(ii) It would introduce yet another distortion into the fiscal system at a time when one of the Government's major objectives is to try to simplify it.

(iii) If the size of the relief and rate at which it was given was set at a high level, the cost and risk of abuse would be disproportionately increased. But if, for this reason, the relief was limited, most of those taking advantage of it are likely to be mainly attracted to shares in large established companies rather than small private firms and new enterprises. The former already benefit indirectly, however, through the institutional reliefs and it is against investment in the latter that the fiscal system could be said to discriminate most.

(iv) Particularly if set at a low level, the relief could encourage individuals of relatively modest means to acquire assets which they would not otherwise have bought in the market, which might be more risky and less liquid than equivalent assets held through intermediaries and which would be subject to a tax penalty if realised within a certain period. It could therefore bring share investment into disrepute, particularly if its introduction coincided with a fall in the market.

90. In sum, the gains from a general relief of this kind seem to be unclear and unquantifiable, while the costs are clear and substantial. We do not therefore favour it.

91. Some members of the group do, however, feel that, for the reason given in paragraph 89(iii), there is a stronger case for considering whether it is possible to overcome the undoubted difficulties to provide a relief confined to investment in smaller, unlisted companies. They therefore welcome the work which they understand to be already in hand on this in another group.

## VI OTHER WAYS OF ENCOURAGING DIRECT INVESTMENT

92. The alternative to specific reliefs as a way of encouraging greater direct personal investment in the equity market is changes in taxation aimed at making the holding of

equities more attractive in a more general way. Some of these changes may, of course, also be justified for other reasons. The benefit from them would not accrue only, or even mainly, to individuals holding shares directly. But they could have a much more powerful effect at the margin than the particular specific measures we have considered.

93. Four main possibilities have been suggested:

(i) the abolition of the investment income surcharge;

(ii) alleviation of capital gains tax;

(iii) a reduction in transfer stamp duty;

(iv) reallowance of interest.

The investment income surcharge

94. The investment income surcharge is at present levied at a rate of 15 per cent on all investment income above a threshold of £5,500 (the investment income of life assurance and pension funds is, of course, exempt). For this purpose the investment incomes of a husband and wife are added together, even if they have jointly elected to have the wife's earned income taxed as if she were single (the wife's earned income election). The yield in 1980-81 is expected to be about £310 million.

95. Investment income has effectively been taxed at a higher rate than earned income for many years on the basis of arguments such as the relatively precarious nature of earned income, the personal work and effort involved in acquiring it and the difference in taxable capacity implied by the existence of underlying capital. But the earned income relief which marked the difference up to 1973 applied to all earned income up to a ceiling, whereas the surcharge applies only to investment income above a threshold (which is now indexed). Since 1973 the differential tax treatment has therefore applied only to those with a fair measure of underlying capital. In this sense the surcharge is justified less by fiscal or economic arguments than as distributional and revenue-raising measure.

96. Its abolition would, because of the present relatively high level of the threshold, mainly benefit those with a fairly substantial amount of income-yielding capital (although 40 per cent of surcharge payers are otherwise liable to income tax only at the basic rate, implying that their total income is by no means substantial). On the face of it, this is exactly the group who might be interested in direct equity investment. But, for the same reason, the change could be politically contentious and the resulting uncertainty about the possible re-imposition of the surcharge with a future change of Government could reduce its impact. There is also the point that such a change would increase the relative attraction of high income-yielding assets such as gilts by comparison with those offering the prospect of

capital gains.

97. Alternatives to complete abolition, which might be politically less difficult, include the following:

(i) The re-instatement of a separate, higher threshold for those over retirement age. This would mean reverting in part to the situation which existed before the increase in the threshold and the abolition of the lower 10 per cent rate band in 1979. The cost of a differential threshold for those aged 65 or over of, say, £6,500 would be around £30 million.

(ii) The provision of separate thresholds for husband and wife, which would cost around £80 million.

(iii) The extension of the wife's earning election to investment income. This would give a separate income tax allowance and rate bands to a wife with investment income, as well as a separate surcharge threshold, and would cost around £300 million.

(ii) and (iii) are possibilities which were discussed in the recent Green Paper on the taxation of husband and wife and, unlike some of the other options discussed there, could be introduced within the next three or four years.

Capital gains tax

98. A second possible approach is to make further reductions in the burden of capital gains tax, which is of course something to which the Government is already in principle committed. Again, this could be done in a number of ways. The most straightforward would be an increase in the £3,000 annual exemption introduced in the Finance Act 1980. An alternative would be to introduce separate exemptions for husband and wife, which would eventually be necessary in any event if the mandatory independent taxation option in the Green Paper were to be adopted.

99. A further suggestion in this area is a capital gains tax rollover relief for individuals who re-invest the proceeds of sales of shares in other qualifying securities, along the lines of the relief which already exists for the replacement of certain business assets. The main beneficiaries would be expected to be fairly wealthy investors, the less wealthy already being substantially assisted by the annual exemption which may well take them out of charge altogether. The cost is difficult to quantify. If the relief was restricted to the proceeds of sales of equities re-invested within the same Stock Exchange account, and present patterns remained unaltered, it could cost up to £20 million. But some behavioural changes to get within the relief would be inevitable and the cost would be increased accordingly.

100. The intention would be to remove an impediment to efficient portfolio management by private investors which is not shared by gross funds. Even if those concerned took full advantage of the annual exemption, it could, however, have the effect of locking them into the market as a result of the ever-increasing tax cost of getting out (when the previously deferred charges would catch up with them). Perhaps more importantly, if confined to equities it would introduce a further distortion into the system. There would be strong pressure to extend it to unquoted shares and securities and it would in practice be difficult to exclude land, given the relative ease with which this can be converted into the form of shares by transfer into corporate ownership. This could add considerably to the cost, which could be increased to anything up to £200 million.

Reduction in transfer stamp duty

101. At present, transfers of equities incur a stamp duty charge of 2 per cent, except for overseas residents who pay at a rate of 1 per cent. Transfers of gilts and most other forms of fixed-interest stock (including corporate debentures) are exempt. Transfers of property (including houses) are exempt below £20,000 and subject to a reduced scale between £20,000 and £30,000. The anticipated yield from stamp duty on stocks and shares in 1980-81 is £235 million.

102. Stamp duty accounts for a fairly substantial part of the total transactions cost involved in buying or selling securities. It is widely regarded in the market as a major impediment to stimulating greater personal investment, though the comparatively small effect on volume of the doubling of the stamp duty rate in 1974 lends only limited support to this view. The "round trip" cost of buying a share in amounts of less than £7000 and subsequently selling it is currently around 8 per cent (including the jobber's turn as well as the broker's commission), of which stamp duty is responsible for one quarter.

103. A reduction in duty to, say, 1 per cent (as urged in the Stock Exchange's recent Budget representations) would probably directly reduce revenue by around £105 million, allowing for some increase in turnover. More than half of the benefit of this would, of course, accrue to the institutions.

104. In practice, however, it would be difficult to restrict a reduction in the rate of duty to equities and exclude other property. As already mentioned, it is relatively easy to convert land into the form of shares by transferring it to corporate ownership; and it might politically be very difficult to exclude transfers of housing over the present £20,000 threshold. The result could be to add very substantially to the revenue cost. An across-the-board reduction in stamp duty to 1 per cent would cost around £275 million in 1980-81, of which less than a third would go to equities. It is sometimes suggested that this could be offset by the simultaneous imposition of stamp duty on transfers of gilts. But this is not in

practice feasible for legal reasons associated with the prospectus documents, even if the case in principle for such a change was accepted.

105. A possible alternative to a general cut in duty would be an exemption or special rate of duty for small purchases of shares. This would, however, encourage the splitting of transactions into smaller parcels, which would increase transactions costs. No effective counter to this kind of splitting is available since stamp duty is geared both legally and administratively to looking at documents relating to individual transactions and not, as with many other taxes, at a series of transactions involving one person. The revenue cost would therefore be likely to be high in relation to the benefit really going to those acquiring small parcels of shares to form part of a modest portfolio.

Reallowance of interest

106. The final suggestion is to reallow tax relief for interest paid on borrowing, possibly subject to an upper limit of, say, £3,000.

107. This is, of course, an issue with a long history. The argument for the relief in this context is that if an individual needs temporary liquidity he cannot borrow against the collateral of any equities he may hold and get relief on the cost of borrowing corresponding to the tax paid on the income arising from his portfolio. If, however, he sells the shares he might be faced by a capital gains tax liability. The effect may be to reduce the attraction of holding shares by comparison with, for example gilts or building society or bank deposits.

108. It would, however, be very difficult to provide relief in this way and exclude hire purchase and other consumer credit debt. The revenue cost would then be very substantial indeed, possibly of the order of up to £500 million even if relief were confined to the basic rate, and the monetary implications would be most unwelcome. The administrative costs could also be fairly substantial. Finally, much of the case for any general change would, of course, fall to the ground if it were possible to make a further substantial increase in the capital gains tax threshold. It might, however, be possible to look again at the existing relief for the cost of borrowing undertaken to purchase shares in private companies to see if it is too tightly drawn.

## VII CONCLUSION

109. This report has examined the fiscal treatment of the two main forms of institutional saving, and that of individuals investing their savings directly in the equity market, in the context of a continuing shift in the ownership of equity capital away from individuals towards the institutions. This shift is presently proceeding at a rate of about 2 per cent a year. While we do not necessarily subscribe to some of the more extreme forecasts, some considerable further growth in institutionalisation is in prospect as existing funds continue to

mature and because of other developments which could lead to fairly substantial additions to pension liabilities. There is no conclusive evidence that it has damaged the effectiveness of the capital markets, but a number of potential causes of concern undoubtedly exist. Moreover, a wider degree of direct share ownership is also often regarded as a desirable objective in its own right.

110. Against this background, our main conclusions are as follows.

111. First, the causes of the trend towards greater institutionalisation are by no means confined to the tax advantages of saving through life assurance and pension funds. Institutional factors have also been important; and individuals' investment preference have been affected by inflation and by the fiscal treatment of owner-occupied housing. It follows that action in these areas might be necessary if a reversal of the present trend is to be achieved.

112. Secondly, our broad conclusion is that distortions in the pattern of savings would be countered more effectively by general measures to increase the relative attractions of equity investment than by replacing one form of specific bias with another.

113. We have considered a number of suggestions of this kind involving changes in the investment income surcharge, reductions in the burden of capital gains tax, a reduction in the transfer stamp duty and re-allowance of interest. We would give greatest priority to the first two of these.

114. Thirdly, a number of the possibilities in this area involve changes in the present treatment of husband and wife, which could be justified in terms of the removal of existing inequitable discriminations and might therefore be less contentious politically. For example, separate thresholds for husband and wife could be introduced for the investment income surcharge and for capital gains tax. The effect of such changes is difficult to assess, particularly because of the inadequacy of information about wives' investment income and capital gains. But in principle there should be a greater incentive to saving and direct investment arising from the reduction in the overall tax burden on married couples where both partners have substantial investments. Reactions to the Green Paper may help to indicate how far such changes would be generally acceptable.

115. Fourthly, we do not favour the introduction of a general relief for direct personal investment in equities along analogous lines to the Loi Monory (though we recognise that somewhat different considerations apply to a relief confined to investment in small companies).

116. Fifthly, with the exception of the representative of the Department of Trade, we believe there to be a case for at least a substantial further reduction in life assurance premium relief. How this should be achieved would require further consideration in the light of the difficulties which might be caused for policyholders and the insurance industry. One possibility would be to remove it altogether from new policies taken out after some future date; a second is to make a phased reduction over a fairly substantial period in the rate at which relief is given on premiums paid on existing policies; a third is to do both. We recognise, however, that such changes, worthwhile though they might be, would not immediately release a great deal of additional revenue nor substantially reduce the total volume of institutionalised saving.

117. The outside members of the group believe that any reduction in life assurance premium relief should be balanced at the same time by changes in other areas, such as those discussed in paragraph 113, so as to maintain the overall incentive to saving. Mr Stewart has suggested that one other possibility, described in more detail in his note at Annex 8 but raised too late to be discussed by the group as a whole, would be an SAYE share purchase scheme for employees in unlisted companies providing for investment in authorised unit or investment trusts.

118. Finally, we believe that there is a case in principle for taxing the lump sum element of pensions. But the additional revenue raised might be fairly small, the effect on the balance between personal and institutional investment could, if anything, be unhelpful and there would be a number of practical difficulties. We do not therefore recommend any change in this area at the present time, though the possibility of introducing a flat rate cash limit on the amount of pension which can be taken tax-free in the form of a lump sum, in addition to the existing proportional limit, could be given further consideration.

## ANNEX 1: OUTSIDE MEMBERS OF THE GROUP

| | |
|---|---|
| Ronald Artus | (The Prudential) |
| John Critchley | (Chartered accountant) |
| Roger Plant | (Estate Duties Investment Trust Ltd) |
| Anthony Rudd | (Rowe Rudd and Co) |
| Ian Stewart MP | |

ANNEX 2

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Ronald Artus Esq
Chief Investment Manager
Prudential Assurance Co Ltd
Chief Office
High Holborn
London EC1

/ July 1980

Dear Ron,

WORKING GROUP ON TAX AND SAVINGS

From time to time doubts are expressed - most recently by the Wilson Committee - about the pattern of tax reliefs for different types of savings. As you know, some forms of savings receive very generous tax treatment indeed - eg savings for life assurance and superannuation purposes - while other types of savings receive no tax relief at all - such as personal direct investment in equities. The doubts which are expressed stem partly from the fact that some of the reliefs were introduced largely for historical reasons which seem out of place in our current circumstances. And partly, I think, because the very existence of a multiplicity of reliefs both complicates the tax system and erodes the tax base, making the rates of income tax higher than they might otherwise be. On the other hand, there is frequent complaint that no reliefs are available for direct investment by individuals in equities, even though there is an acknowledged need to encourage wider share ownership.

There are clearly a lot of major questions to be considered here, with wide ramifications. We have been giving them some thought within the Treasury. To carry this further, I plan to set up within the Treasury a small working group which will, I hope, look at both the case for the main tax reliefs for "institutional" investment - such as investment in life assurance and superannuation companies -as well as the case for introducing new tax reliefs for direct personal investment in equities. I am also asking the working group to examine, amongst other things, the French Loi Monory scheme which, within limits, gives the individual tax relief for equity investment.

I have in mind that the working group could most usefully consist of officials and people from outside Whitehall. The outsiders would be chosen on the basis of their first-hand knowledge of both the working of the city institutions, and the financial needs of productive industry. The chairman of the group will be Peter Middleton, Deputy Secretary in the Domestic Economy Sector of the Treasury. The officials will be drawn from a number of Whitehall Departments which have an interest in these issues. I plan to invite about half a dozen others, to become members of the group, and I very much hope that you will agree to be one of them. I need hardly add that this invitation is made to you on a personal capacity.

I do not think you would find that membership of the group would involve a great deal of your time. What I envisage is that the group will hold half a dozen or so meetings between now and, say Christmas, and produce a report which could be considered by Ministers before next year's Budget. If you felt you needed any further information about the proposal I am sure that Peter Middleton would be happy to have a word with you (his telephone number in the Treasury is 01-233-5627).

I plan to make an announcement in fairly general terms in due course, that a number of people outside Whitehall will be associated with this study of tax and savings. Until I do so, I should be grateful if you would treat the contents of this letter as confidential.

I do hope you will feel able to help.

GEOFFREY HOWE

## ANNEX 3: LIST OF PAPERS CIRCULATED TO THE GROUP

1980

1 Institutional and personal investment in equities: note by the Treasury
2 Life assurance premium relief: note by the Revenue
3 Tax relief on superannuation: note by the Revenue
4 Personal investment in equities: note by the Revenue
5 Taxation of life assurance companies: note by the Revenue
6 Future meetings
7 The work of the Group: note by the Chairman
8 Tax relief for investment in private businesses: paper by the AIB
9 Membership of the group: note by the Secretary
10 Dates of future meetings
11 Profit - sharing schemes: note by the Revenue
12 Costs of tax reliefs for savings: note by the Revenue
13 Taxation of dividend income: note by Mr Plant
14 Taxation of life offices and life assurance premiums in Australia: note by the Secretary
15 Equity ownership, the sprats and the dolphins: note by Mr Rudd
16 Tax treatment of life assurance in the EEC: note by the Revenue
17 A general relief for contractual savings: note by the Revenue
18 Tax paid by life assurance companies: note by the Revenue
19 Industrial life assurance: note by the Secretary
20 Occupational pensions: note by the DHSS
21 Comparative benefits of saving in different forms: notes by Mr Critchley and the Revenue
22 Some interim comments: note by Mr Artus
23 Draft report
24 The relative importance of listed and unlisted companies: note by the Treasury
25 The taxation of dividend income: note by the Revenue
26 Two notes by Mr Critchley: life assurance premium relief and lump sum payments
27 Personal share investment: note by Mr Plant

1981

1 Capital gains tax rollover relief for shares and securities: notes by the Revenue and Mr Plant
2 Life assurance premium relief: note by the Department of Trade
3 Possible changes in the tax treatment of husband and wife: note by the Revenue
4 Draft report: second version
5 Comparative revenue costs of various general savings reliefs: note by the Revenue

ANNEX 4: TAX TREATMENT OF LIFE ASSURANCE IN OTHER COUNTRIES

| Country | TAX TREATMENT OF PREMIUMS | | Tax Treatment of Life Fund Income | Tax Treatment of Policy Proceeds |
|---|---|---|---|---|
| | Limitations | Special Conditions | | |
| USA | No relief | - | Special tax deductions for insurers | Taxable only to the extent that they exceed the consideration paid. Proceeds paid on death exempt. Income-averaging may also apply. |
| Canada | No relief | - | Special tax deductions for insurers | Excess over premiums paid taxable except where proceeds paid following death - these are exempt |
| Japan | Deductible in full up to 25,000 Yen Between 25,000 & 50,000 Yen, deduction is 25,000 + 50% of excess over 25,000<br>Between 50,000 & 100,000 Yen deduction is 37,500 Yen + 25% of excess over 50,000<br>Maximum relief: 50,000 Yen | Not deductible if paid if foreign insurance companies or if a benefit is paid within 5 years. | No special treatment known | Probably taxable as "miscellaneous" income or "occasional" income if the latter 500,000 Yen + ½ balance is deductible |
| Belgium | Deductible from earned income only, up to 15% of first 50,000F and 6% of next 625,000F. Maximum deduction 45,000F (about £650), including mortgage protection. | Own life premiums only. | No special treatment by statute. Not known if any given by administrative rules. | Generally taxable if relief given for premiums. Reduced liability if surrendered within 5 years of maturity. |
| Denmark | Deductible, maximum deduction for premiums plus certain other payments is 3,000 Kr (about £225). | Own life premiums only. | No special treatment by statute. Not known if any given by administrative rules. | Not generally taxable. |
| France | Maximum deductible 3,250F (£325) plus 600F (£60) for each dependent child. | Endowment policies must have a duration of at least 10 years. | No special treatment by statute. Not known if any given by administrative rules. | Not generally taxable. |
| West Germany | Deductible subject to a limit including also social security and building and loan contributions, which varies with marital status and number of dependent children. | - | Policyholders' income and reserve to meet claims generally exempt. | Not generally taxable. |
| Ireland | Deductible up to ½ premiums paid subject to limit of lesser of 6% of total income or £I.1,000. | Endowment policies must have a duration of at least 10 years. Eligible premiums may not exceed 7% of capital sum assured. | Policyholders' income generally exempt. | Not generally taxable. |
| Italy | Joint limit to deductions for life, sickness and accident insurance premiums and voluntary social security contributions 2,500,000L (approx. £1,200). | Insurances on life of taxpayer, spouse and dependent children only. | Reserve required by law exempted. | Proceeds on surrender within first 5 years taxed at 10%. Otherwise not taxed. |
| Luxembourg | Deductible up to approx. £350 (single) £700 (married) plus allowance for dependent children. | Insurances on life of taxpayer, spouse and dependent children only. Endowment policies must have a duration of at least 10 years. | No special treatment by statute. Not known if any given by administrative rules. | Not taxable. If policy is surrendered premium relief is recovered. |
| Netherlands | No general relief. | - | Policyholders' share of profits, and reserve to meet claims generally exempt. | Excess over premiums paid is generally taxable unless the occasion is death under 72 years of age. |

ANNEX 5

## LIFE ASSURANCE PREMIUM RELIEF: NOTE BY THE DEPARTMENT OF TRADE

This note seeks to analyse the probable effect on life assurance companies of the abolition of life assurance premium relief (LAPR) on (1) new policies and (2) existing policies. Under present rules a policy qualifies for LAPR if it runs for at least 10 years, but the relief is not claimed back on lapsed policies if at least four annual premiums have been paid. The note has been written in consultation with the Government Actuary's Department but the judgements are essentially subjective. Quantification of the effects has not been possible. There has been no consultation with the industry except that the forecast of the way in which the industrial life companies would react has been made in the light of advice kindly provided by Mr Artus.

### ABOLITION OF LAPR ON NEW POLICIES

#### Endowment Policies

2 These are the mainstay of the business of the traditional companies. Although they provide substantial life cover throughout their currency their purpose is mainly saving and the majority are with-profits. With high inflation the return to a policyholder is not particularly attractive. Withdrawal of LAPR would raise the annual cost of a given return to the policyholder by 21% compared with the cost in 1980/81. It seems certain that without the incentive of LAPR fewer persons would be disposed to take on the commitment of long term saving and there would be a fall in sales.

3 Sales of this type of policy linked to house purchase have been particularly buoyant in recent years. Without LAPR for most people this route would not compare favourably with repayment mortgages offered by Building Societies and it seems likely that sales of such policies would be considerably reduced.

4 Although the reserving of life companies should enable them to meet their obligations even if new business disappears, at a time of high inflation the expenses of servicing old policies with relatively low premiums are in part borne by the proceeds of new policies. A sharp reduction in new premiums means that expense ratios rise and the return to policyholders becomes less. This reduction applies to an extent to the holders of old policies as well. Most traditional companies pay substantial bonuses to with-profit policyholders and they can vary the rate at which they are declared at any time. If new business falls heavily they are likely to be reduced.

5 If policyholders believed that the return on their policies would fall their propensity to discontinue their policies would increase; and this would exacerbate the effect of falling new income.

#### Linked Policies

6 The advantage of a linked policy over regular saving with a unit trust is partly life cover and partly the benefit of LAPR.

If the life cover is small the effective selling point is LAPR. The value of units credited after taking account of expenses is normally greater than the premium (net of tax relief) actually paid. If LAPR is withdrawn this sales point disappears and unit trusts are likely to be preferred. They are exempt from capital gains tax and individuals can realise units and take a profit up to £3,000 a year without capital gains tax. Hence premiums on new regular premium linked policies will decline steeply. Part of this saving may go into unit trusts but a significant part will also go into consumption, as there will be no commitment - as there is with a life policy - to regular saving.

Industrial Life

7 The expenses of industrial life policies are already high. The addition of 21% to the cost of a given return would make them less attractive. Rationally this business ought to fall steeply. In practice salesmanship would mitigate that effect.

Single Premium Policies

8 These policies which attract a substantial flow of funds do not enjoy LAPR and would be unaffected by abolition. They are issued on attractive terms by companies who have no tax liability because of credits carried forward and even with companies in a normal tax position they may be an attractive investment to high tax payers.

Term Policies

9 Term policies are not savings policies. Their attraction does not lie in LAPR and the volume of business flowing into them would not be much affected. They tend to be relatively unprofitable. Even if there was some increase in term insurance eg to cover the risk of death by mortgagors the return to the companies would be very modest. Premiums might have to rise if this business had to carry a significant share of life company expenses.

ABOLITION OF LAPR ON EXISTING AS WELL AS NEW POLICIES

Endowment Policies

10 The effect of abolition would be to raise the annual cost of a given return by about 21% compared with the cost in 1980/81. A proportion of these policies is surrendered every year and it is likely that it would rise significantly. More would also be converted into paid-up policies. In sum the effect on life companies would certainly be a reduced premium income and it is possible that surrenders would oblige some to disinvest.

11 Endowment policies covering house purchase are a special case. It would not be easy for the house purchasers to surrender. Many policyholders have committed themselves to the limit to finance house purchase. An increase of 21% in the premiums on the policy providing for the repayment of capital might involve some hardship, particularly if it took effect at a time when interest rates were rising.

## Linked Life Policies

12 The penalties on surrendering a linked policy are often not as great as for traditional whole life and endowment policies. Few would want to increase their premium by 21% for a given return and surrenders and conversions to paid-up would be numerous.

## Industrial Life Policies

13 Since most benefits were increased (rather than the premiums reduced) when the LAPR system changed the industrial offices would seek to reverse this arrangement as they are doing when LAPR is reduced in 1981/82. It is probable that if there were a further reduction many policyholders would feel cheated and convert to paid-up or surrender. Although salesmanship would mitigate this there would be serious consequences for the smaller companies whose expense ratios are already very high.

## Single Premium Policies

14 There would be no effect.

## Term Policies

15 It is not likely that there would be any significant effect on policies of this type.

## POLICYHOLDER REACTION: SUMMARY

16 In summary if the withdrawal of LAPR was limited to new policies there would be a decline in the inflow of funds into endowment policies taken out for savings purposes only and marked reduction in endowment policies issued in conjunction with house purchases. Sales of regular premium linked policies would also fall very steeply. Together these make up the bulk of the life offices' business qualifying for LAPR. Rationally industrial policies should attract far less savings but the salesforce might delay this. Term insurance, whole life policies and single premium policies would be little affected.

17 If abolition applied to all policies there would be more surrenders of endowment and linked policies and a substantial conversion to paid-up policies. The psychological effect of withdrawing relief on old and new policies together would be very much greater and policyholders would tend to feel cheated and to terminate contracts where it was not prohibitively costly.

## PROFITS FROM LIFE ASSURANCE

18 Because of the greater impact of overheads with a smaller volume of business there would be some decline in profits if withdrawal was limited to new policies; and a greater decline if withdrawal applied to all policies. Since many life companies are mutuals and since conventionally 90% of profits in proprietary companies go to with-profits policyholders the effect of withdrawal would be felt not only through the increased premiums but through

reduced benefits. There is likely to be an adverse effect on existing policyholders even if withdrawal affected only new policyholders.

WHERE THE MONEY WILL GO

19 Predictions about the proceeds of surrendered policies are mere guesses. The probability is that much of it would go to consumption. Not much would go into equity holdings. If the sums are large enough to make this sensible surrender is unlikely to be rational. Very large policies are often taken out for reasons unconnected with LAPR.

20 As to new savings those who do not want to put their money into a long term scheme are likely to opt for regular purchases in unit trusts; and those who are prepared to make a long term commitment have an attractive option in taking out pension policies where the premiums are wholly deductible for tax purposes. This will be easier for the self-employed and those not in an occupational scheme but it should be possible also for most of those in approved private schemes by way of additional voluntary contributions. At present there is little scope for brokers to develop this kind of business, but since their present sources of income will be largely cut off their resource in finding new ways of developing business should not be underestimated.

21 In the long run it is likely that the life companies will develop new policies emphasising the life cover available and playing down the savings element. But much less money will find its way into life assurance. Term life cover at lower rates of premium is likely to replace some endowment policies.

EFFECT ON LIFE COMPANIES

22 The effect on individual life companies will vary according to their portfolios. If withdrawal applies to new business only those worst affected are likely to be the relatively young companies set up to develop linked policies. Their main selling point vis-a-vis unit trusts will go. Some of them may not want to continue to take new business. If so, they will have to be run as closed funds with all the disadvantages that entails of lost investment flexibility and rising expenses. Many are likely to be forced into mergers to remain viable. In principle all these companies should be able to meet their liabilities, but a steep decline in business could cause a crisis. If the withdrawal of LAPR applied to existing business also there would be more surrenders and the run down might be so rapid that some would become insolvent.

23 The long established companies with much of their portfolios in traditional with-profit policies are in a stronger position. But some of them have concentrated heavily on mortgage linked endowment policies and new business of this character might be greatly reduced causing a substantial fall in new premium income. Rising expense ratios are already something of an anxiety especially for some of the smaller companies and would be exacerbated if new business fell substantially. This would be reflected in lower bonus rates, but as the return fell surrenders would receive some stimulus and that would reinforce the vicious circle.

24 Many large companies have pension business which would be unaffected by LAPR. Although the pension policyholders would be unlikely to tolerate the subsidising of the ordinary life business out of pension business the sharing of common expenses would ease the problems to some extent. But for companies without significant pension business - in practice the smaller and less dynamic ones - the effect might be serious. The most vulnerable would be those also heavily committed to mortgage related policies. Although in principle all should be able to meet their liabilities the possibility of failures among small companies cannot be ruled out.

25 If withdrawal of LAPR applied to existing as well as new policies the effect would be greater and more quickly felt as income from the old policies would also fall. The psychological effect would also be much greater.

26 In summary the withdrawal of LAPR on new policies would be likely to cause serious difficulties for companies concentrating on linked business and on mortgage-related policies. A number of mergers and take-overs among the former would have to follow. Among the traditional companies the fall in new business would probably be reflected in lower returns to with-profits policyholders and there would probably have to be mergers to reduce the number of small companies. If withdrawal was total the decline in existing as well as new business would greatly increase the ill-effects and there would be a risk that the industry could not be restructured quickly enough to avoid some failures.

A REDUCTION IN LAPR

27 The first results from 1980 show that ordinary life business may well have been rather smaller that year than in 1979. Certainly the buoyancy of recent years has been lacking. Pension business appears to have grown less than recently. This was expected. There has been no suggestion that the impending reduction in the LAPR rate from 17½% to 15% has been a factor in the levelling off. It is therefore worth considering whether a further reduction after a year or two could be imposed without ill-effect.

28 Objectively it seems likely that relief at the rate of say 12½% - ie half the standard rate of tax at which the Government aims - would have a significant incentive effect on saving through life companies. But the psychological effect has also to be considered. One reduction is impending. The companies cannot give effect to any change without a period of notice. Hence a further reduction would not be possible for another year or two. If there were then a further change the impression would probably be created that LAPR was in the course of being phased out and the fall in the mortgage related business and possibly in the linked business would begin at once though the latter would have its full effect fairly slowly. If LAPR had been fixed at 12½% instead of 15% for 1981/82 and onwards the effect on the volume of savings would not have been very large. But as 15% was in fact chosen a further reduction to 12½% would have a different and more damaging psychological effect. For the sake of the small amount of revenue gained the potential damage to the life assurance industry does not seem worthwhile.

Department of Trade
15 January 1981

## ANNEX 6: CALCULATION OF THE COST OF THE TAX RELIEF GIVEN TO SUPERANNUATION

The figure of £700 million mentioned in paragraph 59 is made up as follows:

| | £ million |
|---|---|
| Yield from disallowing employees' contributions | 850 |
| Yield from taxing investment income of pension funds, net of resulting tax credit for pensioners | 750 |
| Yield from taxing income element of pensions in payment | 350 |
| | 1950 |
| Less tax now payable on pensions | -1250 |
| Cost of present reliefs | 700 |

## ANNEX 7: TAX TREATMENT OF SUPERANNUATION IN OTHER COUNTRIES

| COUNTRY | TAX TREATMENT OF PENSION FUNDS | | | | | | TAX TREATMENT OF PENSION PAYMENTS | | STATE PENSIONS |
|---|---|---|---|---|---|---|---|---|---|
| | EMPLOYER'S CONTRIBUTIONS IN HANDS OF | | EMPLOYEE'S CONTRIBUTIONS | INVESTMENT INCOME OF FUND | CAPITAL GAINS OF FUND | COMMENTS | LUMP SUMS | OCCUPATIONAL RETIREMENT PENSIONS | |
| | EMPLOYER | EMPLOYEE | | | | | | | |
| REPUBLIC OF IRELAND | DEDUCTIBLE | NOT TAXABLE | DEDUCTIBLE | EXEMPT | EXEMPT | Combined deductible employer and employee contributions must not exceed 15% of an employee's remuneration. | The greater of £3,000 or 1/20 x average salary of last 3 years x number of years of service is exempted from tax; the rest is taxed normally. | FULLY TAXABLE | Pensions are fully taxable. Contributions are not deductible. |
| DENMARK | DEDUCTIBLE | NOT TAXABLE | DEDUCTIBLE | EXEMPT | EXEMPT | – | A 35% duty is payable. | Fully taxable subject to certain special reliefs for pension income generally. | Pensions are fully taxable. Contributions are a percentage of taxable income and are not deductible. |
| FRANCE | DEDUCTIBLE | NOT TAXABLE | DEDUCTIBLE | See Comments | NOT TAXED | i. French dividends are exempt from tax, but nevertheless the tax credit attaching to them is granted to pension schemes<br>ii. Other fund investment income including real property is taxed at rates of between 10% and 24% compared with the normal company tax rate of 50%. | These are believed to be tax free. | Taxable. A reduction of 10% is allowed (minimum 1,800F, maximum 6,700F), and a further reduction of 20% of the remainder of the pension (up to 360,000F). | Fully taxable with the same reliefs as for occupational retirement pensions. Contributions are deductible. |

| COUNTRY | TAX TREATMENT OF PENSION FUNDS | | | | | | TAX TREATMENT OF PENSION PAYMENTS | | STATE PENSIONS |
|---|---|---|---|---|---|---|---|---|---|
| | EMPLOYER'S CONTRIBUTIONS IN HANDS OF | | EMPLOYEE'S CONTRIBUTIONS | INVESTMENT INCOME OF FUND | CAPITAL GAINS OF FUND | COMMENTS | LUMP SUMS | OCCUPATIONAL RETIREMENT PENSIONS | |
| | EMPLOYER | EMPLOYEE | | | | | | | |
| GERMANY | DEDUCTIBLE | Taxable on the employee in principle, but see comments (a). | Deductible within limits | EXEMPT<br>Numerous conditions have to be fulfilled; ie there is a limit on the monetary amount of individual pensions that the fund can pay out. | EXEMPT | a. within certain limits the employer may it-self assume the tax at a rate of 10%<br>b. There are several types of company pension funding in use.<br>These rates relate only to the UK-type super-annuation fund. The tax regime is very complex and the rates should be read in that light. | Exempt (apparently) | Taxed as purchased life annuities, but only on the interest element. | Most social security pensions, including old age pensions, are not taxed. Where pensions are taxed they are taxed as purchased life annuities.<br>Contributions are deductible within limits. |
| AUSTRALIA | DEDUCTIBLE But see comments (i). | NOT TAXABLE | See comments (ii). | Generally exempt | Not in principle chargeable to tax. | i. Deductible generally within the limit of A $400 or 5% of the remuneration of each employee, whichever is greater, per year.<br>ii. Pension contributions, life assurance premiums etc up to A $1200 are among the expenses qualifying for the general concessional tax rebate. A rebate of 33.07% of all these expenses is given to the extent that they exceed A $1500. | 5% taxable. | Fully taxable. | Fully taxable. There are no social security contributions. |

| COUNTRY | TAX TREATMENT OF PENSION FUNDS | | | | | | TAX TREATMENT OF PENSION PAYMENTS | | STATE PENSIONS |
|---|---|---|---|---|---|---|---|---|---|
| | EMPLOYER'S CONTRIBUTIONS IN HANDS OF | | EMPLOYEE'S CONTRIBUTIONS | INVESTMENT INCOME OF FUND | CAPITAL GAINS OF FUND | COMMENTS | LUMP SUMS | OCCUPATIONAL RETIREMENT PENSIONS | |
| | EMPLOYER | EMPLOYEE | | | | | | | |
| JAPAN | DEDUCTIBLE | NOT TAXABLE | NOT SPECIFICALLY DEDUCTIBLE (See comments) | NOT TAXABLE | NOT TAXABLE | A generous employment income relief is meant to cover an employee's expenses with the exception of social security contributions. | a. Service 20 years or less - deduct 250,000 yen per year of service, with minimum deduction of 500,000 yen.<br>b. Service over 20 years — deduct 5,000,000 yen + 500,000 yen for each year of service over 20 years.<br>In both instances 50% of the remainder is taxed separately from other income on the general income tax scale. | Taxed as employment income | Treated as employment income. Contributions, unlike other employee expenses, are fully deductible. |
| CANADA | DEDUCTIBLE (See comments) | NOT TAXABLE | DEDUCTIBLE (See comments) | GENERALLY EXEMPT | GENERALLY EXEMPT | Both employer (in hands of employer) and employee contributions are deductible within a limit of $ 3500 for each employee per year. | These are fully taxable, but income averaging provisions can be applied to them. | Fully taxable | Fully taxable. The ordinary old age pension is funded from general revenue, but the supplementary (Canada Pension Plan) pension is funded by contributions which are deductible. |
| USA | DEDUCTIBLE | GENERALLY NOT TAXABLE | DEDUCTIBLE | EXEMPT | EXEMPT | — | Generally lump sum distributions are taxable. Complex rules govern the proportion of the lump sum subject to tax, and in some instances the taxable portion may be reduced to nil. | Taxed as purchased life-annuities. | Exempt from tax. Contributions are not deductible. |

## ANNEX 8: NOTE BY MR STEWART

Our report comes to the broad conclusion that distortions in the pattern of savings to the disadvantage of direct investment in quoted ordinary shares should be countered by general measures to increase the relative attractions of equity investment rather than by replacing one form of specfic tax bias with another. Although I generally agree with this. I would like to make one positive proposal for consideration.

2. The SAYE terms coupled with share options are not particularly generous in themselves, and the attractions of the scheme are mainly in the potential for capital gain in the value of shares under option. For many practical reasons such schemes are only available to employees of public companies. For others I wonder whether it would be practicable to introduce an SAYE share purchase scheme instead, providing for investment in, say, authorised unit or investment trusts. The shares would have to be purchased at the outset by a trust fund for employees, and I realise that this would involve financing costs. But if such a scheme proved feasible I think it would be more deserving of tax subsidy than life assurance premium relief, which has been used to achieved similar ends (e.g London and Manchester).

3. Obviously this is much too late and embryonic an idea for Budget consideration this year, but I would be interested to know if it seemed workable on examination. It would be consistent with several of the objectives identified by the Working Group.

Ian Stewart

Econ. Pol. March 80.

Econ Pol.

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/10228/80

Your ref:

15 January 1981

Dear Geoffrey

TAX AND HOUSING: ADMINISTRATION OF MORTGAGE INTEREST RELIEF

Thank you for your letter of 9 January.

I am reassured to learn that there is no intention of the revised scheme for the payment of tax relief being undertaken by my Department and I now accept that the staff savings which you hope to secure justify the study being made. I would, of course, be ready to associate my officials with the work of the proposed study team.

I remain of the view that there will be difficulties in convincing the lending institutions that they should accept the additional burden the scheme will involve for them. However, I do not object to a public announcement of your proposals and I have no substantive comments on the draft Answer attached to your Private Secretary's letter of 31 December.

I would, however, urge you to give the Building Societies Association some advance notice of the proposed study, a step which might prevent them from making a hasty and potentially hostile response, such as Press comment on possible implications for the mortgage rate. You will no doubt also have it in mind to tell the other lending institutions of the study at the time it is announced, although I doubt whether they would need advance warning.

I am copying this letter to the Prime Minister.

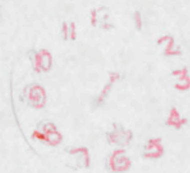
yours ever

Michael

MICHAEL HESELTINE

Rt Hon Sir Geoffrey Howe MP

15 JAN 1981



ECON POL

Await DoE reply

MAP

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

9 January 1981

The Rt. Hon. Michael Heseltine MP
Secretary of State for the Environment

BF 20/1/81

Dear Michael

You wrote to me on 5 January about the review of the mortgage interest relief arrangements which we are planning to announce when the House comes back after the Christmas Recess. As you will now have seen the Prime Minister has agreed the text of the proposed Question and Answer.

I am sorry that it was not made clearer that the scheme the Prime Minister has agreed should be discussed with the lending institutions would not, unlike some of its predecessors, fall to be administered by your Department. When proposals of this kind have previously been considered they have, I am told, usually involved an extension of the option mortgage scheme. I do not now think that this would be a viable option. We have therefore been examining a scheme to be administered by the Revenue under which all (or most) borrowers would, as was commonly the case for other forms of interest prior to 1969, pay interest to lenders net of a deduction at the basic rate. Relief at the higher rates would continue to be given through the tax system. Clearly, however, if a scheme on these lines got off the ground we would need to consider whether the option mortgage scheme still had a role to play and it would, I am sure, be helpful if a member of your Department were to join the study team it is proposed to set up once the public announcement has been made.

As you rightly point out when schemes along these lines have been considered in the past the conclusion reached was that significant staff savings were dependent on the abolition of higher rate relief. As a result of the changes I have made in my two Budgets this problem has been largely overcome. In 1976/77 there were over 1.4 million higher rate taxpayers whereas today there are only

/about 0.7 million

about 0.7 million of which less than half a million are entitled to mortgage interest relief. We are now therefore hopeful that it will be possible to devise arrangements under which we shall be able to achieve eventual net savings of several hundred staff: there will however be a temporary need for additional staff in the period over which the present tax relief arrangements are phased out and the new ones introduced. But we do not envisage any significant staff costs falling on your Department. Indeed to the extent that the new scheme led to a drop in the demand for option mortgages there might I suppose be some small staff savings in DOE as well as the substantial staff savings in the Revenue.

I do not underestimate the difficulty of persuading the building societies and other lending institutions to go along with our plans. There will certainly be some additional costs falling on these institutions and we may, as you say, be pressed to make a financial contribution. This however is a bridge we can cross when we reach it. Computerisation has reduced some of the problems that have previously stood in the way of schemes of this kind and the new life assurance arrangements, while certainly not on all fours with the proposed new arrangements for mortgage interest, have served to pave the way for something in the lines of the proposed plan. We cannot really take the proposals any further without involving the lending institutions in the discussions and we cannot safely do this without a public announcement. A further study by officials would similarly run the risk of a lead - quite possibly a misleading one - which could damage the success of the scheme and could only delay the realisation of the projected staff savings.

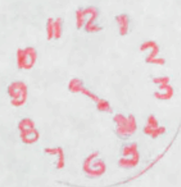
As the draft Answer makes clear we are not at this stage committed to introduce a deduction of tax scheme and there will be adequate time to look at the housing and other implications of the proposal whilst the technical review is in progress. As however the proposed scheme does not involve any changes in the amount of relief provided to owner-occupiers I would be surprised if the implications for housing policy were major ones.

I am anxious that the proposed review should be announced as soon as possible and I trust that in the light of the explanations provided that you will be content for the proposed Question and Answer to go ahead.

I am copying this letter to the Prime Minister.

GEOFFREY HOWE

-9 JAN 1981



2

10 DOWNING STREET

PRIME MINISTER

You agreed last week that the Chancellor could go ahead with an arranged PQ about a possible scheme for "mortgage interest relief at source".

Mr. Heseltine has, somewhat belatedly, argued that any such announcement would be premature. He believes that there are a number of obvious disadvantages to any such scheme, and that an announcement now would merely raise expectations which might not be fulfilled. I understand that he would prefer a quick study of the main issues between the Treasury, the Inland Revenue, and DOE before the Chancellor commits himself to a Parliamentary Answer. He is in discussion with the Treasury now.

MAP

6 January 1981

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/19172/80

Your ref:

5 JAN 81

Dear Chancellor of the Exchequer

TAX AND HOUSING: ADMINISTRATION OF MORTGAGE INTEREST RELIEF

Thank you for sending me a copy of your minute of 28 November to the Prime Minister. I have also seen her Private Secretary's reply of 4 December to yours.

I can see the attraction of saving staff in the Inland Revenue by altering the mechanism by which tax relief is given. I understand that officials in our Departments have in the past looked closely at such a scheme and concluded that significant staff savings were critically dependent upon the abolition of higher rate relief, which is to be retained in your proposal. Indeed the study concluded that there could even be a net addition to civil service manpower. There would certainly be a very costly transition period for at least 2 years, with a net staff increase over that period. In addition, unless DOE staff had access to Revenue records safeguards to accountability would be inadequate.

Secondly, you acknowledge that there would be considerable practical administrative problems. It will be necessary to examine these thoroughly. You mention that higher rate relief would need to be administered separately, presumably by Inland Revenue. In your latest minute you do not say whether you envisage amalgamating the arrangements for standard rate relief with the existing option mortgage scheme. Your minute of 7 August, which I have only just seen, suggests however that you were then proposing that the administration of the new system should fall to my Department. Before I accepted that, I should need to know the staffing implications, and what arrangements were envisaged for policing the entitlement of mortgagors to deduct basic rate tax at source.

Thirdly, the attitude of the building societies and other lenders must be considered. The arrangements recently made for the payment of life assurance premiums net of tax are not an exact analogy. I would expect the building societies to require a lot of persuasion to adopt the suggested new arrangements. Although you visualise

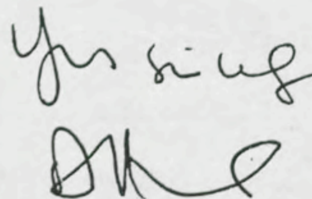
reimbursing the societies the net tax shortfall they would suffer, the administrative burden of the change would be inherently greater than it was for the life insurance offices: the interest component of most mortgage payments alters continually during the life of the mortgage, with consequent changes in the amount of relief.

Unless the Government were prepared to contribute to the administrative costs of the building societies and other mortgagees, I should think that they would have no alternative but to pass on their greater costs in a higher mortgage rate. And whether they would be willing to play their part on that basis - indeed whether the Government should be instrumental in pushing up mortgage costs - must be doubtful.

I conclude that we should look very hard at the implications of moving from the existing arrangements for mortgage interest tax relief to "mortgage interest at source" before making up our minds. Before any approach is made to the building societies and other lending institutions I suggest that the Treasury, the Inland Revenue and my own Department should work out in greater detail what a new system would entail, and what its administrative consequences would be, and what implications it might have for housing policy.

I am copying this letter to the Prime Minister.

Yours sincerely



For MICHAEL HESELTINE

(Letter approved by the Secretary of State and signed in his absence)

-5 JAN 1981

The Rt Hon Sir Geoffrey Howe QC MP

cc Mr Ingham                    20.

10 DOWNING STREET

*From the Private Secretary*

2 January, 1981

Tax and Housing: Administration of Mortgage Interest Relief

The Prime Minister has read your letter of 31 December and is content with the proposed arranged Question and Answer. But she has asked that the press briefing should make it absolutely clear that the quantum of mortgage relief is not going to be changed.

I am sending a copy of this letter to David Edmonds (Department of the Environment).

T. P. LANKESTER

John Wiggins, Esq.,
HM Treasury.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

31st December 1980

T.P. Lankester Esq.
10 Downing Street
LONDON
SW1

Dear Tim,

TAX AND HOUSING: ADMINISTRATION OF MORTGAGE INTEREST RELIEF

In your note of 4 December 1980 you conveyed the Prime Minister's approval of the Chancellor's proposal to examine a scheme of 'mortgage interest relief at source' and to make an announcement to that effect.

An arranged question and answer would be an appropriate method and I attach a draft. As you will see it makes it very clear that there is no intention of restricting the amount of the relief; and that decisions on whether to introduce a new scheme or not are reserved. If the Prime Minister is content with it the Chancellor is minded to have the question answered as soon as is convenient so that the Revenue can open the discussions.

I am sending a copy of this letter to David Edmonds (Department of the Environment).

Yours

John

A.J. WIGGINS
Private Secretary

DRAFT OF ARRANGED QUESTION AND ANSWER

QUESTION: To ask Mr Chancellor of the Exchequer, whether he is satisfied with the present administrative arrangement for giving effect to relief for mortgage interest through the PAYE system.

ANSWER: I can well understand my hon. Friend's concern. The present procedures are administratively cumbersome and impose a high staff cost on the Inland Revenue. There are especial difficulties for taxpayers and for the Revenue when the rate of interest changes. I am therefore asking the Inland Revenue to study, together with the major lending bodies, how the arrangements for giving relief might be altered so as to make them more efficient. Considerations arising from the Option Mortgage Scheme will be taken into account in this study, so far as relevant.

I should make it clear that the purpose of the study is to explore the possibilities and that no decisions will be reached until it has been completed. I should also emphasise that it will be concerned with the mechanisms for giving the relief, and that it is not the Government's intention to restrict the amount of relief to which taxpayers are entitled.

31 DEC 1980

CONFIDENTIAL

FILE Sup
bc. Mr. Ingham
Econ Pol.

10 DOWNING STREET

*From the Private Secretary* 4 December 1980

TAX AND HOUSING: ADMINISTRATION OF MORTGAGE INTEREST RELIEF

The Prime Minister has now considered the Chancellor's minute of 28 November on the above subject. She is content for him to initiate an investigation of the proposed scheme of "mortgage interest relief at source", and that an announcement should be made to this effect. But this is on the understanding that no decision on whether to introduce the scheme will be taken until the investigation is completed.

I am sending a copy of this letter to David Edmonds (Department of the Environment).

T. P. LANKESTER

A.J. Wiggins, Esq.,
HM Treasury.

KRB

CONFIDENTIAL

1

# 10 DOWNING STREET

Prime Minister

Before writing to the Treasury on this, I thought I ought to point out - in case you missed it - that the Chancellor will need to announce that the investigation will take place - because of the need to discuss with the building societies (see last page - x). But as you say, there must not be any commitment at this stage to the scheme. Content?

Yes MT.

TL 3/12

Confidential

Econ Pol

Tx to note

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

2nd December 1980

D. Edmonds, Esq.,
Private Secretary to
the Secretary of State,
Department of the Environment

Dear David,

Your office asked me for a copy of a minute the Chancellor sent to the Prime Minister on 7 August about taxation and housing.

With the Chancellor's agreement, I am now enclosing a copy of the document with this letter. As you will see, it surveys a range of tax issues - which probably have as much significance in the context of the politics of income distribution as in that of the economics of the housing market - from the standpoint of the Chancellor's own Departments. As you will know, the Prime Minister has not favoured changes in the tax treatment of building societies and people who borrow from them, and the Chancellor's minute of 28 November reflected further work on one specific aspect of present arrangements which does not give rise to the difficulties which the Prime Minister saw in any more far-reaching changes.

In view of the political sensitivities involved in this correspondence and its subject matter, I should be grateful if you would restrict the circulation you give to the Chancellor's minute in your Department, and also ensure that it is handled very carefully.

I am sending a copy of this letter to Tim Lankester.

Yours ever

John Wiggins

A.J. WIGGINS

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

TAX RELIEFS FOR HOUSING

Since the Budget, I have pressed ahead with preparations to involve a few experienced people outside Whitehall in the work on taxation and savings which you endorsed earlier in the year (your Private Secretary's letter of 31 March to mine). The involvement of the outsiders was made public in a Written Answer on 4 July. I am also asking officials (but not the outsiders) to consider the tax treatment of gilts and chattels as you suggested.

Background

2. You also mentioned the present bias towards housing. I have been thinking carefully about the scope for doing more work on this. This is a difficult area, and I thought it might be useful to set out some of the considerations which we would need to take into account in deciding what work to put in hand. There are a number of conflicting issues.

3. I have not concerned myself with rented housing - either in the public or private sectors - but have concentrated on owner-occupation, where the tax reliefs are given. What we decide on owner-occupation, however, will need to be viewed alongside our policy in the public rented sector, where our aim is to increase rents and reduce subsidies, and in the private rented sector where one of our aims is to improve the working of the market by reducing the extent of rent controls.

The Reliefs Available

4. The main tax provisions from which owner-occupiers can be said to benefit (apart from general help for housing) are:-

(a) mortgage interest relief on loans up to £25,000 for the purchase or improvement of one's main or only residence;

(b) exemption from capital gains tax on disposal of one's main or only residence;

(c) exemption from stamp duty on the transfer of residential property not exceeding £20,000, and reduced rates up to £35,000; and

(d) (included for the sake of theoretical completeness) the absence since 1963 of tax on the "imputed" income from owner-occupation - the old Schedule A tax.

5. The cost of these provisions cannot be calculated with any degree of certainty. It would be misleading simply to aggregate the various costs in calculating the total tax subsidy to owner-occupation. But the cost in 1979-80 of mortgage interest relief was around £1.4 billion (and is estimated this year to be around £2 billion), and the cost of the stamp duty relief some £230million. The tax "forgone" in giving CGT relief and from the absence of Schedule A is likely to be more than £1 billion in each case.

6. The value of these reliefs has continued to increase rapidly in recent years with the growth in the size of mortgages (due to inflation) and the increase in mortgage rates. In 1973-74, for example, the cost of mortgage interest relief was only £500 million - equivalent to about £1.2 billion at 1979-80 prices.

7. On the other hand, domestic rates, which yielded last year nearly £3 billion, work in the opposite direction to these reliefs. They are a tax on the occupation of property, and assessed on its annual value. As such they are paid by those who rent their house as well as by owner-occupiers; but even so they represent something of an offset to the fiscal concessions outlined above (though domestic ratepayers are still better treated than industrial and commercial ratepayers because of domestic rate relief).

The issues

8. The reliefs for owner-occupation are now very generous - arguably too generous, at least in the extent to which they are particularly concentrated on those who already own, in contrast with those wishing to buy for the first time. Indeed, from an economic, social and fiscal point of view, a case can certainly be made for re-examining them. They are not a very cost-effective way of increasing owner-occupation; the fiscal incentives push up house prices so that much of the benefit goes to existing owners, rather than first-time buyers. By diverting savings flows away from the capital market, they raise the cost of money to industry and commerce and may crowd out productive investment. Some reduction in the tax concessions would go some way to widen the income tax base. And it should reduce the overall level of interest rates at which the monetary target can be met. (Tax relief damps the price sensitivity of demand for housing credit and so raises total credit for any given level of interest rates generally, except insofar as housing finance is directly rationed.)

9. On the other hand, as a Government, we are committed to a property-owning democracy and it is right that we should retain a range of generous incentives in this area. I would not, therefore, want to make a substantial reduction in the total scale or scope of reliefs - at least while mortgage rates remain relatively high. If at any stage the pattern of reliefs was changed, that would need to happen gradually to avoid hardship.

10. Certainly this does not mean that we should rule out making changes at all. But in considering what might be done, the points I would wish to stress are these:-

(i) the need for tax simplification. We must try to reduce the administrative complications of the present arrangements. Mortgage interest relief is costly in manpower - requiring some 1400 Inland Revenue staff, and even more when PAYE codes have to be changed mid-year to take account of alterations in the mortgage rate;

(ii) the effect of labour mobility. As part of our policy of improving the supply side of the economy, we should aim to make changes that will encourage labour mobility. I have little doubt, for example, that the present burden of stamp duty on house transfers is harmful in this respect;

(iii) the possible need for greater competition among the building societies. We have up to now acquiesced in exempting the building society cartel from restrictive trade practices legislation because it helps to ration mortgage finance and so keeps down mortgage rates. But there can be little doubt that the building society cartel creates inefficiency. It restricts price competition between the societies, ensuring that the least efficient can survive. One conspicuous consequence of the cartel has been the recent increase in the number of high street building society branch offices.

Possible developments

11. If we were thinking of making changes, I would suggest the following broad approach:

12. Schedule A. I cannot believe that we could or would wish to turn back the clock and re-introduce Schedule A. It would be costly to administer, and cause enormous trouble with our supporters.

13. Capital gains tax. Nor could we contemplate taking away the exemption from capital gains tax for owner-occupied houses. It would be absurd to impose a heavy CGT charge on owner-occupiers, with the most damaging effects on labour mobility, at a time when we are still giving thought to reducing the burden of this tax generally.

14. Stamp duty. Clearly there is a good case for reducing or even abolishing stamp duty on house sales. A change here would encourage labour mobility, and abolition would represent a useful simplification of the tax system. But stamp duty is now a big revenue-raiser and changes would be expensive.

15. Mortgage interest relief. There are a number of possibilities here. We could reconsider the £25,000 ceiling, and the rate of tax at which relief is given. The ceiling has remained unchanged since 1974 and there are strong pressures within the party to increase it. One possibility which has been suggested would be to increase (or even abolish) the ceiling whilst restricting the value of the tax relief to the basic rate. (We should need to examine the distributional consequences of this and other possibilities.)

16. A second possibility would be introduction of a universal option mortgage scheme - replacing the present tax relief with a direct

subsidy paid by the Government to the building societies, who would then pass it on to the mortgagee in the form of a lower mortgage rate. The Government could then choose to set the subsidy at whatever rate it wished. Such a scheme would produce staff savings in the Inland Revenue, though these would be partly offset by the extra staff needed by the DOE for a wider option mortgage scheme.

17. A more radical approach, of which Peter Bottomley is a persistent advocate, might be to do away with mortgage interest relief as such, replacing it with a general relief covering life assurance premiums, mortgage interest and possibly other forms of contractual or medium-term savings. Supporters of this scheme see it as a way of limiting relief for owner-occupiers, whilst removing some of the existing distortions in the tax field. Though it would raise difficult problems, it is certainly an interesting longer-term idea.

18. Lastly, there is a rather separate point on the building societies. The Wilson Committee recommended a number of changes in the tax treatment of the societies which are not far removed from this general area and I am arranging for these to be looked at in the Tax and Savings Group.

Conclusions

19. There can be little doubt that the tax treatment of those already established in owner-occupation is generous. This reflects the priority we give to encouraging home ownership. Whether we want to make any changes is as much a matter of politics as of economics, and is something which you will no doubt want to consider very carefully. I would rule out any thought of re-introducing Schedule A or removing the CGT exemption. But it might be worth commissioning some work on the various suggestions for mortgage

interest relief, along with reducing or even abolishing stamp duty on house sales. There could be a useful package here which would make better use of the revenue involved and save staff, whilst simultaneously reinforcing the forces of competition and encouraging and assisting labour mobility.

20. If you wanted to proceed, I would ask officials in the Tax and Savings Group (without outsiders for this purpose) to embark on a study. But perhaps we should first discuss.

(G.H.)

7 August 1980

- 2 DEC 1980

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

PRIME MINISTER

Prime Minister
The Chancellor's proposal concerns machinery to save manpower, not policy. It seems alright to me. Do you want to discuss with the Chancellor: or shall we say 'yes' subject to any comments from Mr Heseltine?

TAX AND HOUSING: ADMINISTRATION OF MORTGAGE INTEREST RELIEF

Flag A

You will remember that I sent you a fairly wide-ranging minute on the subject of Tax and Housing on 7 August, and your Private Secretary replied on 8 August saying that you were not prepared to countenance any reduction in mortgage interest relief and that you did not favour the possibility - mentioned in my minute - of the so-called "Universal Option Mortgage Scheme".

2. I recognise the difficulties of making any change in the relief for mortgage interest. Nevertheless I think that it is important to distinguish between the level of the relief and the administrative arrangements for giving it. I am not now seeking to change your view on the first point. But that, of course, is no reason for regarding the machinery for giving effect to the existing relief as sacrosanct, particularly if large staff savings could be achieved by streamlining the procedure. I accept that the description of such changes under the title of "Universal Option Mortgage Scheme" was unfortunate. What is contemplated and the point to which this memorandum is directed, is simply to give the present relief by way of a different mechanism. To make this clear it would be desirable to use a more accurate name for the proposals in mind and I refer to them in future as the "Mortgage Interest Relief at Source".

3. At present the relief is given case by case, through the adjustment of individual tax liabilities. This is a complicated and cumbersome business, involving a staff cost

/in the

in the Inland Revenue of some 1,400 even in a year when the rate of mortgage interest remains unchanged; a rate change can cause an additional staff cost of up to 1,000, depending on the size of the change, when it takes place, and so on. It would be possible to save a very substantial part of this staff cost if the relief could be given in a different way, and indeed the possibility of doing this was included in the list of options for staff savings which I sent to the Lord President in July.

4. As you know, for many years the normal income tax rule (which had been with us virtually since the inception of the tax) was that an individual paying interest should do so under deduction of tax. The present Building Society Arrangement was a departure from that rule, in that it allowed interest to be paid gross, the tax being collected from the Building Society and relief being given to the payer by way of adjustment of his PAYE coding or otherwise. The rules were changed in 1969, to make interest payable gross; and what I now have in mind is in substance that we should, within the area covered by the proposal, revert to the old rule. The borrower would thus get his tax relief by paying his interest net of tax. There would be no need, save in specific and limited circumstances, for an adjustment to the borrower's tax liability. The tax suffered by the societies by this form of deduction would be greater than their liability under the present Arrangement: and we should need to repay them - as we repay other people such as pension funds who are not liable to tax. There are of course considerable practical problems which will inevitably be reflected in the administrative arrangements but the principle underlying these arrangements would be as I have set out below.

/5. A similar

5. A similar exercise relating to relief for life assurance premiums has recently been successfully completed. Policy holders now obtain relief by paying reduced premiums rather than through their tax codings or assessments, and the tax relief is paid direct to the assurance companies by the Revenue. The relief in respect of those who are not liable to income tax scores as public expenditure. The change has been generally welcomed by policy holders and, despite the extra work for them, the assurance companies. Eventual staff reductions should be at least 1,000; over 900 have already been saved.

6. Any change on the mortgage front will of course require the most careful preparation and presentation. We will need the co-operation of the building societies, who will face extra costs and we shall have to carry them with us. One of the points to discuss with them is how to try to ensure that new arrangements do not significantly disturb the present pattern of borrowers' costs. Yet another sensitive area is the relief against the higher rates of tax. We shall have to make it clear that the fact that this will require to be given as a separate operation is not to be taken as implying that we have any intention whatever of withdrawing this relief. But I do not think that these considerations should deter us from carefully examining whether we can go ahead with the change. The prize in terms of staff savings is a very substantial one, and without it I see no prospect of being able to reach my target for staff reductions. It would also be a significant further step in simplifying the personal tax system.

7. Such a fundamental change in the administrative arrangements for mortgage interest relief cannot be introduced quickly; the best estimate is that because of the changes in the building societies' working arrangements which are likely to be needed,

/the date

the date of implementation will have to follow some two years or so after legislation. But before we can contemplate legislation, a lot of work on the details of the scheme will need to be done, and this will require discussions between the building societies and the Inland Revenue, and also DOE. Because of the long time-scale, there is a need to get discussions moving quickly if the staff savings in their turn are not to be delayed. But the first step must clearly be some kind of preliminary announcement about our intentions to enable discussions with the building societies to be opened. This announcement would of course make it clear that no-one should be worse off as a result of the change.

8. Before taking this step, however, I should wish to be assured that you are in agreement to my going forward on the lines proposed.

9. I am copying this minute to Michael Heseltine, in view of his interest in housing generally and in the present Option Mortgage Scheme in particular.

(G.H.)

28 November 1980

cc: CST
FST
MST C
MST L
Sir D Wass
Mr Ryrie
Mr Byatt
Mr Middleton
Mr Battishill
Mr Kemp
Mr C D Butler
Mr Corlett
Mrs Gilmore
Mr Unwin
Miss Brown
Mrs Case
Mr Cropper

Brown Pol.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

31st October 1980

Andrew Hardman Esq.
Department of Employment

TR
31/10

Dear Andrew,

Thank you for your letter of 27 October on the text of the Green Paper on the Taxation of Husband and Wife.

On your Secretary of State's general point, it is helpful to know the importance he attaches to the publication of background papers and the Chancellor will bear in mind the point about securing adequate publicity for them.

I gather that Revenue officials have been in touch with yours about the drafting change suggested to the Foreword, and that your Officials now agree that as it is factually accurate to say that "today about half of all married women are in paid employment" there is no need for this sentence to be changed (particularly as the formulation suggested in your letter might be misleading). As I understand it, it is now agreed that the only change necessary is to remove the words "or looking for work" from the previous sentence, and the text of the Foreword will be revised accordingly.

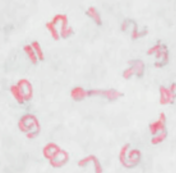
I am sending copies of this letter to the Private Secretaries of E Committee, Don Brereton (DHSS), David Wright (Cabinet Office), Richard Prescott (Paymaster General's Office), Gerry Spence (CPRS) and Nick Sanders (No.10).

Yours ever,

Richard Tolkien

R.I. TOLKIEN
Private Secretary

31 OCT 1980



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Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

28 October 1980

Richard Prescott Esq
Paymaster General's Office
Russell Way
Crawley
West Sussex
RH10 1UH

Dear Richard,

GREEN PAPER ON THE TAXATION OF HUSBAND AND WIFE

The Chancellor was grateful for Mr Maude's comments on the draft of the Green Paper, which you passed on to me in your 17 October letter.

Although "disaggregation" is not a new word (its use, in fact, goes back to 1828) the Chancellor agrees with Mr Maude that it is not exactly musical for the general reader. He would rather not use the word "segregation", but - except for a couple of places where it fits well in opposition to "aggregation" - the draft will use other words instead of "disaggregation".

The Chancellor has considered Mr Maude's point about tax relief for the cost of domestic help for working married women, but would prefer not to mention it in the Green Paper. There has been no particular pressure for a relief in this particular form, but there could be more widespread support for a tax relief for child care expenses where the mother is working. The Chancellor does not wish to encourage expectations that a relief of this sort might materialise, by mentioning it in the Green Paper, because it will be expensive, complicated and involve a large number of civil servants. It is for this reason that the draft relegates this particular proposition to a passing (and fairly dismissive) mention in Chapter 9 of the Green Paper (9.4.1. and 9.4.2.), where the argument is focused on the child care expenses for single parents.

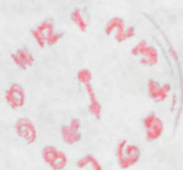
I am sending copies of this letter to the Private Secretaries of E Committee, Don Brereton (DHSS), David Wright (Cabinet Office) and Gerry Spence (CPRS).

Yours ever,

Richard Tolkien

R I TOLKIEN
Private Secretary

28 OCT 1980



Civil Service Department,
Whitehall,
London, SW1A 2AZ

*With the Compliments*

*of the*

*Private Secretary*

*to the*

*Lord President of the Council*

Civil Service Department
Whitehall London SW1A 2AZ
01-273 4400

27 October 1980

R I Tolkien Esq
Private Secretary to the Chancellor of
the Exchequer
HM Treasury
Parliament Street
LONDON SW1P 3AG

Dear Richard,

GREEN PAPER ON TAXATION OF HUSBAND AND WIFE

Thank you for sending me a copy of your letter of 16 October to Nick Sanders together with the draft Green Paper.

In his letter of 18 August the Lord President agreed in principle with your proposal to publish a Green Paper. The revised draft now brings out more clearly the relative manpower costs of the various options, so that the public will be able to make a more informed judgment of the possibilities for change. In these circumstances the Lord President is content for you to go ahead with publication.

He has asked me to stress again, however, that decisions on this issue will have to face the problem of where staff are to be found to implement any change. The more expensive options, even if they are not adopted for several years, will still pose a considerable problem in staff terms, given the Government's commitment to a downward trend in the size of the Civil Service. This point will need to be kept in mind in evaluating the response to the Green Paper.

I am sending copies of this letter to Nick Sanders, to the Private Secretaries to members of E Committee, to Don Brereton (DHSS), David Wright (Cabinet Office), Richard Prescott (Paymaster General's Office) and Gerry Spence (CPRS).

Yours ever,

Edward

E G M CHAPLIN
Private Secretary

28 OCT 1989

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✓ MS

R I Tolkein Esq
Private Secretary
H M Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

27 October 1980

Dear Richard

GREEN PAPER ON TAXATION OF HUSBAND AND WIFE

My Secretary of State has seen the draft of the Green Paper enclosed with your letter of 16 October and in general is content that it should be published in that form.

The Department's view is that the taxation changes discussed in the Green Paper are likely to have a marginal effect only on women's participation in the labour force and the Secretary of State considers it important to leave no room for any doubt or misunderstanding about this. He is therefore disappointed that it has not been considered appropriate to incorporate within the Green Paper references to the wider considerations which can exercise a powerful influence on women's decisions about work, to which attention has previously been drawn by officials. However, he is encouraged to learn that it is intended to publish, in addition to the Green Paper, complementary background papers which will give a fuller account of those wider considerations. He thinks it is important that those papers should be made available at the same time as or very soon after the publication of the Green Paper and that they receive appropriate publicity.

On a point of detail, it is not correct to say in the Foreword that "about half of all married women are in paid employment". Officials here have already indicated to Inland Revenue that it should read "about half of all married women are in the labour force".

I am sending copies of this letter to the Private Secretaries of E Committee, Don Brereton (DHSS) David Wright (Cabinet Office), Richard Prescott (Pay Master General's Office), Gerry Spence (CPRS), and Nick Sanders (No 10).

Yours sincerely

ANDREW HARDMAN
Private Secretary

27 OCT 1980

VMS

From: THE PRIVATE SECRETARY

HOME OFFICE
QUEEN ANNE'S GATE
LONDON SW1H 9AT

24 October 1980

Dear Richard,

GREEN PAPER ON THE TAXATION OF HUSBAND AND WIFE

You sent me a copy of your letter of 16th October to Nick Sanders seeking any final comments on this draft Green Paper.

This is to record that, subject to the views of his colleagues, the Home Secretary is content with the version of the Green Paper which you circulated. Although some of the options which the draft discusses could well prove controversial the Home Secretary considers that the paper should make a valuable contribution to public debate on a complex issue.

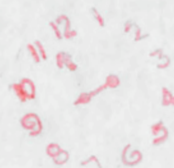
Yours,

[signature]

S. W. BOYS SMITH

R. I. Tolkien, Esq.

27 OCT 1980



Econ Pol.

20 October, 1980.

The Prime Minister has seen and noted your letter to me of 16 October and the attached draft Green Paper on the taxation of husband and wife. She has not made any comments on the draft.

I am sending a copy of this letter to David Wright (Cabinet Office) only.

N. J. SANDERS

R.I. Tolkien, Esq.,
HM Treasury.

with compliments

Private Secretary to the
PAYMASTER GENERAL
68 Whitehall London SW1A 2AT
Telephone 01-233-8632

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

17 October 1980

R I Tolkien Esq
Private Secretary to the
Chancellor of the Exchequer
H M Treasury
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

R
29/10

Dear Richard,

GREEN PAPER ON THE TAXATION OF HUSBAND AND WIFE

The Paymaster General has seen the draft of the Green Paper on Taxation of Husband and Wife. He has only two comments.

The first is a simple drafting point. He is very much against the official creation of new and unnecessary jargon words, and he reacted strongly against the word 'disaggregation' in paragraph 1.3.b. In his opinion, the opposite of 'aggregation' is 'segregation', and he sees no reason not to use it.

On content, he feels that there will certainly be adverse comment, especially from married women with high professional qualifications, if there is no discussion at all of the question of admissibility for tax relief of the cost of domestic help needed to enable a married woman to pursue even a part-time career. This is a widely felt grievance; and while the Paymaster General recognises the difficulties and does not wish to propose remedies, he feels the subject ought at least to be mentioned if we are to forestall criticism.

I am sending copies of this letter to the Private Secretaries of E Committee, Don Brereton (DHSS), David Wright (Cabinet Office), and Gerry Spence (CPRS).

Yours ever
Richard Prescott

R E S PRESCOTT
PRIVATE SECRETARY

18 OCT 1980

2

PRIME MINISTER

To see. There is a summary of the issues for discussion in Chapter 11 (flag A)
MS

17/10

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

16 October 1980

N. Sanders, Esq.,
No.10, Downing Street

Dear Mick,

GREEN PAPER ON THE TAXATION OF HUSBAND AND WIFE

You wrote to John Wiggins on 11 August to say that the Prime Minister was content with the Chancellor's proposals (in his 8 August minute to the Prime Minister) for publishing a Green Paper on this subject in October or November and for settling the text by correspondence.

The Ministers on E Committee, and the Social Services Secretary, who commented on the draft, were content with the substance and general presentation. There were a number of comments on detail and minor points of presentation (for which the Chancellor was grateful) which are reflected in the attached re-draft (for convenience, the changes from the previous version are sidelined).

The Chancellor intends to publish the Green Paper in this form, subject to any final comments that the Prime Minister or other Ministers may wish to make. He hopes the publication date will be before the end of November, and would therefore be grateful if any comments on the draft could reach me by Friday, 24 October.

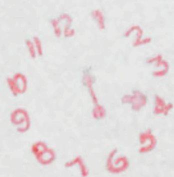
I am sending copies of this letter to the Private Secretaries of E Committee, Don Brereton (DHSS), David Wright (Cabinet Office), Richard Prescott (Paymaster General's Office) and Gerry Spence (CPRS).

Yours ever,

Richard Tolkien

R.I. TOLKIEN

16 OCT 1980



# FOREWORD TO GREEN PAPER ON THE TAXATION OF HUSBAND AND WIFE

This Green Paper raises far reaching issues which could affect every taxpayer in the land - married or single, man or woman. I hope that it will be carefully studied and widely discussed, and that it will be possible to draw some definite conclusions from the debate.

2. Over the last hundred years there has been a tremendous change in the economic status of women, and of married women in particular. As recently as 1921, less than one in ten married women were working or looking for work. Today about half of all married women are in paid employment. Nowadays a woman can be earning as much as or more than her husband, and a woman may well enter married life with savings of her own.

3. It is not surprising that there has been growing criticism of a tax code which proceeds on the basis (originally enacted in 1806) that "A woman's income chargeable to tax shall... be deemed for income tax purposes to be his income and not to be her income"*. The surprise, to most who study the matter, lies in discovering how difficult it is to find a better system than that which we have today. A number of recent measures, of course, have removed some of the more offensive features of the old code: but the central dilemma remains.

4. Many people feel that we should break away from present arrangements, which basically treat the income of husband and wife as one for income tax purposes. In most cases, where husband and wife each have an income, the best answer probably lies in some form of separate taxation. But having said that, one runs into the difficulty that for a significant part of her life, a married woman may not have any earned income of her own, and she may well have no investment income either. In those circumstances the personal tax allowance, which would

*Section 37, Income and Corporation Taxes Act 1970.

be hers by right under a system of separate taxation, would have no value to her. Maybe, it will be said, the "unused" part of the wife's personal allowance should be transferred to her husband - and then, when she begins work again, it should be transferred back. And so on. But the complexity is already mounting. How, for example, to cope with frequent changes in the husband's tax code in the case of a wife who intersperses spells at work with spells at home?

5. The truth is that, in the real world, any tax change that is beneficial to one group of people must, almost by definition, work to the detriment of another group of people. Of course, a tax change may be right even if it does leave some taxpayers worse off. That is for politicians to decide, knowing that if they get it wrong they will suffer for their misjudgement. But it is a course to be taken only when one is very sure of the facts.

6. Change in the present system of family taxation could well leave the working couple relatively worse off and the couple where one spouse (usually the wife) stays at home looking after the family correspondingly better off. Various alternative solutions suggest themselves; each has its strengths and weaknesses. Each meets, in varying degrees, the desire for financial independence often expressed by married women. Each, it should be added, would involve more civil servants and cost money to implement.

7. Although I have pondered this problem often over the years, I have not myself reached a final view. That is why I have asked for this consultative paper to be written and published. It is not easy reading, because the subject - when it comes down to the nuts and bolts - is inevitably complicated. I hope, however, that those who have already written and spoken - often with understandable passion - about the taxation of husband and wife, as well as representatives of the much larger number who have not, will be ready to continue the debate now that they are invited to comment on the issues raised in this Green Paper.

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CHAPTER I - INTRODUCTION

1.1 This Green Paper is about the tax treatment of the income of husbands and wives and is intended to open up discussion on the present system and on possible alternatives.

1.2 The subject is topical and important, because there has been growing dissatisfaction with the present system, particularly over the last few years. Admittedly, the present system broadly reflects what is probably still the normal arrangement under which the husband is the principal breadwinner. But many would not accept this as the foundation upon which the tax laws should be built; and even those who do not press for changes recognise that certain features of the system have been difficult to defend. The time is therefore ripe for a review; and, because most people have a direct interest in the outcome and because there is no prospect of a perfect solution to the complex of problems and conflicting interests involved, the Government have thought it right to open the review as widely as possible by publishing this consultative document.

1.3 Chapter 2 of the Green Paper describes the present system; Chapter 3 summarises the main criticisms; Chapter 4 looks at possible modifications of the existing system and the extent to which they would meet these criticisms; and Chapters 5-8 consider the possibility of a more fundamental change, which would involve making the individual taxpayer, whether single or married, the basic unit for tax purposes. But, before embarking on these chapters, it may be helpful to summarise the main issues at stake, and to do so by reference to the main criteria against which any system for taxing married couples should be judged - fairness, simplicity, sex equality and privacy.

Fairness. No tax system will command general support if it is seen to be unfair. Here, fairness is best measured by the fairness of the relativities between the various groups in question - between married and single people, between one-earner and two-earner couples, and between men and women. The latter is best considered separately, under the criterion of sex equality (below). For the rest, questions arise from several different directions. Thus:

a. The gap between the tax allowances for single and married people. How big should it be? Is the present differential of between 50 and 60 per cent about right? The answer may depend on the circumstances of the couple under consideration. Thus, it may vary according to whether one partner of the marriage is financially dependent on the other, and, if so, whether the dependent partner is looking after the home or is looking after children or elderly parents as well.

b. Is aggregation[1] fair? In other words, does the adding together for tax purposes of the income of husband and wife produce a defensible result? It can be said that the United Kingdom system is not unfair for earned income, because it is open to the couple to claim disaggregation, and have their earnings taxed separately, where this is to their advantage. For investment income, it is arguably unfair: the tax bill on the combined incomes may be greater if the couple are married than if they are two single people, each with part of the total income. Critics could fairly point out that, in this

admittedly limited area, there is a fiscal disincentive to marriage. Clearly disaggregation would provide an incentive for transfers of capital between husband and wife to minimise their tax liability. Some people would argue that this would be a powerful force leading to more equal sharing of property by husband and wife and that this was, on social grounds, a good thing. Other people may well regard it as a form of tax planning which called for counter measures, for example in the rules governing capital transfer tax under which transfers between spouses are exempted.

c. The tax treatment of the working wife. Under the United Kingdom system, is the tax advantage where the wife works too great in comparison with the treatment where the husband only is working? The wife's earnings allowance gives a working wife the equivalent of the single allowance. The fact that the husband is in these circumstances still entitled to the married allowance, although his wife is not financially dependent on him (so that the working couple receive in total the equivalent of the married and single allowances, ie about two and a half times the single allowance), is regarded in several quarters as anomalous. Should there be a fiscal incentive for the wife to work; or would it be fairer if the tax system were neutral in this respect?

Simplicity. Like fairness, this is a general requirement of a tax system. Many of the dilemmas in tax administration arise from the difficulty of combining fairness with simplicity. The present system of taxing husband and wife is relatively

simple, although it is undoubtedly complicated by the options for disaggregation (the wife's earnings election[1]) and for separate assessment of husband and wife[1]. Against this relative simplicity must be weighed the complications which would arise if the options within the present system were to be extended in the way considered in Chapter 4 or - more particularly - if an "individual" basis with special provision for the spouse at home were adopted (Chapter 6).

Sex equality. A good deal of the recent criticism of the present system has been governed by this criterion. It has been directed initially at the aggregation rule in Section 37 of the Income and Corporation Taxes Act (ICTA) 1970, under which a wife's income is deemed to be her husband's for tax purposes. Although the effects of this have in practice been substantially alleviated over recent years, its continued existence in the statute book is seen by its critics as a serious offence against the principle of sex equality. If this were all, it might be relatively easy to amend the law so as to satisfy this criterion. But objection is also taken, under this head, to the married allowance - a higher tax allowance which, except where the wife is the sole bread-winner[1], is given only to married men. If, in the interests of sex equality, the married man's allowance were to be withdrawn, then, as these critics see it, the only change which would really meet this criterion would be a change under which each spouse would be treated as a taxpayer in his or her own right; and this would mean a fundamental change in the system.

Privacy. This is closely related to sex equality. Wives should be able to keep particulars of their

income and tax affairs confidential from their husbands (and husbands from their wives). Some would attach more importance to this than others as a necessary feature of a system; and there are those who argue that it would be more desirable to have a system of joint taxation under which there is no privacy between husband and wife, but both are jointly responsible for declaring the combined incomes and paying the total tax.

1.4 Such are the main criteria by reference to which the present system and possible alternatives can be judged; and between them they raise the main issues which form the subject of this Green Paper. No system can satisfy all criteria: for example, it is inevitably difficult to reconcile 'sex equality' with those definitions of 'fairness' which focus on families rather than individuals. This is another way of saying that it is difficult to reconcile in a single system the preferences of those who advocate independent treatment for all married women and those who believe that the desirability of married women staying at home to look after their families should be fully recognised in the tax system. The present United Kingdom system is a compromise, which largely meets the criterion of simplicity, but has only gone some way to meeting the other criteria. Any significant change must alter the relative share of the total tax burden borne by the different groups under consideration. In examining alternatives to the present system, the Green Paper brings out these shifts in people's relative tax bills and in doing so enables the virtues as well as the inadequacies of the present system to be more clearly seen.

1.5 Costs. It is necessary to take account of the costs that could be involved in considering the merits, and disadvantages, of alternatives to the present system. There are two points to be considered here.

The first is the cost to the Exchequer of financing changes in the tax treatment of husband and wife. The more substantial the change, the greater the cost of ensuring that those who are made worse off in relative terms are protected, wholly or in part, from an increase in their tax bills. The second aspect is the administrative cost, which includes the number of additional civil servants needed to operate a change in the system. Here, also, the more far-reaching the change, the greater the number of extra civil servants likely to be needed. It has to be recognised that these costs are a measure of the resources that could otherwise have been used in other areas, including, for example, reductions in tax rates or improvements in the social services. It has to be recognised, therefore, that solutions which may seem attractive in terms of the criteria set out in this chapter may nevertheless have to be ruled out, at least for some years, because the revenue or staff costs prove to be unacceptable in the prevailing economic circumstances.

1.6 The changes examined in this Green Paper are mainly changes to the tax system, although there is also some discussion of possible changes in Social Security benefits (in relation to wives who are financially dependent on their husbands and lone parents - Chapters 6 and 9). The Green Paper does not touch on the possibility of some form of tax credit scheme which would effectively bring together the tax and social security systems. A Green Paper on Proposals for a Tax Credit System was published in October 1972, and the Government have stated that they wish to move towards the fulfilment of the original tax credit objectives as and when the resources become available. While it is not thought appropriate to examine in this Green Paper the implications for the taxation of husband and wife of a tax credit scheme (which would go far beyond the scope of this Green Paper), none of the changes considered here would

be incompatible with a tax credit scheme if it were to be introduced at some time in the future.

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[1] The various technical terms used throughout this Green Paper are explained in the Glossary (pps ).

## CHAPTER 2 - THE MARRIED COUPLE IN THE PRESENT SYSTEM

### Aggregation

2.1.1 The present income tax treatment of the married couple turns on Section 37 ICTA. This provision, which dates back to the very beginnings of income tax in 1799 (see Appendix 2 listing the main historical landmarks in the development of the system), states that:

> "A woman's income chargeable to tax shall during (any year) in which she is a married woman living with her husband be deemed for tax purposes to be his income and not to be her income."

2.1.2 From this two important consequences flow. First a married couple is taxed basically as a single unit: the incomes of husband and wife are added together, tax is charged, subject to any allowances, on the total as if it were the income of one person, and only one set of rate bands is available against the joint income. Second, it is the husband who is in law the person responsible for the couple's tax affairs, and hence the person with whom the tax authorities deal. It is the husband who must complete the tax return when required, claim the allowances due for the couple, and take ultimate responsiblity for the tax due on both his and his wife's income (although the Revenue have discretion under Section 40 ICTA to collect tax from the wife in respect of her own income, if her husband does not pay it).

### Allowances

2.2.1 The personal allowances reduce the amount of income which is subject to tax. Their purpose is to recognise that, because of varying circumstances and family responsibilities, people whose incomes are the

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same may not be equally able to pay tax on them. They are not intended to reflect actual expenditure, as that can vary widely between households of the same size, but serve to graduate the personal tax burden broadly according to family circumstances. Appendix 3 sets out the current values of the main personal allowances.

2.2.2 Since 1918 a married man has received an allowance higher than that given to a single person, in recognition of the special legal and moral obligations he has to support his wife. Thus the married man's allowance is essentially an allowance for two people, but it has always been less than twice the single allowance, since the expenses of two married people sharing one household are considered less than those of two single people maintaining separate households. But the precise gap between the married and single allowances has varied over the years. Up to the early sixties the married allowance ranged from 1.5 times to 1.8 times the single allowance. In the subsequent ten years the gap narrowed quite markedly: in the early seventies the married allowance was only 30 per cent higher than the single allowance. Since then the differential has widened again and today the married allowance is 1.56 times the single allowance. The current relationship of 1:1.56 is more or less in line with the 1:1.6 relationship established for social security purposes.

2.2.3 In addition to the married man's allowance, the husband whose wife goes out to work also gets the wife's earned income allowance. This allowance, which is set against the wife's earned income but not against her investment income, is equal to the single person's allowance or the amount of her earnings if less. It was first introduced in 1920 when it equalled the difference between the married allowance and two single allowances. During the last war it was increased to the same level as the single allowance, specifically to

encourage married women to remain in employment in the public interest. It has remained at that level ever since, partly because it has not been felt appropriate to remove the incentive for married women to work, and partly because it is administratively convenient for the wife's earned income allowance and the single allowance to be the same amount. This means that the married couple where the wife goes out to work get more allowances in total than two single people (2.56: 2), and considerably more than the couple where she stays at home (2.56: 1.56).

2.2.4 In addition to the main personal allowances - the single person's allowance, the married man's allowance and the wife's earned income allowance - an individual's tax bill may be reduced by other reliefs and allowances, eg relief for mortgage interest payments. In the case of the married couple, the aggregation rule means that (except for the wife's earned income allowance, which is given automatically against her earnings) these reliefs and allowances have to be claimed by and given to the husband even where the expenditure giving rise to the allowance is incurred by the wife - though for PAYE purposes a different allocation may be agreed by both husband and wife.

Year of marriage

2.3 In the year in which marriage takes place different rules apply (unless the marriage takes place on 6 April, in which case the normal rules described above apply). For that year only husband and wife continue to be taxed separately. Both complete their own tax returns and have responsibility for the payment of tax on their own incomes (earned and investment). Each is entitled to his or her own set of rate bands. The wife gets the single allowance and the husband is entitled to single allowance plus 1/12th of the difference between the

single and married allowances for each month in the tax year after the date of marriage.

Separate assessment and wife's earnings election

2.4.1 The normal rules for treating married couples can be varied in either or both of the following ways:-

a. separate assessment,

b. wife's earnings election.

Separate assessment

2.4.2 Ever since 1914 either husband or wife has been able to apply for separate assessment. This option does not reduce the total amount of tax which the couple pay, but it makes both husband and wife responsible for handling their individual tax affairs, and for the payment of their own share of the tax due. It also enables them to complete separate tax returns if they wish. Under separate assessment the tax due from the couple is worked out in the normal way, and then the available reliefs and rate bands apportioned between them broadly in the same proportion as each spouse's income bears to the total. (Appendix 4 illustrates how these calculations work). The main exception to these general rules is where the wife has earned income, in which case her share of the total reliefs must not be less than the wife's earned income allowance due against her earnings.

2.4.3 The advantage of separate assessment is that it secures for the wife the right to handle her affairs independently, and releases her husband from the responsibility for paying the tax due on his wife's income. It secures for the wife greater privacy; but even so it is possible for each spouse to deduce - from his/her own allocation of the tax bill - the approximate size (though not the sources) of the other's income.

Wife's earnings election

2.4.4 A couple may jointly elect to have the wife's earnings taxed separately as if she were a single person with no other income. This option, which is also illustrated in Appendix 4, was introduced in 1971 and is known as the wife's earnings election. When it is in force the wife is entitled to the single person's allowance (in place of the wife's earned income allowance) against her earned income. The husband also receives a single person's allowance in place of his married man's allowance. The election is of advantage only where the couple's total income and the wife's earnings are of such a size that if she is taxed separately on her own earnings, the reduction in their higher rate tax outweighs the loss of his married allowance. Although the wife's earnings election enables the wife to be treated as a single person so far as her earnings are concerned, receiving her own repayments and making good any underpayments on her earnings, any investment income she has continues to be treated as belonging to her husband for tax purposes. In addition he retains responsibility for completing returns of both his and his wife's total income.

Recent developments

2.5.1 In recent years the administration of the income tax system has been changed in a number of respects to provide more equal treatment for married women. These changes have affected:

a. the collection of tax where a husband and wife are both working and liable to higher rate tax;

b. the rights of married women to receive their own repayments;

c. Inland Revenue practice on correspondence with married women.

Collection of higher rate tax

2.5.2 Where a husband and wife are both working and their joint earnings are sufficient to bring them into higher rates of tax, some adjustment to their tax codes is needed in order to ensure that enough tax is deducted at higher rates. This adjustment, which has the effect of reducing the allowances which one spouse can set against his/her income, is known as the "excessive basic rate" (EBR) adjustment. Until very recently tax offices made this adjustment in a wife's coding, so increasing the amount of tax which was deducted from her income (which in most cases was smaller than her husband's). But from 1980/81 onwards tax offices will make this EBR adjustment in the husband's coding unless it is clear that the wife's earnings are likely to be the higher of the two, or the couple notify the tax office that they would prefer the reduction to be made in the wife's coding.

Repayments to married women

2.5.3 The general rule is that the husband is liable to make good any underpayment of tax and to receive any repayment due, since he has overall responsibility for the tax on both his and his wife's income. There have, however, long been exceptions to this rule. The wife is entitled to her own repayment (and has to meet any underpayment) if separate assessment and a wife's earnings election are in force. In addition, repayments due in the course of the year in respect of a wife's earnings subject to PAYE have always gone to the wife. In the last five years, the number of occasions on which the wife receives her own tax repayments have been increased. They now include:

a. any repayments of PAYE tax due to the wife in the year following that in which the tax was deducted;

b. repayments to wives whose husbands have already been assessed, and wives who claim repayment later than one year following the tax year;

and

c. the "breadwinner" wife to whom repayment is due as a result of giving her the benefit of allowances due to her husband, which he is unable to use because he has insufficient income.

The result is that most wives who pay tax under PAYE are entitled to receive any repayments due on their earnings. However some wives who are liable to higher rate tax and those wives who pay tax under Schedule D do not get their own repayments.

Correspondence with married women

2.5.4 Traditionally the normal Inland Revenue practice was to write to the husband (who was in law responsible for any tax due) on a matter concerning his wife's tax affairs. But recently these rules were changed, and tax offices were instructed to reply direct to a married woman who had written to them about her own tax affairs. This change of practice has now been extended and the current rule is for the Revenue to write to the married woman herself whether or not she has written to them first. The present practice does not apply where the correspondence involves reference to the husband's income as well as the wife's nor does it apply to assessments and other formal documents.

Conclusion

2.6 Notwithstanding these recent changes, some of the present rules for taxing husband and wife are still of considerable antiquity. However the mere fact of

antiquity does not mean that, taken as a whole, the system is necessarily out of date or incapable of catering for society as it is today. Already the net result of the current rules is to give a married woman a considerable degree of independence - at least as far as her earned income is concerned. She gets the same personal allowance against her earnings as a single person, and receives most of her own repayments and tax correspondence. And where the effect of aggregation is to bring a couple into the higher rates of tax, there is an option (wife's earnings election) whereby the wife can be taxed as a single person on her earnings. Furthermore the separate assessment option, while it does not affect the total amount of tax payable, extends a married woman's individual responsibility to cover the tax on her investment income as well as on her earnings.

## CHAPTER 3 - CRITICISMS OF THE PRESENT SYSTEM

### Introduction

3.1 Though the present system has changed in several respects in recent years, to some extent it inevitably reflects ideas and social patterns which were current in the early decades of this century. Within the last 50 years society has changed dramatically, and it is these changes which underlie much of the present criticism of the taxation of married couples.

### Social Change

3.2.1 Much the most important social development has been the changing role of a married woman within the family. At the time when the income tax system took shape the vast majority of women gave up work on marriage to spend the rest of their lives looking after their home and family. This is not true today. The significant change which has taken place in the last three or four decades is chronicled in the Report of the Committee on One Parent Families (Cmnd 5629, July 1974):

> "Women's contribution to the country's labour force hardly varied between 1851 and 1951 but it has risen since 1961. Their contribution to the national economy has been regulated by the timing of marriage and the progress of family building. In the generations before the second world war women used to work for several years between leaving school earlier than they do today and getting married later than they do today. They withdrew from the labour market on marriage. Few ever returned and then only if they had suffered domestic catastrophe in such form as a broken marriage or a disabled or unemployed husband unable to provide. So, before the last world war, representative women workers were young and single. Working women in the older age groups were mostly

lifelong spinsters drawn from the reservoir of unmarriageable women. The custom then both among the middle and the working classes was for work to cease on marriage and therefore the proportion of married women in paid jobs was less than 10 per cent."

3.2.2 As Appendix 5 on married women in employment demonstrates, whereas in the earlier decades of this century less than 10 per cent of all married women were working or looking for work, by 1951 the proportion had doubled and in the next 20 years doubled again. Since then there has been a further rapid growth, so that today over a half of all married women under pension age are working or actively looking for a job. Married women now count for over a quarter of the total labour force and outnumber single women by 2:1. The married woman may be newly married, simply carrying on the career she pursued when single; or she may have young children and do a part-time job during school hours. (It is noteworthy that in 1978 only 28 per cent of mothers whose youngest child was under 5 worked at all, compared with 67 per cent of mothers whose children were all over 5.) Alternatively, she may be an older person who has returned to full-time work after her children have ceased to be dependent; or she may be the family breadwinner with her earnings supporting a husband who is not himself in paid employment.

3.2.3 Married women today may still be financially dependent on their husbands while they are looking after young children, but for much of their married life they have the opportunity to be financially independent. This in turn means there is more financial equality within the marriage. It is social changes like these which underline the growing criticism of certain aspects of the present rules for taxing husband and wife. The various criticisms that have been made are analysed in the following section.

Criticisms of the Present System

3.3.1 There are perhaps two major strands of criticism of the present system of taxing husband and wife. Both focus on the proposition that the married man's allowance in its present form is unsatisfactory. More specifically the first strand of criticism points to the different tax treatment of husband and wife. In other words, it sees discrimination within the family unit. The other strand of criticism, looking at the overall impact of taxation as between different types of family unit - single people, couples with only one earner, couples where both partners go out to work, one-parent families, etc - sees the current rules as favouring some types of family unit at the expense of others.

Discrimination within the Family

3.3.2 The main focus of criticism here is the aggregation rule which deems the wife's income to belong to her husband for tax purposes and makes him responsible for all her tax affairs. This is seen as reducing the married woman to the status of her husband's "chattel". It has been criticized as a matter of principle, and there have been complaints about the practical effects. Some of these points have been met by the procedural changes referred to at the end of Chapter 2. Beyond this however a number of people feel particularly strongly about the issue of the married woman's privacy. Because a husband is liable for tax on his wife's investment income, it follows that he must get to know about any savings or investments she has. Criticism of our tax system as discriminating unfairly between husband and wife does not come exclusively from women: some men object to having to go through the process of obtaining details of their wife's income, dealing with all correspondence relating to it, and being liable for any tax due on it.

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3.3.3 The second criticism focuses on the allowance for a married woman. People have taken issue with the fact that the wife's earned income allowance is given, not to the wife, but to the husband to set against her income and that, unlike all other personal allowances, it can be set against her earnings only and not against her investment income. In addition there has been criticism of the relative size of this allowance. The husband gets a higher tax allowance against his earnings than his working wife gets against hers, so that where two spouses are earning the same amount the wife takes home less than her husband. Allied to this are complaints about the way the couple's other allowances are usually allocated to the husband, thus further increasing his take home pay relative to that of his wife. This issue most often arises in respect of mortgage interest relief and is obviously a source of particular complaint where the wife is the one actually paying the mortgage interest.

Discrimination between Family Units

3.3.4 There are three main areas of criticism:-

a. The favourable treatment where both partners work; this is criticised as excessively generous both by comparison with the treatment of one-earner couples and by comparison with the treatment of single people.

b. The treatment of the one-earner couple. It is argued on the one hand that the allowance is inadequate where one spouse stays at home to look after dependent children, elderly relatives etc, and on the other there is the point of view that there is no reason to give more than a single allowance where the spouse at home has no such responsibilities.

c. The treatment of married couples where each spouse has investment income.

These various criticisms are analysed in turn in the paragraphs below.

Two-earner couples

3.3.5 Since 1942 the couple where both husband and wife are earning has been able to enjoy total tax allowances around 2½ times as large as a single person's allowance, whereas the couple where only the husband works get 1½ times the single allowance. This feature of the tax system may be felt particularly by a couple who move from one category to another - eg where the wife gives up work to start a family. As long ago as 1954 the Royal Commission on the Taxation of Profits and Income concluded that the present arrangements were over-generous to two-earner couples because they gave them greater relief than two single earners. Their proposed solution was to restrict the wife's earned income allowance, but it is now commonly argued that it is the continued entitlement of the husband to a full married man's allowance, while his wife is enjoying the equivalent of a full single allowance, which creates the imbalance between two-earner couples and others.

One-earner couples

3.3.6 In recent years there have been suggestions that the married allowance for one-earner couples should be increased to the equivalent of the allowances given to two single persons. There seem to be two distinct (if inter-related) lines of thinking underlying this. On the one hand there is the body of opinion which considers it important to give every encouragement - fiscal and otherwise - for a mother to stay at home and look after her young children. On the other is the point of view

that housework is just as much work as paid employment and the tax system should recognise it as such. At the same time, from another stand-point, it is sometimes said that the married man's allowance should not be given to one-earner families where the wife has no home responsibilities, on the grounds that in a society where it is common for wives with no home ties to work, it is wrong in principle for the tax system to give any relief for the wife who chooses instead to remain at home.

3.3.7 It is widely held that the present rules are very generous to couples where the wife is the breadwinner and the husband has no income. The couple get the same allowances as a working married couple (married allowance plus wife's earned income allowance), whereas only the married allowance is available where the husband is the breadwinner.

3.3.8 Finally, there is the criticism that, under the present rules, where husbands and wives both have investment income the tax bill can be higher than if they were two single people with the same total investment income split between them. This criticism is more frequently heard now that there are some 2½ million wives with income-producing assets.

Conclusion

3.3.9 It is of course possible to meet each of these criticisms individually but there is no single "solution" which would encompass answers to them all. It is only necessary to consider the two criticisms discussed in para 3.3.6 to see some of the difficulties involved. The obvious answer to those who want more encouragement for family life in its traditional form would be to award the equivalent of two single allowances to all one-earner couples. But this would be objectionable to

those who maintain that only families where the non-working spouse has specific home responsibilities should qualify for additional tax relief.

3.3.10 Moreover any "solution" could well create as many problems as it would solve. For instance, a switch to independent taxation, under which husband and wife would each be treated as separate units, would certainly meet many of the criticisms outlined in the foregoing paragraphs. But a reform on these lines might not find favour with those married women who have no particular quarrel with the status quo. Independent taxation confers obligations as well as rights: every man and woman, married as well as single, would be responsible for filling in his or her own tax return, dealing direct with the tax authorities and paying his or her own tax bill. At present, in the case of a married couple, these obligations fall solely on the husband (subject to the rules for separate assessment under which the wife may choose to assume responsibility for her own share of the tax due). Moreover, as Chapter 6 makes clear, mandatory independent taxation would mean a substantial shift in the relative tax bills paid by different types of family. In particular, couples where both spouses are working would, in relative terms, be worse off than at present.

3.3.11 It is clear, therefore, that any attempt to meet the criticisms of the current taxation of husband and wife must be a compromise between conflicting interests. The previous Chapter has demonstrated how the present system itself represents just such a compromise. Moreover, even today, it is a compromise which seems to be broadly acceptable to many people. Therefore, before turning to the possibility of changing to an entirely different system, it is worth considering the scope for building on the present working compromise in a way which would meet at least some of the criticisms levelled against it. This possibility is examined in the following chapter.

CHAPTER 4 - DEVELOPING THE PRESENT SYSTEM : MAJOR CHANGES

4.1 A system of fully independent taxation would be needed to provide a comprehensive answer to the criticism that the current rules discriminate against married women and also that they favour some types of family at the expense of others. This is examined in Chapter 6. Nevertheless, it would be possible without such a fundamental restructuring to meet some of the main points of criticism by building upon features of the present system which enable, within limits, husband and wife to be treated as individual units rather than as a couple. These would be major reforms of the present system and would go much further than the procedural changes (referred to in Chapter 2.5) which have already been implemented. Before we consider how this might be done, it is worth looking briefly at an alternative way of meeting the criticism that the present aggregation rule is sex discriminatory. Instead of moving towards an "individual" basis, this approach - which may best be described as "joint taxation" - would effectively reinforce the aggregation of the incomes of husband and wife.

4.2 Joint Taxation Several variants would be possible, but essentially this would involve substituting for the present aggregation rule a rule under which the income of husband and wife would be jointly returnable by them, and jointly assessable on them, and there would be a joint responsibility for payment of the tax. This would remove what is seen as the offensiveness of deeming a wife's income to be her husband's, but:

a. In practice this would mean that both husband and wife would be liable for the tax on the other's income. A wife with no income of her own could thus be liable for the tax on her husband's income, even though she had no

resources from which to pay it, and a husband with no income would be in a similarly invidious position. This difficulty might be met by making joint taxation optional. But this would substantially add to the administrative complexity. Furthermore, while in some cases joint liability might work satisfactorily, in others - where the option would have been exercised because of its prima facie attractiveness - there would be difficulty over the years in pinning down responsibility for the submission of returns and payment of tax with neither spouse accepting full responsibility and both employing the delaying tactics which could be open to them.

b. More important, a move to joint taxation would run counter to the overwhelming trend of criticism which has pointed in the opposite direction, towards a system under which husbands and wives would be separately responsible for their tax affairs.

4.3 <u>Rewording the aggregation rule</u> While operating within the existing system, and retaining both the principle of aggregation and the married allowance, it would be possible to remove one of the main sex-discriminatory aspects of the system. The aggregation rule could be re-worded, not to provide for joint taxation but simply to treat the income of husband and wife as if it were one income, the tax remaining assessable etc on the husband, with the existing exceptions of separate assessment and wife's earnings election (see Chapter 2.4.2 - 2.4.4). The income would thus be treated as the joint property of husband and wife and this would meet the objection to the present aggregation rule where the wife's income is deemed to be her husband's.

4.4 <u>Individual Responsibility</u> Such a change in the aggregation rule would not of itself constitute a move towards independence of treatment and individual responsibility by each spouse for his or her own tax affairs. But this could be achieved by building upon the wife's earnings election and separate assessment. In this way it would be possible to create a regime whereby couples had two alternative options for independent treatment open to them. First, they would have their income taxed as if each was a single individual, separately responsible to the Revenue. Secondly, where this first option was not advantageous, because the loss of the married allowance outweighed the benefit of separate single allowances and rate bands, the allowances and rate bands to which the couple were entitled could be split equally between them, with each being separately responsible to the Revenue. This regime might conveniently be described as an option for independent taxation.

4.5 <u>Option for independent taxation: individual taxation of investment income as well as earnings</u> This would mean extending the existing wife's earnings election to investment income. At present, apart from the exemption of the first £70 of National Savings Bank (ordinary account) interest, which is available separately to a married woman, a wife's investment income is always aggregated with her husband's (including liability to the investment income surcharge, where the threshold is the same for a married couple as for a single person). The fact that the wife's investment income is not covered by the wife's earnings election is criticised for two reasons.

a. <u>The tax bill</u>

The effect of the aggregation of investment income is that some men and women may pay more tax when married than when single. In some instances the extra bill resulting from marriage may be substantial. For example, a couple where the

husband has £25,000 earnings and £5,000 investment income and the wife an investment income of £10,000 will pay £3,700 more tax than if they were two single people. In this area, therefore, if can fairly be said that the tax system is not neutral as between marriage and cohabitation. The extension of the wife's earnings election to investment income would remove this discrimination against married couples with investment income. Unlike the present wife's earnings election, the new option could be beneficial even where the total income was below the higher rate threshold: a wife would get a single person's allowance against her investment income so that if she had no earned income (or very little) the option would be advantageous where her investment income exceeded the difference between the single and the married allowance (ie £770 in terms of 1980/81 allowances) which the husband would lose. For example, if she had £1,000 of investment income but no earnings, the couple paying tax at basic rate would stand to gain £69 (30% of £1,000 - £770). (Appendix 4 shows how the calculation would work in detail).

b. <u>Privacy</u>

Some wives object to having to tell their husbands about any savings and investments which they have. They see it as a breach of their personal privacy, perhaps the more so because there is no obligation on the husband to give corresponding information to his wife. This lack of privacy may well be more keenly felt with regard to investment income than earned income, particularly if the investment income is derived from savings from housekeeping money, legacies from the wife's family or her own past earnings, including earnings before marriage. With an option for

independent taxation which extended to a wife's investment income as well as her earnings, the need for the wife to tell her husband about her investments would disappear. So it would seem sensible to allow a husband and wife to make separate returns if they wished. (Under the present rules for wife's earnings election the return is made by the husband alone unless there has also been an application for separate assessment). The option would thus give a wife complete privacy once the couple had exercised it (though husband and wife would have to tell each other sufficient about their incomes to establish that it would be beneficial to take up the option).

c. The numbers benefiting from such an option would be likely to be in the region of 400,000 - as compared with the 100,000 who benefit from the wife's earnings election - at a cost of some £m200 a year. The uncertainties about the distribution of earned and investment income between husbands and wives mean that these figures must be treated with caution. However a recent sample survey conducted by the Inland Revenue gives some indication of the numbers involved. The table below summarises some of the results of this survey, showing the numbers of married couples with investment income in 1977/78, broken down by the respective contributions of husband and wife to the combined income.

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NUMBERS OF COUPLES WITH INVESTMENT INCOME, SHOWING RESPECTIVE CONTRIBUTIONS OF HUSBAND AND WIFE

1977/78

| Range of wife's investment income | Range of husband's investment income | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Nil | | £1-£9 | | £10-£99 | | £100-£499 | | £500-£999 | | £1,000-£4,999 | | over £5,000 | | All ranges | |
| Nil | - | | 309 | (6) | 1,108 | (23) | 617 | (13) | 122 | (3) | 115 | (2) | 7 | (-) | 2,277 | (47) |
| £ 1-£ 9 | 60 | (1) | 117 | (2) | 142 | (3) | 44 | (1) | 5 | (-) | 7 | (-) | - | (-) | 376 | (8) |
| £ 10-£ 99 | 119 | (2) | 52 | (1) | 527 | (11) | 236 | (5) | 53 | (1) | 39 | (1) | 2 | (-) | 1,029 | (21) |
| £ 100-£ 499 | 117 | (2) | 18 | (-) | 48 | (1) | 405 | (8) | 86 | (2) | 75 | (2) | 6 | (-) | 755 | (16) |
| £ 500-£ 999 | 19 | (-) | 1 | (-) | 17 | (-) | 59 | (1) | 69 | (1) | 50 | (1) | 6 | (-) | 221 | (5) |
| £1,000-£4,999 | 6 | (-) | - | (-) | 7 | (-) | 24 | (-) | 28 | (1) | 88 | (2) | 14 | (-) | 168 | (3) |
| Over £5,000 | 1 | (-) | - | (-) | 1 | (-) | 1 | (-) | 1 | (-) | 12 | (-) | 5 | (-) | 22 | (-) |
| All ranges | 323 | (7) | 497 | (10) | 1,849 | (38) | 1,386 | (29) | 364 | (8) | 386 | (8) | 41 | (1) | 4,846 | (100) |

(Numbers of couples in thousands)

Figures in brackets are percentages of the total number of couples with investment income.

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4.6 Under this option for independent treatment each partner would have a separate set of rate bands, as well as a separate tax allowance. So there would be a potential tax advantage to be gained by transferring income from the better-off husband (or wife) to the other spouse. With earned income the opportunity for splitting income in this way hardly arises, except perhaps where the wife works for her husband. With investment income, however, the opportunities would clearly be much greater. In so far as this could lead to a more even distribution of the underlying capital between husbands and wives, this may be regarded as no bad thing. Nonetheless some people might feel that the potential benefit to richer couples would be so great that a limit should be placed on the size of the tax advantage. (This possibility is examined in Chapter 6.3.3 where some of the implications of a mandatory system of independent taxation - as distinct from an optional one - for the treatment of investment income and for capital taxation are further considered). But in any case, under a system whereby husbands and wives could be taxed as independent individuals on the whole of their income (including investment income) it would be necessary to give consideration to the prevention of artificial methods of reducing the tax bill by transferring income from husband to wife or vice versa. It would certainly be necessary to nullify for tax purposes inter-spouse payments under covenant and perhaps also to amend other settlements legislation to take account of transfers of income between spouses.

4.7 <u>Option for independent taxation: equal split of allowances and rate bands</u> Independent taxation of earnings and investment income, as outlined in Chapter 4.5, would not be beneficial to everybody. In most cases the loss of the married allowance would be greater than any benefit the couple could gain by having an extra set of rate bands and an allowance which could be set against all the wife's income, whether earned or from investments. For these couples, it would be possible to build on the present facility for separate assessment, to give each spouse <u>separate responsibility</u>

for his or her own tax affairs with an equal share of any reliefs due. The existing arrangements for separate assessment give some independence to the wife, in that she can make her own returns and pay her own tax; but they are little used and have come in for a certain amount of criticism in recent years. This criticism has focused on three particular points:

a. The split of allowances and rate bands between husband and wife in proportion to their incomes results in the spouse with the lesser income getting the smaller share of the reliefs etc - and this is usually the wife.

b. The basis of the split is complex, and this may be why only some 10,000 couples take advantage of the option.

c. The split in proportion to income means that each spouse can calculate the amount, though not the sources, of the other's income, so that the wife with a small income from savings in practice enjoys little privacy from her husband.

4.8 It would be relatively simple to alter the rules for separate assessment, in such a way that, for cases where it would not be beneficial for the couple to choose to be taxed as two single individuals, they could nonetheless opt for separate responsibility with an equal split of the available allowances and rate bands. Thus -

a. The main allowances and rate bands could be split equally between husband and wife, instead of proportionately to their incomes. Where one spouse had insufficient income to use up his or her half-share of the available reliefs and rate bands, the balance would be transferred to the other spouse. (The calculations in Appendix 4 show just how this would

affect individual spouses' tax bills.) Thus, the married man's allowance and wife's earnings allowance would be divided equally between the spouses. Certain allowances, such as the blind allowance, and reliefs, such as for mortgage interest, might, instead of being split equally, be allocated wholly to the spouse to whom they were appropriate. Separate responsibility on these lines would obviously be simpler than the present basis of separate assessment. In addition, many would regard the equal basis of the split as self-evidently fairer than the present basis: it would mean that the spouse with the lower income would pay a lower share of the total tax bill then at present. On the other hand, the spouse with the larger income would have a greater share of the tax bill than under the present system. Although this may well be right in principle, the spouse with the larger income (usually the husband) who is separately assessed at present, might not welcome the fact that an equal split of allowances would reduce his partner's share of the tax at his own expense.

b. In view of the greater simplicity of separate assessment with an equal split of allowances, this option for separate responsibility would in practice be more attractive than at present.

c. An equal split of the allowances etc would confer a much greater degree of privacy than the present system on both husband and wife in relation to earnings and investment income. In many cases the privacy would be complete: even where it was not, only the spouse with the higher income could calculate the amount (although not the source) of the other spouse's income.

### 4.9 Conclusion

4.9.1 This chapter has examined the possibility of an option for independent taxation within the present system: husbands and wives could choose to be taxed as single individuals on the whole of their income, or they could opt to be separately responsible for their own tax affairs, in which case the available allowances and rate bands on the joint income would be split equally between them. Either of these changes could be implemented on its own. The Government consider that each can be justified on its own merits. But they take the view that their real advantage lies in their value as a package. If a package in this form were implemented, there would be three possible ways in which husband and wife could choose to be taxed:

a. under the present aggregation rules, subject to revision of the wording of the aggregation rule itself;

b. as an alternative, an option for independent taxation which could take one of two forms;

either (i) where beneficial, husband and wife each being treated as separate individuals in respect of all their income;

or (ii) where (i) was not beneficial, equal sharing of the combined allowances and rate bands.

Under each of the options in b. husband and wife could be individually responsible for their own tax affairs. Option b(i) would affect the size of the tax bill on the combined incomes of husband and wife and this suggests that the couple should be required to make a

joint election for it (as is the case with the present wife's earnings election). But either husband or wife could choose option b(ii), like separate assessment now, as it does not affect the amount of tax the couple pay between them.

4.9.2 A change on these lines would have the following results:

a. All spouses, wives as well as husbands, would be able to have a considerable degree of privacy over their tax affairs, and for some the privacy would be complete.

b. Married women would have the option of being treated as taxpayers in their own right - completing their own tax returns and getting relief for any mortgage interest etc they pay. They would also be able to receive their own repayments and conduct their own correspondence with the Inland Revenue, even in cases where the present procedures (described at the end of Chapter 2) do not normally allow this.

c. Married women would be able to benefit from exactly the same personal allowance as their husbands.

d. There would no longer be any tax on marriage - husbands and wives could be taxed as single individuals on <u>all</u> their incomes.

4.9.3 This could be regarded as an answer to the complaints of discrimination between husband and wife (Chapter 3.3.2 and 3.3.3), provided that it were considered sufficient for this purpose that the wife (or husband) who wanted independent treatment could elect for it (so

that the treatment would not be mandatory). It would also be a major step towards giving more equitable treatment as between married couples in different circumstances. It would not meet many of the arguments that the present system is discriminatory between different family units - for example, the criticism that it is excessively generous to two-earner married couples (Chapter 3.3.4 and 3.3.5). But by the same token it would avoid the major shift of the tax burden between different family units which would be produced by a system of mandatory independent taxation (described in Chapter 6), under which the married allowance would be abolished. By comparison with mandatory independent taxation, it would have the advantage of being relatively cheap, relatively inexpensive in terms of staff (though the revenue and staff costs would nevertheless be substantial in absolute terms) and capable of early implementation. But at the same time it would also be compatible with a subsequent move to such a system of independent taxation. For those who regard full independent taxation as a desirable ultimate solution, the changes discussed in this Chapter could be regarded as a step on the road.

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CHAPTER 5 - CHANGING TO A NEW SYSTEM : THE TAX UNIT

Introduction

5.1.1 The fundamental question underlying any option for structural change in the taxation of the family is the choice of the unit of taxation. There are in principle three basic approaches. The first is to treat the family (husband, wife, children, perhaps also other dependants) as the unit. The second approach takes the married couple (husband and wife) as the tax unit. The third is to look at each person as a separate individual unit regardless of whether they are single or married. It is of course possible to mix these approaches in a particular tax structure (this is the case, as Chapter 2 has demonstrated, in the present UK structure), but it is helpful in any analysis to distinguish between them.

Family as a unit

5.2.1 A family tax unit would involve aggregating the incomes of all members of a family household, and taxing them, subject to any appropriate allowances, as one. One version of this is the French family quotient system under which incomes of spouses, dependent children and certain close relatives living under the same roof are added together. The total income is then divided into a number of "parts" according to the number of persons in the family (children for this purpose count as a half "part"). The tax chargeable on a single "part" is then multiplied by the number of parts to give the total amount payable. Responsibility for making returns and paying the tax is placed on the husband.

5.2.2 How a quotient system, which is based on the family as a unit, works can best be illustrated by a hypothetical example. Assume a country where each adult counts for one unit and each child for a half unit. This country has a progressive income tax structure, with rate bands of -

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| | | |
|---|---|---|
| 0-£ 5,000 | - | 30% |
| £ 5,000-£10,000 | - | 40% |
| £10,000+ | - | 50% |

A two-child family, where the husband's salary is £12,000, the wife's earnings £6,000 and each of the children has an investment income of £1,500, would have a tax bill calculated as follows:

Total family income - £21,000
Total number of units - 1 + 1 + ½ + ½ = 3
therefore income per unit - £7,000

Tax chargeable on income of each unit

| | £ |
|---|---|
| £5,000 at 30% = | 1,500 |
| £2,000 at 40% = | 800 |
| | 2,300 |

Total family tax bill = £2,300 x 3 = £6,900

In effect, therefore, this family pays 3 times the tax paid by a single person with a third of the family's total income.

5.2.3 The tax payable under such a system depends on the weight given to each family member. A husband and wife could, for example, count as 1.5 units rather than 2, and a child could be brought in at less, or more, than a half unit. The tax payable on this income under a UK-type system would depend on the allowance levels and on the treatment of the investment income. At present levels of allowances in the UK, the tax bill would be around the same as under the quotient system described - less if the investment income were treated as the children's, more if it were treated as the father's. But the effect could vary substantially with the family income level, and a quotient system would produce considerable shifts in the relative tax burdens of different family groups.

Husband and wife as a unit

5.2.4 This involves aggregating the incomes of a married couple and taxing them, subject to the provision of the appropriate allowance, as one. The present UK structure works in this way: the income of a married woman living with her husband is "deemed for income tax purposes to be his income and not her income". Treating husband and wife as one unit need not, however, involve treating the income of one spouse as belonging to the other. The law could simply provide for the spouses' incomes to be added together and make them jointly responsible for any tax due (though it would be difficult to make a system like this mandatory, cf para 4.2).

5.2.5 The UK system taxes the joint income of the two spouses according to the same scale of rates as applies to a single person. In West Germany, on the other hand, a married couple may be taxed in much the same way as the family under a quotient system: the joint income is divided by two, and the tax applicable to this sum is calculated and then doubled to give the total tax bill - in other words the married couple's tax is calculated as if their joint income were divided equally between them. This could be regarded as a quotient system (see 5.2.1-3) confined to husband and wife, instead of all members of the family. Some features of this approach are present in the United States system. Further details about these and other countries' tax systems are contained in Appendix 7.

Individual as a unit

5.2.6 The starting point here is that each person - single or married - should be treated as a separate individual for tax purposes. Husbands' and wives' incomes are taxed separately, with each partner having his or her own set of rate bands and the same tax allowance as a single person. Where one spouse has insufficient income

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to use up his or her allowance there may be provision for transferring some or all of the unused allowance (see next Chapter). But, unlike a quotient system, rate-bands are not transferable under individual taxation: a married couple where only one spouse has income will have one set of rate bands, not two. In a system where the individual is the tax unit, each spouse is separately responsible for completing his or her own tax returns, conducting his or her own correspondence with the tax authorities and paying his or her own tax.

Direction of change

5.3.1 In principle, a quotient system which takes the family as the unit can be justified as a means of measuring personal tax liability. But, if one is to judge by the criticisms of the present system outlined in Chapter 3, it seems unlikely that there would be much support in the UK for a change in this direction now. Many of the criticisms of the way the present system treats married couples would apply with even greater force to a quotient system or to any other system based on a family unit. For example, a married woman would have no more privacy than she does at present and, depending on the precise form of the system, her husband and children could have considerably less.

5.3.2 In addition, a family tax unit would produce major changes in the treatment of children. In principle it would mean that income of a dependent child would be added to his parents' income for tax purposes. With one brief exception, direct aggregation of children's income with their parents' has never been a feature of our tax system. The exception was from 1969 to 1972, when the principle of aggregation was extended to include children's investment income (though not their earned income). As a corollary of aggregating their income, the use of the family as a tax unit would also call for some relief in respect of children eg as half units under a quotient

system (see paragraph 5.2.2). But child tax allowances have now been largely withdrawn and replaced by tax-free child benefits, and in this sense it would be a retrograde step to reintroduce tax relief for children as such.

5.3.3 More generally, to move to a family tax unit would be to fly in the face of recent changes in our personal tax system. The UK tax system has already modified the aggregation principle in important respects - giving the wife an allowance against her earnings equal to the single person's allowance and introducing an option for the separate taxation of wife's earnings - to provide more individual treatment for married women. Moreover, as Appendix 7 demonstrates, international trends over the last decade have almost all been in the direction of individual taxation. Against this background it seems unlikely that the substantially wider aggregation a family tax system involves would be generally acceptable in the UK today.

5.3.4 In practice, therefore, the choice for the basic tax unit seems to rest between the married couple (ie continuing to aggregate husband and wife's income) and the individual. The first of these options has already been discussed in Chapter 4, which has examined the extent to which the criticisms of the present system might be met by retaining the married couple as the basic tax unit but modifying the existing rules. The following Chapter deals with the consequences of moving to an individual tax unit.

CHAPTER 6 - MANDATORY INDEPENDENT TAXATION

6.1.1 Chapter 4 described an option under which married couples could choose to be treated as separate individuals. Here we are concerned with a change to a new system under which independent taxation would be the rule for all married couples. Such a mandatory system of independent taxation would mean the abolition of the married allowance and of the aggregation rule, so that all married women would become taxpayers in their own right, with their own personal allowance and rate bands. They would complete their own tax returns, conduct their own dealings with tax offices, and be ultimately responsible for paying any tax due on their own incomes. In this respect all married people would get the treatment which would be available as an option under the schemes outlined in Chapter 4. But the changes in personal allowances would give rise to significant shifts in the share of the tax burden borne by different family groups. The implications of this are examined under three heads -

a. the treatment of the one-income couple where one spouse is financially dependent on the other;

b. the treatment of investment income;

c. other effects of independent taxation; and the distributional effects of the various options are illustrated in Appendix 6.

6.2 <u>The one-income couple</u>

6.2.1 <u>Case for a transferable allowance</u> Proponents of a system of independent taxation must face the question of providing for the case where one spouse has little or no income, so that he or she cannot use, or fully use, the single allowance. Should there in these circumstances be provision for transferring the allowance to the supporting spouse who would thus receive an allowance higher than

the single allowance? There is clearly a strong case for such a provision on grounds of equity. In the present system the married allowance recognises the special legal and moral obligations on a husband to support his wife. In recent years the tendency has been for these obligations to become reciprocal: thus the Matrimonial Causes Act 1973 gives husbands the same right of support against their wives on divorce as wives have against their husbands. All this suggests that, with the abolition of the married allowance, some allowance in excess of the single allowance is needed in recognition of the support the one spouse gives to the other out of his or her own income. To put it another way, where one spouse is dependent upon the other for financial support, there is a case for some recognition by the State. In so far as the need to support the dependent spouse reduces taxable capacity, then tax relief should be increased to take account of it. Savings from abolishing the married allowance could be used at least in part to provide transferability of allowances between spouses, so giving the supporting spouse a higher allowance, not as now simply in recognition of marriage, but in recognition of the need to give financial support to the other. Those who argue that recognition should be given through a cash benefit rather than a tax allowance (see 6.2.7-6.2.9 below) would see the savings from abolition of the married allowance used instead to provide a new benefit (or to improve an existing benefit).

6.2.2 <u>Fully or partially transferable</u>? Allowances within a system of independent taxation could be made fully or partially transferable.

a. With <u>full transferability</u> any unused allowance could be used by the other spouse. Thus, if the single allowance was £1,000 and the wife had no income, the husband would get the full £1,000 of the wife's allowance, in addition to his own. If the wife's income was £500 the husband would get £500 in respect of her unused allowances, and so on. So each £1 of the supported spouse's

income would reduce the allowance transferred to the other spouse by £1 until it ran out entirely where the supported spouse's income reached the level of the single allowance.

b. Partial transferability, on the other hand, would limit the transferable allowance to a proportion of the single allowance. Thus, if the partially transferable allowance were to give the one-income couple the same relativity as now to a single person, ie 1.56:1, then if the single allowance was £1,000 the supporting spouse would get £1,560 (through transfer of £560). The amount of allowance transferable would vary with the supported spouse's income. Income up to £440 (£1,000 - £560) would not affect the amount transferred: it would remain at £560 because income below this level would be disregarded. This would mean that no tax liability would arise where the supported spouse had small part-time earnings or income from savings which amounted to less than the disregard limit. Any income above this £440 disregard would reduce the transferable allowance £1 for £1, from £560 to nil. Thus, where the supported spouse had income in the range between the disregard limit and the single allowance (ie £440 to £1,000), each extra £1 of income would reduce the transferable allowance and would thus effectively be taxed at the other spouse's marginal rate in the same way as with fully transferable allowances. If the wife had £450, the husband would get £550 in respect of her unused allowances; if she had £500 the husband would get £500, and so on. The level of the transferable allowance (and its converse, the disregard) could be varied according to the view taken of the reduction in table capacity arising from the need to support two married persons on one income.

6.2.3 In assessing the merits of fully or partially transferable allowances, the following criteria are relevant:-

a. Equity

Whether allowances were fully or partially transferable, there would be an effect on the relative incidence of taxation among different types of families. On either basis two-earner couples would not, as now, have greater allowances than two single people, and, depending on how much of the allowance was transferable, the one-earner couple could have relatively greater allowances than now. (Here, and elsewhere in this part of the Green Paper, couples are referred to as "one-earner" or "two-earner" because the context is primarily that of one or both going to work; but the same considerations arise as to the transferability of allowances etc whether the incomes are derived from earnings or investments or a mixture of the two). But in general these shifts in the contributions of different family groups to the total income tax revenue (which are set out in detail in Appendix 6) would be more marked with fully than with partially transferable allowances:

i. The main effect of fully transferable allowances would be to tilt the balance in favour of the couple where one spouse stays at home as compared with two-earner couples and single people. Taking the illustration in paragraph 6.2.2, the one-earner couple would now get allowances of £1,560, the two-earner couple £2,560, and two single people £2,000. Under fully transferable allowances, these different types of households would all get total allowances of £2,000. Some people would welcome this relatively generous treatment of

the one-earner couple, as it would recognise the contribution of the spouse at home and cushion the drop in income when, for example, the wife gave up work to have children. Others, however, would regard it as unfair not to recognise through a higher allowance the extra expenses involved when both spouses go out to work. Also, it might be thought unfair that single people and widows, who might also be running a household on a single income, should get only half the allowances of a one-earner couple.

ii. Partially transferable allowances would also mean that the two-earner couple were given no more allowances than two single people (ie £2,000 if one follows the illustration above). But, for the couple where one spouse stays at home, partially transferable allowances would have an inbuilt flexibility: their level could be adjusted as seemed appropriate in relation to the allowance given to single people and working couples. It could be set so as to maintain the present relationship between the married man's allowance and the single allowance (£1,560 as compared with £1,000 in terms of the illustrative example), thus continuing to mirror the ratio borne by the married to the single rates of social security benefits. This relationship would be regarded by many as a fair reflection of the reduction in taxable capacity caused by the need to support a spouse at home. But if it were felt desirable

to give even greater recognition to the contribution of the spouse at home, the transferable allowance would be set at a higher level - (so that, in terms of the illustrative example, the one-income couple's allowances amounted to between £1,560 and £2,000). A much lower allowance, on the other hand, would recognise the contrary point of view that the spouse at home is not so much a financial liability for the spouse at work as a provider of various services which would otherwise have to be bought on the market. With partial transferability, unlike full transferability, the size of the allowance given to the one-income couple could be varied to reflect the weight given at different times to such different views.

b. Work incentives

The present system contains a provision - the wife's earned income allowance - specifically designed to encourage married women to go out to work. This would disappear under independent taxation. Under fully transferable allowances, a wife's income up to the level of the single allowance would effectively be taxed at the husband's marginal rate. The married woman herself would not pay any income tax but the husband would lose the transferable allowance from his PAYE code which he had enjoyed while he was the sole earner. Looked at from the point of view of the family as a whole, a fully transferable allowance could well discourage some married women from taking up work in the first place. This would be particularly true where she was comtemplating part-time work, when all her income could bear tax at her husband's

marginal rate. If the allowance was only partially transferable, the wife's earnings or other income below the disregard limit would not affect the couple's tax bill. So any disincentive would apply for a narrower range of income than with fully transferable allowances.

c. Privacy. Unless the allowances were non-transferable, the supporting spouse would necessarily know something about the other spouse's income, if it was below the level of the single allowance, since it would affect the level of his own tax allowance. If they were fully transferable, he would know of changes in the level of the other income from nil up to the single allowance. However if they were only partially transferable he would only know of changes between the disregard limit and the single allowance; below that limit he would know only that it was below the disregard but not by how much. This would effectively give almost total privacy for wives with a small income, and it is perhaps in relation to small amounts of savings income - the nest egg - that the need for privacy is most strongly felt. With a transferable allowance complete privacy could only be achieved in all cases if the dependent spouse was given the right to refuse to transfer any unused allowances. This would of course mean that the total tax on the couple's income could be significantly increased.

d. Administrative costs Under fully transferable allowances, the fact that every £ of the supported spouse's income up to the level of the single allowance would affect the allowances of the other spouse would have serious administrative implications for the Inland Revenue requiring thousands of extra staff (see Chapter 10). If the allowances were partially transferable, the

administrative costs would be less severe (since the transfer of allowances would apply only within the range of income from the disregard limit to the single allowance) but they would still be substantial.

e. Revenue cost. This would vary with the extent of transferability. Clearly, full transferability would be more expensive than partial transferability. With either system the cost could be phased over a period by starting the transferable allowance at a relatively low level and then raising it. This possibility is examined further in Chapter 8.

6.2.4 Status of supported spouse : Restriction on transferability It has so far been assumed that the mere fact of a spouse's financial dependence would give the supporting spouse entitlement to some additional allowance. But it is arguable that this should not be so and that the transferability of the allowance should depend on the status of the supported spouse. Whereas the case for a generally available allowance depends on fiscal arguments (see paragraph 6.2.1 above), the case for restriction would be derived largely from social considerations. Thus, it could be argued that the circumstances where one partner has no family responsibilities but does not work should not be reflected in the tax bill of the partner with the income and that there should be no allowance unless the non-working spouse had specific home responsibilities.

6.2.5 The implications of this are best examined by reference to the circumstances which are likely to cause husband or wife, usually wife, to stay at home:-

a. Dependent children It is clear that most married women who stay at home do so because they have dependent children to care for (see Appendix 5). It would be hard to exclude these wives from transferability, at least where there was a child under 5 and, in the view of many, where there was a child under 16.

b. Dependent relatives Those who look after an incapacitated or elderly parent or other relative would be regarded by many as equally entitled to a transferable allowance as those who stay at home to care for dependent children. The burden of caring for adult dependants is often heavier, may go on for longer, and is not chosen in the way couples choose to have children.

c. Incapacity There would also be strong arguments for recognising the case where one spouse is incapacitated and thus cannot work. (At present the family with children where the wife is totally incapacitated gets an extra allowance - the additional personal allowance - on top of the married man's allowance. But under independent taxation, this extra allowance for the husband with an incapacitated wife could hardly continue in its present form).

d. Older spouses There would be a clear case for recognising spouses who are over retirement age and who are neither working nor drawing a pension in their own right. But it would be difficult to exclude those below retirement age whose children have grown up (or whose elderly dependent relatives have died) and who may no longer be able to find suitable employment.

e. The "involuntarily unemployed" At whatever age the line was drawn under d. above, there would be many without dependants to look after who, though relatively young, might find it very difficult to get suitable employment, eg because they live in an area where jobs are scarce. In equity their position should be recognised, but they are not easily defined as a group. If, eg transferability of the allowance for this group were made dependent on the wife registering for work, substantial numbers of wives might register as unemployed primarily for tax reasons.

6.2.6 These considerations suggest that, if one started from the proposition that some restriction would be desirable, one would be likely to find that on the merits few cases would fall into the restricted category. On fiscal grounds, the case for an unrestricted allowance is strong. Likewise, administrative considerations would point this way, since restrictions would inevitably introduce complexity. And, if on the merits the majority of supported spouses would fall outside the restriction, it seems doubtful whether even on social grounds there is a good case for it.

Provision through cash benefit rather than tax allowance

6.2.7 Some would argue that the need to provide for a dependent spouse should be met through social security rather than through a tax allowance. The comparative effects would depend upon the nature of the social security provision, but in general the major differences would be these -

a. Moving from a tax allowance, the value of which varies with the taxpayer's marginal tax rate, to a cash benefit would alter the relative positions of families at different income levels. Higher rate taxpayers would lose - relatively if not absolutely - and those below the tax threshold would gain (subject to the point that many of those below the tax threshold are already in receipt of some social security benefit which could be reduced by the amount of any new benefit).

b. Within the family, there would be a transfer from the supporting spouse, who would suffer a reduction in take-home pay, to the supported spouse who would receive the benefit (on the assumption that the benefit would be paid to the spouse at home).

c. If the benefit were to be withdrawn from a spouse who began earning, as with a transferable tax allowance, there would be a marked disincentive for married women to take up or return to part-time, perhaps even full-time, work. This could be more marked than with a tax allowance, because it would be the supported spouse taking up work who would directly suffer the penalty of withdrawal. If on the other hand benefit were not withdrawn from part-time earners, it would be difficult to defend the provision of full benefit, regardless of total income, where one spouse earns full-time and the other part-time.

d. Even if the effect was to leave an individual family with the same net income as before, substituting a cash benefit for existing tax allowances would mean increasing public expenditure. In the Government's view more than accounting conventions are involved here: the distinction between cash benefits (which increase public expenditure) and tax allowances (which do not) is an important one.

6.2.8 If social security provision were made, it would be administratively simpler to build on an existing benefit. The possibilities would appear to be -

a. <u>Child benefit</u> "Savings" from the abolition of married allowance could be used to increase child benefit, either for the first or for all children. But, to fit the case of the mother at home for whom the benefit would be intended (as distinct from the working mother), the additional child benefit would have to be payable only to non-working mothers, however defined. Administratively, this would be very costly and it would be difficult to prevent abuse. On the other hand, if the additional

benefit went equally to two-earner and one-earner families, this would mean that one-earner families with children would be no better off, relative to two-earner families with children, than under the present system.

b. <u>Invalid Care Allowance</u> This is the nearest equivalent in the present system to a cash benefit for spouses at home who care for elderly or sick dependants. But at present it applies only where the dependant is very severely disabled and it is not given to married women looking after such dependants. It could however be extended, in such a way that, if it were coupled with an addition to child benefit for the mother at home looking after children, there would be provision for virtually all wives who do not work because of home responsibilities.

c. <u>Housewives' Non-contributory Invalidity Pension</u> This is a benefit for married women who are incapable both of paid work and of normal household duties. In principle it could be built upon to cover all incapacitated spouses. In its present form, however, it does not cover all disabled married women who are unable to take up suitable work, but the possibility of altering the rules is currently under consideration.

6.2.9 An alternative approach would be to devise a new cash benefit for the supported spouse. The two main possibilities would appear to be -

a. <u>Home Responsibility Payment</u> This could be based on the home responsibilities protection incorporated into the new pension scheme, which provides pension coverage for people at home for a whole tax year in which they are in receipt of child benefit or have care of a relative in

receipt of attendance allowance or constant attendance allowance, or in receipt of supplementary benefit to look after a sick person at home. It would be possible, though difficult, to pay a benefit to people who qualified for such protection, one of the difficulties being that it would not be known until after the end of the year whether the home responsibility payment would be due. But, unless the qualifying conditions were extended to all spouses at home with care of the sick, many worthy cases would fail to qualify. Moreover, a home responsibility payment, unlike invalid care allowance, would not build up the contribution record for short term benefits, so that it would not help those whose families had grown up or who were seeking employment unsuccessfully. Even on this restricted coverage, a home responsibility payment could be very costly in staff terms.

b. <u>Financial Dependency Payment</u> Another approach would be to devise some payment which recognised the fact of financial dependency. Even if this were practicable, it would be unlikely to command much support. Thus, it would be payable to many wives who, though financially dependent, were because of their husband's resources self-evidently not in financial need. Such a payment could also be represented as reinforcing the traditional domestic role of women.

<u>Other Possibilities</u>

6.2.10 It would be possible to replace the married allowance by some combination of tax allowance and cash benefit. Indeed, this is what some critics of the present system have suggested. But, apart from the arguments against cash benefits summarised in the following paragraph, such an approach would involve setting up systems both for a transferable allowance and for new or revised cash

benefits. The administrative costs of such a combination could well be much greater than either a cash benefit or a tax allowance on its own.

6.2.10A The preceding paragraphs have assumed that each spouse would be entitled only to a single allowance and that, where one was financially dependent upon the other, this would be recognised by transferability of the tax allowance or by a cash benefit (or by some combination of the two). It can however be argued that on top of the transferable tax allowance (or cash benefit) there should be an additional allowance or benefit, so that, if the basic tax allowance was fully transferable, the supporting spouse would get twice the single allowance and in addition an allowance (or benefit) in recognition of the dependent spouse's home responsibilities. This could be seen as extending the family's freedon of choice - eg for the wife to give up employment and stay at home to look after children or an elderly parent - and unlike a transferable tax allowance it would be in specific recognition of the circumstances that required her to stay at home. On the other hand, whereas independent taxation with a transferable allowance would remove what many people see as the bias in the present system in favour of a wife going out to work, an additional allowance for home responsibilities would introduce a new bias in favour of the wife staying at home in certain circumstances and against her going out to work; and it would produce a corresponding increase in the relative tax burden of working couples as compared with one-earner couples. Unless additional resources were available for such a new allowance (or benefit) its introduction would inevitably mean that the single allowance (and hence tax thresholds generally) would have to be held down to finance it. Furthermore, such a combination of allowances (and or benefits) would be more complex than either a transferable tax allowance or a cash benefit on its own and could greatly increase the number of staff needed to run the system.

6.2.11

Conclusion

The main arguments for provision for the dependent spouse through cash benefit rather than tax allowance would seem to be that this would ensure that the benefit went direct to the supported spouse, and that it would be equally available for those whose incomes were below the tax threshold so that they could not benefit from a tax allowance. On the other hand:

a. Distributional effects. While the effects of providing for a dependent spouse through social security rather than through a tax allowance (noted in paragraph 6.2.7 above) do not point clearly towards or against a cash benefit, they indicate some of the difficulties inherent in a cash benefit approach. Replacing a tax allowance which varies with the taxpayer's marginal tax rate with a flat rate benefit, and transferring income within the family, could be regarded as comparable with those which have arisen from the switch from child tax allowance to child benefit. But, whereas with child tax allowance it was not the claimant's own allowance which was at stake but only in effect an additional allowance for a dependant, with the abolition of the married allowance married men might be even more inclined to regard themselves as "losers" particularly if their circumstances were such that the family did not stand to benefit from the additional social security provision available (eg if the couple were childless and the additional provision were made through child benefit). With regard to the question of what happens to the provision for the wife at home when the wife takes up work, it is evident that the problem of the wife who is a part-time earner would be considerably more difficult to solve satisfactorily with a cash benefit than with a transferable tax allowance.

Whereas a cash benefit has either to be paid in full or withdrawn completely, under a transferable allowance scheme the amount of the allowance available to the supporting spouse would be tailored to the level of the other spouses income.

b. <u>Form of the benefit</u>. But even greater problems arise when one considers the form which the benefit might take. Neither of the new forms of benefit described in paragraph 6.2.9 is attractive; and, although the Government would welcome comments on these and suggestions for other forms of benefit which might be more suitable, it seems unlikely that a satisfactory form of new benefit could be found. But, if one turns to the possibility of building upon existing benefits as examined in paragraph 6.2.8, it is apparent that, although it might be possible by a combination of the three benefits there mentioned to achieve a coverage which could be broadly comparable with that of a transferable tax allowance, full coverage would not be attainable. If one turns to the circumstances listed in paragraph 6.2.5, child benefit, invalid care allowance and housewives non-contributory invalidity pension might be extended in such a way as to cover categories a., b. and c. (dependent children, dependent relatives and incapacitated spouses). But they could not be extended to cover categories d. and e. (older spouses and the involuntarily unemployed). It would not be easy to defend the denial of provision for these cases on abolition of the married allowance; but it would be extremely difficult to provide for them through social security in a satisfactory way.

6.2.12 In the Government's view, the arguments against provision for a dependent spouse through the social security system, as set out in the preceding paragraphs, are very weighty; and it follows from this that, if the married man's tax allowance is to be abolished, there is a very strong case for replacing it with a transferable tax allowance along the lines examined in paragraphs 6.2.1 and 6.2.3 above.

The treatment of investment income

6.3.1 The main criticisms of the present treatment of investment income, that the system is unfair because it is not neutral as between the married couple and two single people living together and that it involves a breach of the wife's personal privacy, would be substantially met if the present system were to include options for independent taxation of the kind described in Chapter 4. But a mandatory system of independent taxation would be necessary to ensure that both criticisms were fully met in all cases. Under such a system no married couple's tax bill would be affected by whether the income of husband or wife came from earnings or investments, subject only to any surcharge imposed on investment income (and husband and wife would have separate thresholds to the surcharge, instead of as now the same threshold for a married couple as for a single person). If each had sufficient income - earned or investment - to absorb the whole of the personal allowance, each would have complete privacy over investment income as well as earnings. If the allowance was wholly or partially transferable, the degree of privacy would be more limited - the more so, the greater the degree of transferability - for the reasons described in paragraph 6.2.3c.

6.3.2 Measures would be needed, as under an option for the separate taxation of a wife's investment income as well as her earnings (see Chapter 4), to prevent avoidance through schemes for transferring income between spouses. In addition it would be for consideration whether, for

investment income unlike earnings, independence should be limited, in other words, there should continue to be at least partial aggregation. This might involve, as in Sweden, allowing each spouse a slice of investment income which would be taxed individually, and aggregating investment income above this slice in such a way that the excess would be treated as income of the better off partner in order to determine the tax payable. But such a combination of disaggregation for earnings and partial aggregation for investment income would be difficult to defend on grounds of fiscal principle and administratively complex; and it could only be justified in political or social, not in fiscal terms.

6.3.3 If the combination of total disaggregation of investment income for income tax purposes with the favourable treatment of transfers between spouses for capital tax purposes were considered too generous, an alternative to partial aggregation would be some restriction applied through the capital taxes. Taking first capital gains tax, independent taxation would in any event involve separate thresholds for husband and wife; but it would also logically require the withdrawal of the present facility whereby the losses of one spouse can be set against the net gains of the other. It would be possible to tighten the regime under independent taxation, so that transfers between husband and wife on a "no gain, no loss" basis would cease to be exempted. The case for a comparable change in the capital transfer tax is less clear cut. Removal of the spouse exemption at death could hardly be justified as a corollary of independent taxation for income tax. The case for withdrawing the exemption for lifetime transfers would be perhaps somewhat stronger; but it would be a major change in the capital transfer tax system to charge the tax on lifetime transfers and exempt those at death. Such a change would be complex and administratively expensive, and many of the transactions that were thus brought into tax might not in fact be effectively compensated by any reduction in income tax through independent taxation.

Other effects of independent taxation

6.4 Mandatory independent taxation would totally end the problems (described in Chapter 3.3.2-3.3.3) of discrimination between husband and wife which tend to be focal points of criticism under the present system, subject to the difficulty of ensuring complete privacy described in Chapter 6.2.3c above. The options for independent taxation described in Chapter 4 would also remove them to the extent that the options were exercised with, again, a qualification about privacy - see Chapter 4.5b. Reference has also been made to the problems which can arise under the present system on the allocation of allowances and reliefs between husband and wife. A particular example of this is the relief for mortgage interest, which, even where the wife pays the interest, can be allowed in her PAYE coding only if the husband agrees. Under mandatory independent taxation all wives would as of right be given relief for mortgage interest which they pay, just like any other relief to which they would be entitled in their own right, and the options for independent taxation described in Chapter 4 could achieve the same result where they were exercised.

CHAPTER 7 : THE ELDERLY

## The elderly within the present system

7.1.1 Ever since 1925 our income tax system has included, in some form or other, special relief for elderly taxpayers of modest means. The present age allowance, which dates from 1975/76, provides higher tax thresholds for all taxpayers aged 65 or over whose total income does not exceed a prescribed limit. If their income exceeds this amount, the special relief is reduced by £2 for every extra £3 received until it is the same as the ordinary single or married allowance, as appropriate. Appendix 3 sets out the current values of the age allowance and income limit.

7.1.2 The present reliefs for the elderly are given on the grounds that a reduction in taxable capacity comes with the onset of old age. In addition age allowance has certain practical advantages. Because it is set at a level somewhat above the National Insurance Retirement Pension, elderly people can also have a small occupational pension or a modest amount of earnings without becoming liable to tax. Single pensioners, for example, can supplement their pensions at present by up to £10.11 a week without incurring any tax liability.

7.1.3 On grounds both of principle and practice, therefore, it has been accepted that some special tax relief for the over-65s should be retained. International practice reinforces this approach: of the countries covered in the Appendix on international comparisons (Appendix 7) only in Australia and New Zealand is there no fiscal preference for the elderly. The rest of this Chapter therefore proceeds on the assumption that, in any scheme of structural change, something similar to the existing age allowance is likely to be required.

Developing the present system (Chapter 4)

7.2.1 In essence the possible developments of the present system discussed in Chapter 4 would have much the same effect on the elderly as on other taxpayers. However, the option for a wife to be taxed independently on her investment income as well as her earnings (paras 4.5 to 4.6) could prove to be relatively more advantageous to elderly taxpayers as a group than to the non-elderly, and about one third of the total £m200 tax reductions would accrue to the elderly as a group. Two factors are relevant here. First is the tax treatment of pensions paid to a wife by virtue of her husband's contributions, such as the Category B National Insurance Retirement Pension, paid to married women who do not qualify for a retirement pension on their own contributions. Like all pensions, these are taxable as earned income. But these particular pensions, unlike a pension which arises from the wife's own contributions, do not qualify for wife's earned income allowance. Under an option for independent treatment, however, a married woman would be entitled to an allowance which she could set against all her income, including pensions paid to her by virtue of her husband's contributions. Whatever the basis of her entitlement, such a pension is entirely separate from her husband's. The married woman makes her own claim, has her own pension book and receives her own cash. The net effect of treating such pensions as the wife's income under such an option would be to increase the numbers of elderly people who would benefit from the option.

7.2.2 Second, under the present rules for wife's earnings election there is no entitlement to age allowance, so that husband and wife are each limited to the single allowance, regardless of age. This is of no significance in practice, since wife's earnings election is only beneficial to higher rate taxpayers and higher

rate thresholds have always been well above the income limit for special relief for the elderly. However, a number of taxpayers below the higher rate thresholds would stand to gain if the wife could be taxed as a single individual on all her income. Under an option for independent taxation, there is no good reason why the age allowance should not be available to a spouse over 65 (or to both, if both are over 65). Though it would inevitably complicate the calculations necessary to decide whether or not it would be beneficial to take up the option, the effect of admitting age allowance would likewise be to increase the number of over-65s who would stand to gain.

7.2.3 The other development of the present system, which would have a similar effect on the elderly as on other taxpayers is the new system for separate responsibility proposed in paras 4.7 to 4.8. This would split the elderly couple's total reliefs and allowances between the two spouses in precisely the same way as with non-elderly couples. Where, however, one spouse was over 65 and the other under 65, it would be for consideration whether the benefit of any age allowance they were entitled to should also be divided equally between them, or given to the spouse who is over 65.

Mandatory Independent taxation (Chapter 6)

7.3.1 If there was a move to mandatory independent taxation on the lines discussed in Chapter 6, age allowance could not continue in precisely its present form. These questions would arise:

a. The age condition. At present a married couple qualifies for age allowance if either spouse is aged 65 or above. Independent taxation of married couples would logically imply the withdrawal of age allowance from a

spouse aged less than 65, who currently enjoys the benefit of it because the other spouse is over 65.

b. Transferable allowances. Under a scheme of independent taxation with transferable allowances it would be for consideration what amount of allowance should be transferred. Where husband and wife were both over 65, it would follow naturally from the fact that the difference between married and single allowances for the over-65s is greater than for the under-65s that the transferable allowance should be similarly higher. But if, where the supporting spouse was over 65 but the dependent spouse under 65, the latter had available for transfer only the amount allowed for persons under 65, one-income couples could be relatively worse off than at present. In practice this would not happen often, since, under a system where independent taxation was mandatory as under an option for independent treatment (see para 7.2.2), the wife would have an allowance to set against her Category B National Insurance Retirement Pension, so that ordinarily there would be no unused allowance available for transfer. But the possibility of a relative increase in the tax liability of some old people could be avoided if the transferable allowance where either was over 65 reflected the present difference between the single and married allowances for those over 65, ie was set at a higher level than for those under 65.

c. Income limit. Under the current rules the same income limit - £5900 - applies to the joint income of a married couple as to that

of a single person. If an income limit were to continue under a system of mandatory independent taxation, the obvious course would be to apply it to each spouse individually; and, to avoid some older people being adversely affected when the new system was introduced, each would have to be entitled to the equivalent of the joint limit at the time of change.

Tax treatment of pensions

7.3.2 The case for treating pensions paid to the wife by virtue of her husband's contributions as her income, not his, applies with even more force to mandatory independent taxation than to an option for independent treatment (see para 7.2.2). But it should be noted that the overall result of treating these pensions in this way would be to make a switch to independent taxation relatively more advantageous for elderly taxpayers than for the non-elderly. (In 1980/81 terms, elderly couples paying tax at basic rate could have their tax bill reduced by up to £196.) In particular the large numbers of elderly couples where the wife's only - or main - source of income is a Category B National Insurance Retirement Pension would stand to gain.

## CHAPTER 8 - SWITCHING TO INDEPENDENT TAXATION

8.1 Independent taxation for everyone would produce substantial shifts in relative tax burdens, largely because the present married allowance would disappear. It would necessarily increase the burden on two-earner couples, relative to single people; most couples where the wife is the breadwinner would be worse off, relative to all other groups; and the position of other one-income couples would depend on the amount of the transferable allowance. These distributional effects are further examined in Appendix 6. An important question is whether it would be feasible, and at what cost, to prevent an <u>absolute</u> increase in the tax burden for these groups in the year of change to mandatory independent taxation.

8.2 <u>One-income couples</u> (apart from those where the wife is the breadwinner) would not suffer an absolute increase in the tax burden, provided that there were a transferable allowance which when added to the single allowance equalled the level of the married allowance in the year preceding the year of change. However, <u>breadwinner wives</u> would effectively suffer a reduction in their tax allowances from 2½ times the single allowance to the single allowance plus the transferable portion of their husband's allowance. Particularly if only part of the husband's allowance were transferable, an absolute increase in the family's tax burden could not be avoided at any acceptable cost by juggling with the levels of the allowances. To prevent an absolute increase a special transitional regime for breadwinner wives would be needed; so that in terms of tax allowances they could at least mark time until the allowances to which they were entitled under the new regime reached an acceptable level.

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8.3.1 Two-earner couples are in a different case. Whatever form mandatory independent taxation took, the effective reduction in their tax allowances would be from 2½ times the single allowance to twice the single allowance, which in present terms, for a couple paying tax at the basic rate, would be an increase in their annual tax bill of £231. A change of this order might, unlike that for breadwinner wives, prove not to require any special regime at the time of change. Nevertheless, if the change from married allowance plus wife's earnings allowance to 2 single allowances were to be effected in one year, an absolute increase in the tax burden of two-earner couples could be avoided only at what might prove to be substantial revenue cost. They would need a single allowance which was equal to half the total of the present married allowance and wife's earnings allowance; and the yield from abolition of the married allowance would not pay for a single allowance of this magnitude, if under independent taxation the single allowance were to be transferable. The greater the degree of transferability, the greater the shortfall. At present levels of tax allowances and rates, it would cost £3$\frac{3}{4}$ billion to ensure that two-earner couples were not worse off absolutely if the allowance were fully transferable. The cost would be £2$\frac{3}{4}$ billion with a partially transferable allowance which maintained the present relativity between married and single allowances (as in the example in paragraph 6.2.2 above).

8.3.2 Costs of the order of £3 billion or £4 billion would represent a substantial demand on resources. The problem of financing costs of this order in any one year would be even greater. This suggests that the introduction of mandatory independent taxation might be phased in over a period, so that the cost of preventing any absolute increase in the tax liability of two-earner couples, could be spread over a number of years. One method would be to increase the single allowance

gradually relative to the married allowance prior to the year of change, thus reducing the actual cost in the year of change of providing a single allowance which was equal to half the married and wife's earnings allowances. However, this approach would only yield a significant saving in the year of change if the transferable allowance, under independent taxation, was substantially less than the present difference between the single and married allowances. Moreover, it would be open to the serious objection that it would mean a relative increase in the burden of tax on married couples (in particular, one-earner couples), as compared with single people, during the transitional period. Even given acceptance of the ultimate goal, this would be undoubtedly difficult to justify. For similar reasons, another possible method - allowing the wife's earnings allowance to fall below the level of the single allowance in the years preceding the change - would be unlikely to command support.

8.3.3 An alternative, and more attractive, approach would involve a transitional period following, rather than preceding, the year of change to independent taxation. The single allowance and the transferable portion of the allowance for the spouse at home could be gradually increased, while over the same period the allowance given to a married man in his own right was brought down to the level of the single allowance. This is illustrated by the following table in which year Y represents the year of change to independent taxation.

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| Year | | Y-1 £ | Y[1] £ | Y+1[1] £ | Y+2[1] £ | Y+3[1] £ |
|---|---|---|---|---|---|---|
| 1. | Single allowance (and wife's allowance) | 1,375 | 1,475 | 1,575 | 1,675 | 1,760 |
| 2. | married man's allowance/ husband's allowance | 2,145 | 2,045 | 1,945 | 1,845 | 1,760 |
| 3. | transferable to husband | - | 255 | 515 | 770 | 985 |
| 4. | (not transferable to husband) = disregard limit (1-3) | - | (1,220) | (1,060) | ( 905) | ( 775) |
| 5. | Total allces for two-earner couple (1+2) | 3,520 | 3,520 | 3,520 | 3,520 | 3,520 |
| 6. | Total allces for one-earner couple (2+3) | 2,145 | 2,300 | 2,460 | 2,615 | 2,745 |
| | Cost | | 1,290m | 1,720m | 2,250m | 2,650m |

[1] All the figures quoted are in constant prices. Allowances would ordinarily be uprated each year in line with prices: the increase in the single and transferable allowances (Items 1 and 3) during the transitional period would thus be additional to, and not at the expense of, the increase in line with prices.

Items 3 and 4 reflect the system of partially transferable allowances examined in paragraphs 6.2.2-3 above. Thus, in year Y+1, a married man whose wife had no income would be entitled to an allowance of £2,460 (£1,945 + £515), whereas if his wife had an income of £1,200 he would be entitled to £2,320 (£2,460 as before less the amount by which the wife's income exceeded the disregard limit - ie £1,200 - £1,060). Although over the phasing period the wife's allowance would be smaller than her husband's, the goal of equal allowances in year Y+3 would be in sight. On this approach, the phasing could in fact be spread over any number of years, in order to reduce the extra cost in each year: the total cost of the process of transition would be higher than the cost of a change in a single year, but it would be spread.

## CHAPTER 9 - SINGLE PEOPLE, LONE PARENTS AND CHILD CARE

### Introduction

9.1.1 The foregoing Chapters have been concerned with the taxation of married couples. But it is necessary to ensure that the distribution of the tax burden resulting from changes in the tax rules for this group is fair to all sections of the community, not only married couples but single people as well. This Chapter accordingly looks first at the tax treatment of single people including widows and lone parents in the present system. It goes on to examine the implications of structural change in the taxation of married couples for single people in general and in particular for single persons who have children to support.

### Present system

9.2.1 Widows and other single people. All single people, including those who are widows/widowers, separated or divorced, are entitled to the single person's allowance. In addition to their single allowance, widows are entitled to an extra allowance - the widows' bereavement allowance - for the tax year in which their husband died. This allowance, introduced in the 1980 Finance Act, brings the widow's total allowances for this period up to the level of the married man's allowance.

9.2.2 Lone parents. Those 825,000 (1978 figure) people who have single-handed responsibility for a child may also qualify for the additional personal allowance (APA). All lone parents who have at least one child under 16, or over 16 in full time education, living with them are entitled to the APA. This means that, in cases of separation or death, the deserted wife or widow who is left with the children gets the single person's allowance and the APA from the date of separation or

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bereavement. Since 1975, following a recommendation of the Finer Committee, the APA has bridged the gap between the single and married allowances. The Finer Committee considered that an allowance at this level was the proper way to recognise through the fiscal system the sort of additional expenses that were likely to arise when there was only one parent. They took the view that a fair relativity would be established between one and two parent families if the tax threshold for both were set at the same level (disregarding any entitlement to wife's earned income allowance).

9.2.3 Today therefore the allowance is £770, worth about £4.40 a week to a lone parent paying tax at the basic rate. Some 425,000 lone parents currently claim the APA. This includes about 50,000 who are taken out of tax altogether by the allowance, and a further 5000 who are liable to tax at higher rates. The cost of the allowance is currently about £m90.

<u>The treatment of lone parents under a system of independent taxation</u>

9.3.1 Under any of the schemes for mandatory independent taxation discussed in Chapter 6, the current criterion for determining the level of the APA would necessarily disappear. The APA could no longer simply equal the difference between the single and married allowances, because there would be no married allowance as such. If independent taxation were implemented, therefore, it would be for consideration at what level the APA should be set.

9.3.2 There is no reason why independent taxation should of itself call for any changes in the relative tax treatment of lone parents and single persons without such family responsibilities. Although some might argue that the APA should be relatively increased, the relativity

recommended by the Finer Committee seems to be generally regarded as reasonable; and there are certain administrative advantages in an allowance for lone parents which is at the same level as the married allowance. If a partially transferable allowance which bore the same relativity to the single allowance as the present married allowance were to be introduced for a supported spouse, preserving the status quo would be fairly straightforward: the APA could simply equal the maximum of that allowance. An allowance which was fully transferable between spouses, so that the one-income couple would get double the single person's allowance, would, however, pose the question of whether the lone parent's lead over other single persons should be increased to this extent.

9.3.3 An alternative approach would be to question whether the tax system should continue to recognise the special position of a lone parent. Now that child tax allowances have been replaced by Child Benefit, the tax system no longer takes account of the effect of a dependent child on taxable capacity. Like all other parents whose children are under 16 or under 19 and still at school, lone parents get a tax free Child Benefit of £4 per week (£4.75 from November 1980) in respect of each of their children. Furthermore, some 420,000 child benefit recipients receive an additional amount, also tax free, worth £2.50 per week (£3 from November 1980) per family. This additional sum, known as Child Benefit (Increase) is primarily of benefit to working lone parents, though it is not payable immediately on separation.

9.3.4 Thus the case for the APA today can only rest on the diminution in taxable capacity caused, not by the child as such, but by the need to maintain a household as a single person. On this basis, it is not easy to see why a single parent should enjoy a higher tax allowance than for example, a working widow without children, except in so far as the presence of the child involves

somewhat greater expenses (for child care, etc) which are perhaps not fully recognised in the existing child benefit arrangements (see Chapter 9.4).

9.3.5 If the APA were to be abolished an obvious means of providing a corresponding cash benefit would be to increase CB(I), the additional amount payable to lone parents with their Child Benefit (para 9.3.3). Such a move would have a number of advantages. It would concentrate help for lone parents in the single form of a regular cash benefit; low paid working lone parents whose earnings are below the tax threshold would gain financially and their incentive to work would be improved.

9.3.6 Abolition of the APA would, however, have disadvantages as well as advantages. It would mean that those lone parents who currently benefit from the APA would have a lower tax threshold than at present. More people would be brought within the scope of income tax and for others it would increase the tax payable. If the additional benefit which replaced it reflected the value of the APA to basic rate taxpayers, higher rate taxpayers would lose.

9.3.7 A further important area of difference between APA and CB(I) concerns the provisions for increasing the value of the tax allowance and the benefit. The allowance is increased each year, in line with the movement of prices, under the statutory requirement applying to personal tax allowances generally, whereas there is no statutory requirement to increase child benefit or CB(I). Conversion of the allowance into CB(I) would mean, therefore, that this requirement no longer applied. However, the child benefit legislation requires the Secretary of State for Social Services to review the rate of child benefit in payment each year. Moreover, in July 1980 he announced that it was the Government's intention, subject to economic and other circumstances,

to uprate child benefit each year in line with prices. This undertaking will, of course, apply also to CB(I) which has been increased twice by the Government since taking office. In practice, since it was introduced, CB(I) has more than kept its value, a recognition of the fact that one parent working families are amongst the hardest pressed families.

9.3.8 A number of other questions would arise. As structured at present CB(I) does not benefit all lone parents who currently qualify for the APA. For example, those receiving long-term national insurance benefits (eg widows) are not entitled to the CB(I); and, for those dependent on supplementary benefit, CB(I) and Child Benefit are fully deducted from benefit entitlement. In addition, whereas no child benefit is available for students in advanced education, a lone parent may qualify for APA even though the only child is such a student: the case for making any special provision for such parents is clearly much less strong than for parents with younger children, and it would not be consistent with the existing child benefit concept to provide CB or CB(I) in respect of students in advanced education. Another difficulty is the effect of a higher cash benefit on entitlement to housing benefits which are normally assessed on gross income, including child benefit and CB(I). Measures would be examined to safeguard the position of lone parents receiving these benefits.

9.3.9 There would also be a number of practical issues to be faced. If the additional benefit were at the value of the APA to the basic rate taxpayer, the switch from APA to CB(I) - producing a weekly cash benefit of £7.40 (at November 1980 rates) - would probably lead to increased take-up above the current estimated level of about 60 per cent. This would add both to the expenditure on the benefit and to administrative costs. DHSS in particular would require extra staff to deal with the substantially higher number than at present of

claims to the benefit. In addition, if its value were more than doubled, improved procedures could be necessary to check on entitlement to benefit.

Child care and cash benefits

9.4.1 Replacing the present APA with a bigger CB(I) would also have an impact on the argument, which is sometimes advanced, that lone parents should get tax relief for the expenses of child care. As far as the tax system is concerned this proposal is open to a number of objections, both in principle and in practice. Relief related to specific expenses would call into doubt the general rule under which no tax relief is available for expenses of a personal nature. Moreover a tax relief on these lines would impose a considerable administrative burden. This would fall both on the lone parent in providing evidence of the precise child care costs he or she had incurred, and on the Inland Revenue.

9.4.2 Furthermore, a tax deduction confined to lone parents would arguably be unfair to two-parent families, many of whom also incur child care costs. In the countries which provide such a deduction, with the exception of France, it is extended to two parent families where both husband and wife go out to work. But in fact it is only in relatively few countries that such a deduction is available at all.

9.4.3 If tax relief were given at a flat rate rather than by reference to actual costs, this would be tantamount to an addition to, or replacement of, APA. This would meet the fiscal and administrative objections outlined in 9.4.1, although not the point that it would discriminate between lone parents and two-parent families. But in

any case, because child support is now provided directly as a cash benefit rather than indirectly through the tax system, it would be inappropriate to build upon, or create, a tax allowance which was essentially related to maintaining a child.

9.4.4 Another possible approach would be to provide for lone parents' child care costs directly in the form of a cash benefit, rather than indirectly through the tax system. The existing CB(I) (just like the income tax APA) already recognises in broad terms the extra expenses involved in lone parenthood, and typically these would include child care costs. Theoretically there may be an argument that, where individual lone parents incur particularly heavy child care expenses, there should be some <u>extra</u> compensation through the benefit system. But it is questionable whether extra compensation of this sort would be any more appropriate in the benefit system than it would in the tax system. And to tailor a cash benefit paid to individual costs incurred would pose considerable administrative problems. Assuming that it could be done at all, it would be a particularly staff-intensive - and hence costly - operation. All this suggests that support for lone parents in respect of child care should be recognised in the level of the CB(I), rather than through a cash payment related to specific costs or through tax relief.

Support for lone parents: conclusion

9.5 Any major structural change in the taxation of married couples would be bound to call into question the current tax treatment of lone parents. But changes in the regime for lone parents need not turn on changes in the taxation of married couples: they can be considered on their own merits. The Government would therefore welcome views on the proposal to replace the existing APA by an enhanced CB(I) (paragraphs 9.3.5-9.3.9).

CHAPTER 10 - ADMINISTRATION

10.1.1 One of the main yardsticks set out in Chapter 1 for assessing any system for taxing married couples is that of simplicity. The simpler any set of rules, the easier they are for taxpayers to understand, for employers to operate, and for the Inland Revenue to administer. The present Chapter focusses on this particular criterion, by looking at the administrative implications of the possible changes discussed in the earlier Chapters.

10.1.2 It is the Government's objective to reduce the size of the Civil Service, and any additional tasks for the Inland Revenue must be seen in this context. Because of the continuing search for more economical methods of administration, implementation of some, or all, of the possible changes in the tax treatment of husband and wife might not mean more public servants in the Inland Revenue than at present. In addition the level of tax thresholds - and hence the number of taxpayers - also has a significant impact on the numbers needed to run the tax system. But, in order to bring the effects of the various policy changes into sharper focus, this Chapter proceeds on the basis of current administrative practices and current levels of taxation.

The present position

10.2.1 Nine out of ten people who pay income tax today come within the PAYE system whereby employers deduct tax at source from wages and salaries. These deductions enable the correct amount of tax to be deducted over the year as a whole, so there is no need for adjustment at the end of the year. In the case of married couples, the tax affairs of the 7 million or so married women without paid employment, but who may have a small investment income of their own, are controlled from their husband's

file in their husband's tax district. The position of the 6 million married women who do have a job and whose earnings are above the PAYE threshold (roughly the level of the single person's allowance) is rather different. Although aggregation means that a married woman in this position is not required to make a separate tax return, in other respects she is treated in just the same way as a single person with earnings. She has her own tax file and her own tax office, determined according to which employer she works for. Often this is not the same one as deals with her husband's affairs, so a certain amount of liaison between tax offices is required.

10.2.2 Quite apart from any changes in the taxation of husband and wife, the present decade is likely to be fairly momentous for the PAYE system as a whole. Except in Scotland, the system still works on a manual basis - that is to say in much the same way as it did when it was set up 35 years ago. However the Inland Revenue are planning for the computerisation of PAYE so as to enable the Department to give a more efficient service to the public. In addition, a computerised system should be more flexible than the present manual one, enabling, for example, changes to tax rates and allowances introduced in a Budget to be implemented more efficiently and, in the longer term, allowing for possible changes in the underlying structure of personal taxation to be implemented over time without the same degree of upheaval which makes such changes impracticable or uneconomic under the manual system. Ministers are considering the proposals and expect to reach a decision shortly.

10.2.3 Computerisation of PAYE will be a major operation. If it is to be completed as quickly and efficiently as possible, during the period of changeover there will inevitably be some constraints on the extent to which the underlying tax system can be changed. This is not to imply that the tax system is effectively frozen between now and the completion of PAYE computerisation. But it does mean

that over the intervening years any disruption to the PAYE computerisation programme will have to be weighed in the balance against the expected benefits of implementing any tax reform sooner rather than later.

Developing the present system: option for independent taxation (Chapter 4)

10.3.1 Chapter 4 examined the possibility of extending the options already available within the present system which enable a husband and wife to be treated as independent units rather than as a couple. The administrative effects of this would depend on which of the two alternative options a married couple chose. As with the present wife's earnings election, it would be for each couple to decide jointly whether it would be to their advantage to opt to be treated independently (when the wife's investment income as well as her earnings would be taxed as if she were a single individual). As there would be more factors to be taken into account - such as the age of the couple, and the mix of their income between earned and investment - this could in some cases be a rather more complex process than with wife's earnings election.

10.3.2 Tax offices would have the job of processing options, issuing returns to all husbands and wives who had opted and making end-of-year assessments in the significant minority of cases where it was not possible to deduct the right amount of tax through PAYE in the course of the year. Largely because four times as many couples would stand to benefit as under the wife's earnings election, this extended option could mean additional work for the Revenue, and, depending on the numbers who opt, this extra work could be significant.

10.3.3 To move from separate assessment arrangements to separate responsibility in the way suggested in Chapter 4 would, for the couples affected and the Inland Revenue,

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represent a simplification. The calculations necessary to split a couple's allowances and rate bands down the middle are a lot less complex than those required to operate the present separate assessment rule under which they are divided in proportion to the spouses' respective incomes. Of itself, therefore, the new system would reduce the time spent on each case in tax offices. But with the switch to separate responsibility, the option is likely to become more popular, in which case the net staff requirement would rise.

10.3.4 It seems probable that both of these new options for independent treatment could - unlike mandatory independent taxation (see 10.4) - be implemented before PAYE computerisation. However they are substantial changes and, depending on the numbers opting, could mean a significant change in the workload of tax offices.

Mandatory independent taxation (Chapter 6)

10.4.1 Any of the variants of mandatory independent taxation discussed in Chapter 6 would involve a much bigger upheaval for all concerned with the PAYE system - taxpayers, employers and Inland Revenue alike - than independent taxation on an optional basis. The additional work involved could be substantial and require a much larger number of extra staff to administer the system. It would therefore in any event take longer before such changes could be introduced. The timing of such changes could, however, also be affected by the plans for computerising PAYE. At this stage it is not possible to predict the extent to which the implementation of schemes for mandatory independent taxation would be affected by computerisation (or vice versa). But it seems probable that changes of this magnitude (unlike schemes for independent treatment on an optional basis) could not be implemented before computerisation of PAYE. The problems involved in introducing radical changes in the tax structure whilst the Revenue's staff were engaged on the transition to computerised working could mean that the introduction of schemes for mandatory independent taxation

might have to be deferred for some time to avoid unacceptable disruption of computerisation. This aspect of the matter will require further study. But in any case, the Government believe that before such radical changes were made, there should be time to examine thoroughly their implications, which, as Chapter 6 has demonstrated, are many and far reaching.

10.4.2 With mandatory independent taxation all husbands and wives would become independent units, each with his or her own allowance and set of rate bands. As far as the taxpayer is concerned, the main impact would be on the wife. For the first time she would be required to complete her own tax return, deal independently with her tax office and be legally liable for the tax due. For the Inland Revenue there would be some savings in a change of this kind. These would arise mainly from reducing the present amount of liaison between wife's and husband's districts and from the fact that the existing options for separate assessment and wife's earnings election would be abolished. But there would also be additional work which would be likely to outweigh any savings that would accrue. Married women could no longer be dealt with in the context of their husband's tax affairs. The 6 million or so married women with income above the PAYE threshold would become, for the first time, just like any other taxpayer for whom returns, assessments and related correspondence would be required from time to time, if not every year. In addition a large number of married women with small investment incomes would be entitled to repayment of some or all of the tax deducted at source.

Independent taxation with transferable allowances

10.4.3 Chapters 6.2.1 to 6.2.3 discussed the possibility of providing for the circumstances where one spouse has insufficient income to use up the single allowance by permitting him or her to transfer the unused portion of this allowance to the other partner. The scale of this

operation would be determined largely by the nature of married women's employment. First, many married women have part-time jobs, which means that there are large numbers (perhaps around 2 to 2½ million) earning less than the value of a single allowance. Other married women have a small investment income, which would use up some, but not all, of their single allowance. This means that there would inevitably be many cases where the husband's allowance would have to be adjusted to reflect the precise level of his wife's income.

10.4.4 Secondly changing family commitments mean that married women tend to move in and out of employment rather more than other members of the community. Typically a married woman will leave her job to have a baby and return to work when her child (or children) has ceased to be dependent. In many cases couples will not be able to predict, before the beginning of the tax year, whether - and if so how - their commitments will change during the course of the year. All this suggests that, in order to prevent any possible hardship, every effort should be made to transfer the allowance between spouses during the course of the tax year (though it would not of course always be possible to arrive at the correct tax deductions without some further adjustment at the end of the year). Looking at the operation from the tax office angle, the issue and examination of the extra returns required, the consequential "in year" coding changes, end-of-year assessments and appeals work would represent a substantial additional burden.

10.4.5 A scheme under which the whole of the allowance could be transferred to the supporting spouse would be more expensive in staff terms (as indeed in revenue terms) than one where only part of the allowance was transferable. With fully transferable allowances every £ of one spouse's income would affect the quantum of the allowances available to the other. If only part of the allowance were transferable, on the other hand, the one spouse could have up to a certain level of income - the "disregard

limit" - without in any way affecting the total allowances due to the other spouse. No adjustments - and hence no breach of the supported spouse's privacy - would therefore be required where a spouse had only small part-time earnings or a modest income from savings. Administratively, therefore, a partially transferable allowance scheme would be a cheaper alternative than fully transferable allowances. But, whatever form the scheme took, the numbers of Revenue staff needed to run the system would be significantly greater than now.

10.4.6 From the operational point of view, therefore, as well as for the reasons advanced in Chapter 8, there would be considerable advantages in phasing in independent taxation with transferable allowances. If, as Chapter 8 suggested, phasing in were to be achieved by gradually building up the proportion of the allowance which was transferable, in the early years relatively few couples would be in the 'transferable' band. So the millions of new cases and links between the records of married couples could be set up over a number of years, and the increased burden of casework would build up more gradually.

10.4.7 Chapter 6.2.4 examined the suggestion that only those spouses who are financially dependent for particular reasons - because they look after young children, elderly relatives, are themselves incapacitated, etc - should be allowed to transfer their allowance to the supporting spouse. If the allowance were to be restricted in this way, it would add considerably to the enquiries which the Revenue would have to pursue with a claimant (names/ages of children or relatives, nature of incapacity, facts on registration for employment, etc). It seems however unlikely, for the reasons advanced in paragraph 6.2.6, that the total number of claims would be significantly reduced. The overall effect would therefore be a substantial further addition to Revenue staff requirements, as compared with a scheme which simply recognised financial dependence.

Independent taxation with cash benefits

10.4.8 Chapter 6 (paragraph 6.2.7 to 10) went on to examine the implications of providing for a dependent spouse through social security rather than through a tax allowance. In this case any DHSS staff requirement would need to be added to the Revenue staff needed to cope with basic independent taxation (see paragraph 10.4.2) to give the total staff cost. On the face of it a straightforward increase in child benefit would not involve any additional costs provided the benefit was paid generally; any attempt to confine the increase to non-working mothers only would have major implications for the scheme as a whole, requiring the collection of information about the circumstances of the parents. An increase in child benefit for the first child only would be a substantial change, but at least to a scheme already in existence. The largest DHSS staff implications would be likely to arise on an option for a completely new cash payment such as a "home responsibilities" benefit. In this case the total cost of administering the new system could well be greater than for a transferable allowance scheme (see paragraph 10.4.6).

10.4.9 Chapter 9 discusses the treatment of lone parents under independent taxation and raises the possibility of abolishing the APA and increasing CB(I), the addition to Child Benefit payable to certain lone parents. Under this proposal the premium to Child Benefit would more than double, and a considerable increase in the numbers claiming should therefore be expected. Extra staff would be required to deal with these new claims and with the problems arising out of this substantially higher number of cases - for example the relationship with other DHSS benefits. The higher benefit would also make it more important to check that continuing entitlement to the benefit existed, and procedures would have to be designed with this in mind.

Treatment of Investment Income

10.5.1 If, as suggested in paragraph 6.3.2, within a basically independent system any degree of aggregation of investment income were retained, further staff would be needed over and above those needed to implement basic independent taxation (see paragraph 10.4.2). The main extra work would lie in liaison between spouses' districts when it appeared from either the husband's or the wife's return that aggregation might be required, and the special calculations necessary to determine the rate of tax applicable to the joint investment income. These calculations would be complicated and not easy for those married couples affected - especially those who had no professional advice - to understand. The numbers of extra Inland Revenue staff would depend on the threshold above which husbands' and wives' investment income would be added together and taxed at the higher earner's marginal rate.

Measures to counter artificial reallocation of investment income

10.5.2 If it is accepted that investment income should be taxed individually in all cases, it is arguable that, to limit the scope for artificial reallocation of income between husbands and wives, the rules governing inter-spouse transfers of income and capital should be changed. Tightening up the income tax legislation applying to covenants and settlements between spouses in the way suggested in Chapter 6 would mean some extra work, the extent of which would depend on the precise nature of the measures adopted. The administrative consequences of removing the CTT spouse exemption on lifetime transfers would vary according to the way in which the change was carried out, but it could make it difficult for taxpayers and the Revenue to determine which transactions between husband and wife were transfers of value, which were chargeabl and which exempt. For capital gains tax the withdrawal of

the present 'no gains/no loss' basis would result in extra administrative costs as a consequence of the additional assessments and the valuation work required.

10.6 Conclusion

a. Most of the changes considered in the Green Paper would inevitably introduce some degree of complexity into a system which is now relatively simple. The more complex the administration, the greater would be the staff required to run it - and the greater the difficulties for the taxpayer in comprehending the system and playing his of her part in it. It would be the interests of all concerned to look for a system as straight-forward as possible, which resulted in a regime that was both fair to the taxpayer and workable by the Inland Revenue.

b. It is not possible at this stage to quantify in terms of manpower the effects of modifications in the tax structure as it applies to married couples, particularly as implementation of the more far-reaching changes lies some years ahead and the effect of PAYE computerisation on such changes is at present uncertain. But, two points are clear:

i. Independent treatment on an optional basis should require far fewer additional staff than the schemes for mandatory independent taxation: the staff cost for the optional scheme is likely to run to several hundreds compared with staff costs which would run to several thousands for mandatory independent taxation.

ii. There could be considerable differences between the staff requirements for possible variants of mandatory independent taxation.

Any claims on staff resources would, of course, have to be assessed by the Government in the context of its overall priorities. But it is necessary to make the point quite clearly that the Government is committed to reducing the size of the Civil Service, including the Inland Revenue, and this may well preclude solutions which while theoretically attractive would have an unacceptable staff cost.

CHAPTER 11 - SUMMARY: THE ISSUES TO BE FACED

11.1 This Green Paper raises some far-reaching questions which could affect every individual and every married couple with income above the tax threshold. The main issues are raised in Chapters 4-9. Chapter 1 sets the scene by putting forward some yardsticks for judging any system of taxing the income of married couples. Chapter 2 describes the present UK system, and Chapter 3 outlines the main criticisms that are made of this system today. Chapter 10 brings out the administrative implications of the various changes examined in the intervening chapters, demonstrating that all these changes would, to a greater or lesser extent, involve administrative cost (and would probably not make things easier for the taxpayer) and could not be carried out overnight: the time it would take to implement the changes would vary with the nature and extent of the change to be made.

11.2 The main questions which are thrown up in Chapters 4-9 of the Green paper are as follows:-

a. The case for change and the direction it should take. Should the system remain essentially unchanged, or should it be developed along one or more of the paths marked out in Chapter 4, ie joint taxation or options for independent treatment? Or should there be a fundamental change to mandatory independent taxation of the kind examined in Chapter 6? Development on the lines suggested in Chapter 4 could itself be a stage en route to fundamental change. Each of the options raised can be assessed by measurement against the criteria outlined in Chapter 1, but it is also of crucial importance to weigh the cost to the Exchequer of lessening, if not removing, the adverse effects of a change on particular groups (Appendix 6) and the administrative costs (Chapter 10).

b. Joint taxation. If the present system is developed, should there be a move towards making the husband and wife jointly responsible for the tax on their combined incomes? (4.2)

c. Aggregation rule. Should the formulation of the rule which aggregates the income of husbands and wives for tax purposes be changed, so that instead of deeming the wife's income to be her husband's it should simply treat the income of husband and wife as if it were one income (the tax remaining in general the responsibility of the husband)? (4.3)

d. Option for independent taxation
Disaggregation of the wife's income

i. Still keeping within the structure of the present system, should the present rule under which the couple may elect to have the wife's earnings taxed as if she were a separate individual be extended to her investment income, so that where the couple so wished the whole of the wife's income could be taxed independently? (4.5)

ii. Should the option under which husband and wife can apply to be separately responsible to the Revenue (so that each makes separate returns and is separately assessed, but without affecting the quantum of the tax bill on the total income) be revised so that, when such an application is made, the allowances etc are split equally between the couple, instead of being split in proportion to their respective incomes? (4.7-4.8)

iii. And would there be advantage in carrying out these two changes together, so that husbands and wives would be enabled, if they so wished, to achieve treatment as separate individuals, or where this is not beneficial, to have an equal split of the reliefs between them? (4.9)

e. Separate taxation of investment income. If an option for the independent taxation of a wife's investment income as well as her earnings were introduced, ie if an affirmative answer were given to the question in subparagraph d(i), should there be some compensatory restriction on transfers of income and/or capital between husband and wife, for the purposes of income tax, capital gains tax and capital transfer tax? (4.6 and 6.3.3)

f. Tax unit. If there were to be a structural change in the system, should the family or the individual become the basic tax unit? In other words, should there be a move towards something akin to the French quotient system, or should the move be in an entirely different direction, so that husband and wife (and other members of the family) would be treated as independent individuals for tax purposes? (5.2-5.3)

g. Transferable allowances. Under a system of mandatory independent taxation, where one spouse has no (or not enough) income to use the tax allowance, should it be transferable to the other spouse ? And if it is to be transferable, should the whole of the allowance be transferable, or only part of it? (6.2.1-6.2.3)

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h. <u>Cash benefit alternative</u>. If, where the couple rely on one income, the need of one spouse to support the other is to be recognised, should it be through a transferable tax allowance (as in the preceding subparagraph) or through some form of social security benefit? And if through a cash benefit, what form should the benefit take? (6.2.7-6.2.12)

i. <u>Restriction on provision for supported spouse</u>. Whether the provision takes the form of a tax allowance or cash benefit, should it be restricted by reference to the circumstances of the supported spouse? (6.2.4-6.2.6)

j. <u>Investment income under mandatory independent taxation</u>. Should there be restrictions on transfers of income and/or capital between husbands and wives? Alternatively, should a wife's investment income be only partially disaggregated from her husband's, ie should the investment incomes be aggregated above a certain income level? (6.3.2-6.3.3)

k. <u>The elderly</u>. Assuming the continuance of a special preference for the elderly, how should the present rules governing entitlement to the age allowance be altered under a system of mandatory independent taxation? (7.3.1.)

l. <u>Revenue cost of independent taxation</u>. The tax liability of certain groups (in particular, working couples) would be relatively increased by a change to independent taxation (see Appendix 6). The revenue cost of ensuring that they did not pay more tax in the year of change than in the previous year could be substantial. In recognition of this, should two-earner couples be

protected and the cost spread by phasing in the introduction of independent taxation over a period of years, along the lines considered in 8.3.3?

m. Lone parents. Should the system for lone parents be changed, so that instead of receiving an additional allowance for tax purposes, they would receive an increased cash benefit? If so should this increased benefit recognise the costs of child care? (9.3-9.5)

11.3 These issues are not all of equal importance. The first is obviously fundamental, since the response to this will determine the individual's attitude to most of the other issues. But, apart from this, the questions which are most essential to the debate are probably those posed in subparagraphs d., f. to i., and l. of the previous paragraph. If the Green Paper is to be followed by action, then the timetable for action will largely depend on the response to these questions. If it were decided to develop the present system along the lines suggested in Chapter 4 of the Green Paper, ie if the questions posed in sub-paragraph d. above were answered in the affirmative, then the necessary changes could probably be carried into effect within 3 years (ie from 1983/84), provided that a decision was taken by the Autumn of 1981 and the necessary legislation introduced in 1982. On the other hand, for the reasons explained in Chapter 10, it would take considerably longer to introduce a structural change to mandatory independent taxation, and, if it were to be phased in over a period, as suggested in Chapter 8, the change might therefore not be completed for many years ahead. The two types of change are not of course mutually exclusive. It would be possible to make quite far reaching changes to the present system within the next 3 years or so, and to hold out the prospect of a fundamental change towards the end of the decade.

11.4 Chapter 9 is distinct from the rest of the Green Paper. It is concerned with single people rather than married couples and the main issues which it raises (m. in paragraph 11.2) could be decided independently of decisions on the rest. Independent taxation would, with the abolition of the married allowance, call for review of the additional personal allowance for lone parents (which is currently linked with the level of the married allowance). But the provision for lone parents, and in particular the question whether the tax relief should be replaced by additional cash benefit, could be decided in advance of, and without prejudice to, decisions on the treatment of husbands and wives (though, becuase of existing operational commitments, a change to additional cash benefit could probably not be implemented before 1984).

11.5 The issues raised by the Green Paper are relevant to the great majority of taxpayers. Some of the changes considered could substantially alter the relative tax burdens of many people, single as well as married. Moreover, most will materially affect the married woman's status, and hence her responsibilities within the income tax system. Some of the leading representative bodies have already expressed their views on these matters, and their further views on the issues raised by the Green Paper will be welcome. But one of the main objects of the Green Paper is to open up the issues for a wider debate than has hitherto taken place, so that men and women who have hitherto remained silent can make their views known. The Government will welcome the fullest possible response from individuals as well as representative bodies to the important questions raised by the Green Paper; and these views will be fully taken into account in the formulation of any proposals for change which emerge from the response to the Green Paper. Comments should be sent to the Board of Inland Revenue, Room F11 West Wing, Somerset House, London, WC2R 1LB.

GLOSSARY

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| ADDITIONAL PERSONAL ALLOWANCE | Tax allowance which can be claimed by an individual with single-handed responsibility for a child living with him/her who is under 16 or in full-time education. Provided that there is such a child in the family, the allowance may also be claimed by a married man whose wife is completely incapacitated for the whole of the tax year. |
| AGE ALLOWANCE | Higher tax allowance which can be claimed by a single person or a married man who is (or whose wife is) aged 65 or over. The claimant's income (including wife's income in the case of a married man) must be within the income limit for this allowance, if not the age allowance is reduced by £2 for every £3 over the limit until it equals the ordinary single or married allowance, as appropriate. |
| AGGREGATION | In the context of income tax this refers to the rule whereby the incomes of husband and wife are added together and, subject to any allowances, taxed as one, with only one set of rate bands against the joint income.<br>Under the present UK aggregation rule (S37 ICTA) the husband is responsible for returning and paying tax on the joint income unless there is an election for separate assessment (q.v.) or wife's earnings election (q.v.). |

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| ASSESSMENT, END OF YEAR | Formal calculation of a person's tax bill after the end of the tax year, taking account of the total income received and the total allowances due in that year. |
| BREADWINNER WIFE | An earning wife who may receive the married man's allowance as well as the wife's earned income allowance, because her husband has no earnings or other taxable income of his own. |
| CASH BENEFIT | Cash payment in recognition of a particular need paid through the Social Security system to tax-payers and non-taxpayers alike. |
| CAPITAL GAINS TAX | Tax charged on the capital gain realised in certain circumstances where assets are disposed of. |
| CAPITAL TRANSFER TAX | Tax on transfers or deemed transfers of capital by lifetime gift or on death or held in trust. It is charged at progressive rates on the cumulative total of the gifts made by a person during his life and the value of his estate on death. |
| DISREGARD | In a system of mandatory independent taxation (q.v.) where a spouse's unused allowance may be transferred in part only, the disregard is the amount of the allowance which is not transferable. It follows that the one spouse can have income up to the amount |

of the disregard without either paying tax him/herself, or affecting the allowances available to the other spouse. Once the income of the supported spouse is over the disregard limit, the transferable allowance is reduced £ for £.

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| INDEPENDENT TAXATION OPTION | Possible amendment within the present system enabling a husband and wife to choose jointly, where beneficial, to be taxed as two single individuals. Where this option was taken up each would get a single person's allowance and separate set of rate bands, and be separately responsible to the Revenue for the tax on all their income. (An extension of the current wife's earnings election (q.v.).) |
| INVESTMENT INCOME | For tax purposes this is any income received by an individual other than earned income eg wages, salary, trading profits, pensions. |
| MANDATORY INDEPENDENT TAXATION | System under which the married allowance would be abolished, and all husbands and wives treated as individuals with each receiving a single allowance, making a separate return, and paying tax on his/her income. |
| MARGINAL RATE | Rate of tax payable on the top £1 of total income. |

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| MARRIED MAN'S ALLOWANCE | Tax allowance to set against joint income which can be claimed by a husband living with his wife. It is also available for a husband in the year in which his wife dies or is permanently separated from him; or for a husband who is living apart from his wife but fully maintaining her by voluntary payments. |
| PAYE | Pay As You Earn. The system by which an employer deducts the appropriate amount of tax (calculated according to tables provided by the Inland Revenue) from a taxpayer's weekly or monthly pay before he/she receives it. The employer then pays the tax for all his employees direct to the Revenue. |
| PAYE CODE | This represents the amount of income which a taxpayer is (because of personal allowances, reliefs etc) entitled to receive before any tax is deducted. It is issued to every employee each year by his/ her tax office. |
| PERSONAL ALLOWANCE | In effect the first slice of tax free income, the size of which varies in broad terms according to the taxpayer's personal circumstances. (See THRESHOLD.) |
| RATE BANDS | The rate(s) of tax levied on successive slices of taxable income (ie income after all allowances and reliefs have been deducted). For 1980/81 tax is |

charged at 30 per cent (the "basic" rate) on the first £11,250 of taxable income, and successive slices of income above this amount are charged at the higher rates of 40-60 per cent.

SEPARATE ASSESSMENT

This may currently be claimed by either a husband or a wife who wishes to have independent dealings with the Revenue in his or her own tax affairs. It makes no difference to the total amount of tax paid by the couple; the available reliefs and rate bands are split between husband and wife in the same proportion as their incomes.

SEPARATE RESPONSIBILITY

Possible amendment to the current system under which, although their total tax bill would not be affected, either husband or wife could choose to be taxed separately with an equal split of the available allowances and rate bands. (A development of the existing separate assessment provisions (q.v.)).

SINGLE PERSON'S ALLOWANCE

Tax allowance automatically available to set against income for all single people, including widows/widowers, the separated and divorced as well as unmarried individuals. Husbands and wives who have made a wife's earnings election (q.v.) also get this allowance.

TAX YEAR — This runs from 6 April to the following 5 April.

THRESHOLD — The level of total income at which tax first becomes payable. Less often it represents the point at which tax at a specific rate becomes payable, thus "higher rate" threshold etc.

TRANSFERABLE ALLOWANCE — In a system of mandatory independent taxation (q.v.) where a spouse has insufficient income to benefit from his/her own tax allowance, the unused portion may be transferred in part or whole to the other spouse.

WIFE'S EARNED INCOME ALLOWANCE — Tax allowance automatically available to set against a wife's earnings. It is equivalent in value to the single person's allowance or the level of her earnings whichever is less, but may not be set against any investment income she may have.

WIFE'S EARNINGS ELECTION — A currently available option under which a married couple can jointly elect to have the wife's earnings (but not her investment income) taxed as if she were a single individual. When this election is in force, the married man's allowance is no longer available; instead each spouse receives a single person's allowance.

HISTORICAL DEVELOPMENT OF THE PRESENT TAX TREATMENT OF HUSBAND AND WIFE

| | |
|---|---|
| 1799 | Income tax first introduced. A married woman's income was to be "stated and accounted for by her husband". |
| 1806 | Aggregation rule reached, in substance, its present form: the profits of any married woman living with her husband "shall be deemed the profits of the husband". |
| 1894 | New provision ensured that where a couple's combined income did not exceed £500, the wife qualified for the same tax reliefs as a single person in respect of her earnings. |
| 1909 | Supertax introduced. Henceforth the effect of aggregation could be to push married couples into higher tax brackets. |
| 1914 | Present facility for separate assessment first introduced. |
| 1918 | "Wife" allowance introduced: for the first time married men qualified for a higher allowance than a single person. |
| 1920 | A Royal Commission on the Income Tax examined the current rules for taxing husband and wife. They reported in favour of the aggregation rule: |

> "The aggregation for Income Tax purposes of the income of husband and wife is no dependent upon any mediaevel conception of the subordination of women ... The incomes are aggregated because the law of taxable capacity is the supreme law in matters of taxation, and taxable capacity is, in fact, found to depend on the amount of the income that accrues to the married pai

> and not upon the way in which that income happens fortuitously to be owned by the members of that union. It is beyond question that in the immense majority of cases where the wife has separate means she contributes to the common purse, either by the actual merger of her income with her husband's or by bearing expenses which in less fortunate households would fall upon the husband".

1920 Following Royal Commission's recommendations:

1. Married man's allowance substantially increased to equal 1.6 times the single allowance.

2. Wife's earned income relief (equal to the difference between the married man's allowance and 2 single allowances) replaced 1894 provision for separate taxation of wife's earnings.

1942 Wife's earned income relief increased to the level of the single person's allowance.

1944 PAYE system first introduced.

1948 Working wife given her own reduced rate bands

1954 Whole issue of taxation of married couples reviewed by Royal Commission on the Taxation of Profits and Income (the Radcliffe Commission).

They too endorsed the aggregation of husbands and wives' incomes:

> "We see in the existing rule nothing that embodies an outmoded or unworthy conception of the relations of man and woman in marriage ... It does appear to us ... that marriage creates a social unit which is not truly

> analagous with other associations involving some measure of joint living expenses and that to tax the incomes of two married people living together as if each income were equivalent to the income of a single individual would give a less satisfactory distribution than that which results from the present rule ".

They felt the extra expenses involved where both spouses worked created "a valid difference between the taxable capacity of a married couple where the wife is at work and the married couple where the wife is at home". But they saw the present wife's earned income relief (which gave a two-earner couple 2½ times the single allowance) as "excessive". No action was taken on this particular recommendation.

1971 — Wife's earnings election - which enabled a married couple to opt for the wife's earnings to be taxed as if she were a single person - introduced.

1978 — Wife given statutory right to receive her own PAYE repayments.

1978 — Inland Revenue practice on correspondence with married women changed. Instead of writing to her husband, tax offices were instructed to reply direct to a married woman who had written to them.

1979 — Change of practice to ensure that it is the husband, not the wife, who normally suffers the restriction of allowances (the "excessive basic rate" adjustment) necessary where higher rate tax is due from a working couple's joint income.

Tax office practice of writing direct to a

married woman about her own tax affairs
extended to cover occasions where she has not
initiated the correspondence.

APPENDIX 3

CURRENT INCOME TAX RATES AND ALLOWANCES, AND CAPITAL TAX TREATMENT OF HUSBAND AND WIFE

This Appendix falls into two parts. The first completes the detailed description in Chapter 2 of the present income tax rules applying to husband and wife by setting out the income tax rates and the levels of the relevant personal allowances for the current year (ie 1980/81). Secondly there is a brief description of the existing capital gains and capital transfer tax rules insofar as they affect married couples.

---

1. Income tax rates and allowances

a. 1980/81 tax rates.

| Rate of tax | | Taxable income |
|---|---|---|
| 30% | (basic rate) | £1-£11,250 |
| 40% ) | | £11,251-£13,250 |
| 45% ) | | £13,251-£16,750 |
| 50% ) | (higher rates) | £16,751-£22,250 |
| 55% ) | | £22,251-£27,750 |
| 60% ) | | over £27,750 |

Investment income surcharge

In addition investment income surcharge (IIS) is charged at 15% on all investment income in excess of £5,500.

b. 1980/81 personal allowances.

| | £ |
|---|---|
| Single person's allowance | 1,375 |
| Married man's allowance | 2,145 |
| Wife's earned income allowance | 1,375 |
| Age allowance | |
| - single person | 1,820 |
| married couple | 2,895 |
| (income limit for full age allowance £5,900) | |
| Additional personal allowance | 770 |
| Widow's bereavement allowance | 770 |

## 2. Capital tax treatment of married couples

### a. Capital Gains Tax (CGT)

Capital gains tax is charged at 30 per cent on gains made when assets are disposed of. In general, the CGT liabilities of a husband and wife who are living together are calculated separately. But the husband is liable for his wife's capital gains tax as well as his own unless one of them makes an application for separate assessment, in which case she will be liable for her own tax.

One exception to the rule that the CGT liabilities of a husband and wife are calculated separately is where either of them makes an overall loss, or has brought a loss forward from an earlier year. In this case the loss is set against any gains of the other (whether or not an application for separate assessment has been made). But this does not happen if either of them makes an application for this particular provision not to apply.

Another exception occurs with the annual exemption of the first £3,000 of an individual's gains. A husband and wife have a single £3,000 exemption to share between them. Normally, it is divided in proportion to their net gains for the year (that is after deducting losses of the year and losses brought forward from earlier years). But if the total of their net gains does not exceed £3,000 and there are losses brought forward, they may agree between them how it should be divided.

The final exception occurs with the exemption of an individual's home. A husband and wife get only one exemption between them. So if they own more than one home only one is exempt. This will be the one which is their main home unless they both elect for another home to be exempt.

The other special rule that applies to a husband and wife is that where an asset is transferred from one to the other capital gains tax is not payable, no matter how much is paid for the transfer. For the purpose of calculating capital gains tax on a subsequent disposal, the transfer is deemed to have taken place on a "no gains no loss basis", - in other words the spouse who acquires the asset is treated as having paid the same amount for the acquisition as the other spouse paid to acquire it.

b. Capital Transfer Tax (CTT)

Transfers between husband and wife are exempt from capital transfer tax unless at the time of the transfer, the transferor is domiciled in the United Kingdom and his or her partner is domiciled abroad. In these circumstances the exemption is limited to £50,000 (this is in addition to the normal threshold).

Apart from this special exemption, husband and wife are treated as separate individuals. It follows that any transfers made by either of them which are chargeable to CTT are separately subject to the same rate scales and attract the same exemptions (including the annual exemption of gifts not exceeding a total of £2,000) and reliefs are transfers made by other individuals.

The rates of tax applicable to any transfer depend on the cumulative total of chargeable transfers made during the life of the transferor or at death. No tax is chargeable on the first £50,000 of a person's cumulative total. The next £10,000 is chargeable at 30 per cent if the transfer is made at date or within the three years before death; the starting rate on lifetime transfers if 15 per cent. The top rate of 75 per cent is reached for both lifetime and death transfers on slices of the cumulative total above £2,010,000.

## HUSBANDS' AND WIVES' TAX BILLS

This appendix sets out how a married couples's tax bill is calculated. It shows how the amount of tax an individual husband or wife is asked to pay can already differ according to whether the normal rules apply or whether the couple choose either of the current options for wife's earnings election or separate assessment. The effects on the husband and wife's tax bill of the two major developments of the present system considered in Chapter 4 are also illustrated.

---

In the following illustrations, the husband receives a salary of £7,000 and pays mortgage interest of £500. His wife has part-time earnings of £500 and receives investment income of £3,000. All the calculations are based on the allowances and rates of tax applying in 1980/81.

### 1. Present system: normal aggregation rule (Chapter 2.1-2)

Under the normal aggregation rules the married couple's tax bill is £2,206.50, wholly chargeable on the husband. This figure is arrived at by adding the wife's income to the husband's, as follows:-

| | | £ | |
|---|---|---|---|
| Husband's salary | | 7,000 | |
| Wife's earned income | | 500 | |
| Wife's investment income | | 3,000 | |
| | | 10,500 | |
| less mortgage interest | | 500 | |
| | | 10,000 | |
| Married man's allowance | 2,145 | | |
| Wife's earned income allowance | 500* | 2,645 | |
| | | 7,355 | @ 30% = £2,206.50 |

*When the wife's earned income is less than £1,375, this allowance has to be restricted to the amount of her earned income.

Under the normal aggregation rule the HUSBAND's tax bill is £2,206.50.

2. Separate assessment (Chapter 2.4.2-3)

If either the husband or the wife applies for separate assessment under the existing rules, the overall liability of £2,206.50 will be unchanged, but the tax bill will be split between the two spouses in proportion to their respective incomes.

| | Husband | | Wife |
|---|---|---|---|
| | £ | | £ |
| Salary | 7,000 | | 500 |
| Investment Income | - | | 3,000 |
| | 7,000 | | 3,500 |
| less mortgage interest | 500 | | - |
| | 6,500 | | 3,500 |
| Personal allowances | | | |
| $\frac{6,500}{10,000}$ X 2,645 = | 1,719 | $\frac{3,500}{10,000}$ X 2,645 = | 926 |
| | 4,781 | | 2,574 |
| @ 30% = | £1,434.30 | + | £772.20 = £2,206.50 |

Under separate assessment HUSBAND's tax bill is £1,434.30, WIFE's tax bill is £772.20.

3. Separate responsibility with equal split of tax relief (Chapter 4.7-8)

Under the revised form of separate responsibility, discussed in Chapter 4, the total tax bill would still remain the same but each spouse would receive half ot the available personal allowances. The total tax bill would therefore be split as follows:-

| | Husband | Wife |
|---|---|---|
| | £ | £ |
| Salary | 7,000 | 500 |
| Investment Income | - | 3,000 |
| | 7,000 | 3,500 |
| less mortgage interest | 500 | - |
| | 6,500 | 3,500 |

Personal allowances

| | Husband | Wife |
|---|---|---|
| | ½ X 2,645 = 1,323 | ½ X 2,645 = 1,322 |
| | 5,177 | 2,178 |
| | @ 30% = £1,553.10 + | £653.40 = £2,206.50 |

Under the new form of separate responsibility discussed in Chapter 4 HUSBAND would pay £1,553.10, WIFE would pay £653.40.

4. Wife's earnings election (Chapter 2.4.4)

It can be seen from the following calculation that it would not be to this couple's advantage to make a wife's earnings election. [Their combined income is not high enough for the election to produce a saving of tax at the higher rates, and since the married man's allowance of £2,145 is replaced by the single allowance of £1,375 the total liability is £231 (£770 @ 30%) higher than at 1. above.]

| | (a) Husband (all income apart from wife's earnings) | (b) wife (wife's earnings only) |
|---|---|---|
| | £ | £ |
| Salary | 7,000 | 500 |
| Investment Income | 3,000 | - |
| | 10,000 | 500 |
| less mortgage interest | 500 | - |
| | 9,500 | 500 |
| Single personal | 1,375 | 500* |
| | 8,125 | NIL |

*Although the wife is entitled to the single allowance of £1,375, her earnings are such that she can use only £500. The balance of £875 cannot be transferred to her husband.

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Under wife's earnings election the couples' tax bill is increased by £231, the HUSBAND pays £2,437.50 the WIFE NIL.

5. Option for independent taxation of wife's income (Chapter 4.3-5)

If, as is suggested in Chapter 4, the couple were able to opt to have the whole of the wife's income taxed independently, each would receive the single personal allowance against all his or her own income. Since two single allowances are worth £2,750 compared with personal allowances totalling £2,645 at 1. above, in this particular case there would be an overall tax saving of £31.50 (£105 @ 30%).

| | Husband | Wife |
|---|---|---|
| | £ | £ |
| Salary | 7,000 | 500 |
| Investment Income | - | 3,000 |
| | 7,000 | 3,500 |
| less mortgage interest | 500 | - |
| | 6,500 | 3,500 |
| Single personal allowance | 1,375 | 1,375 |
| | 5,125 | 2,125 |

@ 30% = £1,537.50 + £637.50 = £2,175.00

If the couple were able to opt for independent treatment the couple's tax bill would be reduced by £31.50, HUSBAND would pay £1,537.50, WIFE would pay £637.50.

MARRIED WOMEN IN EMPLOYMENT

This appendix illustrates the place of married women in the labour force. First it looks at how this has changed dramatically in the course of the current century. Secondly it focuses on those married women who do work today, showing how the choice between working and not working is affected by family commitments.

The first table, which is based on census data, shows how the composition of the work force in Great Britain has altered over the last 50 years. During this period, in particular the last two decades, the contribution of married women has increased from 4 per cent of the total to 23 per cent. In 1921 less than 1 in 10 married women were working or looking for work, but by 1971 nearly half of all married women were economically active.

TABLE 1 OCCUPIED/ECONOMICALLY ACTIVE POPULATION AND ACTIVITY RATES, GB 1921-1979

| | 1921 | 1931 | 1951 | 1961 | 1966 | 1971 | 1979 (Provisional) |
|---|---|---|---|---|---|---|---|
| Males and Females (million) | 19.4 | 21.1 | 22.6 | 23.8 | 24.9 | 25.1 | 26.0 |
| - Activity rate % | 58.1 | 60.7 | 59.6 | 60.5 | 62.1 | 61.2 | 62.1 |
| of which:- | | | | | | | |
| Males (million) | 13.7 | 14.8 | 15.6 | 16.1 | 16.0 | 15.9 | 15.8 |
| - Activity rate % | 87.1 | 90.5 | 87.6 | 86.0 | 84.0 | 81.4 | 78.6 |
| - % of total | (70.5) | (70.2) | (69.2) | (67.5) | (64.3) | (63.4) | (60.8) |
| Females (million) | 5.7 | 6.3 | 7.0 | 7.7 | 8.9 | 9.2 | 10.2 |
| - Activity rate % | 32.3 | 34.2 | 34.7 | 37.4 | 42.2 | 42.7 | 46.9 |
| - % of total | (29.5) | (29.8) | (30.8) | (32.5) | (35.7) | (36.6) | (39.2) |
| of which:- | | | | | | | |
| Married Females (million) | 0.7 | 1.0 | 2.7 | 3.9 | 5.1 | 5.8 | 6.7 |
| - Activity rate % | 8.7 | 10.0 | 21.7 | 29.7 | 38.1 | 42.2 | 49.6 |
| - % active females | (12.9) | (15.2) | (38.2) | (50.2) | (57.1) | (63.1) | (65.7) |
| Unmarried Females (million) | 5.0 | 5.3 | 4.3 | 3.9 | 3.8 | 3.4 | 3.5 |
| - Activity rate % | 53.8 | 60.2 | 55.0 | 50.6 | 49.2 | 43.7 | 42.5 |
| - % active females | (87.1) | (84.8) | (61.8) | (49.8) | (42.9) | (36.9) | (34.3) |

Source: 1921 - 1971 Censuses of Population
1979 data are based on results from the European Community Labour Force Survey.

The second table is a snapshot picture of the involvement of married women in the labour force in 1979. It illustrates how their economic activity rates vary with age. Those least likely to be working include married women in the 25 to 34 age group (largely wives who are staying at home to look after young children) and the 55 to 59 year olds (in many cases wives whose families have grown up or whose health may be too poor for them to take a job).

Table 2 - Provisional estimates of the number of economically active and inactive married women under 60, by age: GB, 1979.

Thous

| Age | Economically active* | Economically inactive |
|---|---|---|
| Under 20 | 66 | 63 |
| 20 - 24 | 560 | 412 |
| 25 - 34 | 1,618 | 1,524 |
| 35 - 44 | 1,827 | 895 |
| 45 - 54 | 1,698 | 892 |
| 55 - 59 | 700 | 645 |
| Total | 6,469 | 4,431 |

Source - EEC Labour Force Survey
*Working or seeking work.

The third table confirms that it is largely family commitments which determine whether or not a married woman is likely to be in paid employment. Of those wives aged 25 to 45 who are <u>not</u> economically active, only 9 per cent have no dependent children.

Table 3 - Estimated number of economically inactive wives under pension age, by age and presence of dependent children: GB, 1978.

Thous

| Age | With children | Without children | Total |
|---|---|---|---|
| Under 25 | 465 | 69 | 534 |
| 25 - 44 | 2,235 | 221 | 2,456 |
| 45 - 59 | 374 | 1,065 | 1,439 |
| Total | 3,074 | 1,355 | 4,429 |

Based on DE Labour Force Projections and 1976 FES (SR3).

Dependent children are those aged under 16, or 16 to 18 in full-time education. About 270,000 of the 1,355,00 economically inactive wives without dependent children live in households containing an elderly or disabled person.

Breadwinner wives

There are probably between 150,000 and 200,000 breadwinner wives - ie economically active wives with economically inactive husbands. In the majority of cases the husbands are retired, permanently sick or students, although there are no doubt a few "role reversal" couples - ie couples who have made a conscious decision that the husband should remain at home while the wife works.

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APPENDIX 6

DISTRIBUTIONAL EFFECTS

1.1 Changes to the system of taxation of husband and wife would have the effect of changing the share of income tax paid by different groups of people, including single persons.

1.2 This Appendix gives examples of the effect of the different forms of independent taxation described in Chapter 6. For comparison they are presented in this Appendix on a revenue neutral* basis although in practice, whether or not they are phased in over a period (see Chapter 8), revenue costs would have to be incurred to avoid any absolute reduction in the total allowances received by a working couple. For simplicity the comparison is with the tax system as it stands at present; the figures would differ to some extent (particularly where the wife had investment income) if independent taxation were to be introduced after implementation of the option described in Chapter 4 for extending the wife's earnings election to cover her investment income.

The various schemes considered are:-

1. Independent taxation with non-transferable tax allowances and no cash benefit for the spouse at home.

2. Independent taxation with allowances which are fully transferable between spouses.

3. Independent taxation where up to 56% of one spouse's tax allowance might be transferred to the other spouse (ie a partly transferable allowance scheme which reflects the present relativity between the married allowance and the single allowance).

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*ie the change from one set of tax rules to another is made without any gain or loss of tax revenue: the new system would yield precisely the same amount of revenue as the old.

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4. Independent taxation with non-transferable allowances where the yield of tax from married couples whose total allowances are reduced would finance a general increase in the level of child benefit.

Each of these schemes would allow for the independent taxation of wives' investment income (Chapter 6.3) and for Category B National Insurance pensions to be counted as the wife's income for tax purposes (Chapter 7.3.2).

Tax allowances

2.1 Implementing any of these schemes would mean a substantial change in the relative tax allowances available to different kinds of household. This is illustrated in the table below which compares, for both the present system and each of the independent taxation schemes, the total allowances available to each type of household with the allowance given to a single person under that particular scheme.

| Household type | 1980/81 allowances £ | Present system | As a percentage of single allowance. Independent taxation with: No transferable allowance (Scheme 1) | Fully transferable allowance (Scheme 2) | Partly transferable allowance (Scheme 3) | No transferable allowance, but increased child benefit (Scheme 4) |
|---|---|---|---|---|---|---|
| **Single people** | | | | | | |
| Without children | 1,375 | 100 | 100 | 100 | 100 | 100 |
| With children | 2,145 | 156 | 156* | 156* | 156* | 100 |
| Two single people | 2,750ǂ | 200ǂ | 200 | 200 | 200 | 200 |
| **Married couples** | | | | | | |
| Both husband & wife working | 3,520 | 256 | 200 | 200 | 200 | 200 |
| Husband working, wife no income | 2,145 | 156 | 100 | 200 | 156 | 100 |
| Wife working, husband no income | 3,520 | 256 | 100 | 200 | 156 | 100 |
| Husband working, wife with investment income only | 2,145 | 156 | 200 | 200 | 200 | 200 |
| Wife working, husband with investment income only | 3,520 | 256 | 200 | 200 | 200 | 200 |

ǂAlso applies where a married couple have made a wife's earnings election.

*Assuming that, under independent taxation the support given to a lone parent family would bear the same relativity to the single person's allowance as the APA does at present.

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2.2 Whereas the table above shows the relative amount of allowances that would be available to different types of family unit under each of the independent taxation schemes, the absolute level of the allowances would vary according to which scheme is being considered if the change from the present system were to be made on a revenue neutral basis. The single person's allowance under the various schemes would be as follows:

Scheme 1
(Independent taxation with no provision for spouse at home) £1,655

Scheme 2
(Fully transferable allowances) £1,370

Scheme 3
(Partly transferable allowances) £1,450 with a maximum of £810 transferable to the supporting spouse

Scheme 4
(No transferable allowance but child benefit increased by £4.90 per week) £1,290

2.3 It is possible to compare the absolute levels of allowances as between the different schemes for independent taxation by using a method somewhat similar to that used to illustrate the relativities within each scheme. In the table below the total allowances available to the various types of household are, under all 4 independent taxation schemes, expressed as a percentage of the present single person's allowance of £1,375.

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£1,375 = 100

| Household type | Present system | Scheme 1 | Scheme 2 | Scheme 3 | Scheme 4 |
|---|---|---|---|---|---|
| <u>Single people</u> | | | | | |
| Without children | 100 | 120 | 100 | 105 | 94 |
| With children | 156 | 187 | 155 | 164 | 94 |
| Two single people | 200 | 241 | 199 | 211 | 188 |
| <u>Married couples</u> | | | | | |
| Both husband & Wife working | 256* | 241 | 199 | 211 | 188 |
| Husband working, wife no income | 156 | 120 | 199 | 164 | 94 |
| Wife working, husband no income | 256 | 120 | 199 | 164 | 94 |
| Husband working, wife with investment income only | 156 | 241 | 199 | 211 | 188 |
| Wife working, husband with investment income only | 256 | 241 | 199 | 211 | 188 |

<u>Overall effect on tax bills</u>

3.1 Switching to any kind of independent taxation will make a difference - sometimes a substantial difference - to people's tax bills. There are two main reasons for this. The first is the different personal allowance structure implied by independent taxation which has been illustrated above. Secondly, independent taxation may affect the <u>rate</u> of tax levied on spouses' income. At present a husband and wife, except where they make a wife's earnings election, have only one set of rate bands

*If a wife's earnings election were in force the allowances under the present system would be 200.

to set against their joint income. With independent taxation a two-income married couple would be entitled to two sets of rate bands (though this would affect the total amount of tax they pay only where their joint income, after allowances, would bring them into the higher tax rates - ie is above £13-14,000 a year). The overall effects on individual taxpayers of switching to the various schemes of independent taxation is summarised in the two tables below.

Basic rate taxpayers

3.2

Change in annual net income under scheme:

| | 1 | 2 | 3 | 4* |
|---|---|---|---|---|
| Single persons | +£84 | -£1 | +£22 | -£25 |
| Married, husband only earning | -£147 | +£178 | +£34 | -£256 |
| Married, wife only earning | -£559 | -£234 | -£378 | -£669 |
| Married both earning† | -£63 | -£234 | -£186 | -£282 |
| Married, husband earning, wife with investment income only: | | | | |
| Maximum increase | +£349 | +£178 | +£226 | +£130 |

*In addition, each family with children would receive an extra £255 (£4.90 a week) per child in child benefit

†These figures would apply in all cases where the wife has sufficient earnings to use up the available allowances (ie over £1,375 schemes 2-4 and £1,655 in scheme 1). If the wife's earnings were below this level, the change in net income would be somewhere between the figures in this line and those in line 2 (the "married husband only earning" line).

3.3 For two-income couples who pay tax at higher rates on their joint incomes under the present system, one of the effects of independent taxation would be to give them a full basic rate band and a full set of higher rate bands against both the husband's income and the wife's. The effect of the change to independent taxation in a particular case would depend on the size of the joint income, its distribution as between husband and wife and the split as between investment income and earned income. It would also be affected by whether the present wife's earnings election is beneficial, and whether the couple would benefit from the option for extending the wife's earnings election to cover investment income, if this had been introduced. The following example gives a broad illustration of the relative effects of the independent taxation options, compared with the present tax system, for taxpayers (single and married) with a total income of £25,000 a year.

TAXPAYERS WITH INCOME OF £25,000

| | Present tax bill | Change in annual net income under scheme:- | | | |
|---|---|---|---|---|---|
| | | 1 | 2 | 3 | 4 |
| Single | £9,256 | +£154 | +£3 | +£41 | -£47 |
| Married, income all husband's earnings | £8,833 | -£269 | +£327 | +£63 | -£470 |
| Married, income all wife's earnings | £8,115 | -£987 | -£390 | -£654 | -£1,188 |
| Married, income half husband's earnings, half wife's earnings | £6,675[ƚ] | +£168 | +£63 | +£45 | -£51 |
| Married, income half husband's earnings, half wife's investment income | £9,883 | +£2,326 | +£2,155 | +£2,203 | +£2,107 |

*before allowing for child benefit increase.

[ƚ]assuming couple have made a wife's earnings election.

Shares of the total tax bill

4.1 As well as affecting individual tax bills, a move to independent taxation would obviously have an impact on the contribution to total revenue provided by households of different types. This is illustrated in the table below, which shows, to the nearest £m50, the full year effect based on 1980/81 income levels. (In this table, unlike the earlier tables, a plus sign indicates a bigger tax bill, and hence a smaller net income.)

| | Current system | | Change under scheme:- | | | |
|---|---|---|---|---|---|---|
| | Nos. of taxpayers | Tax bill | 1 | 2 | 3 | 4 |
| | m | £b | £m | £m | £m | £m |
| Aged-Single | 1.2 | 1.1 | -100 | Nil | -50 | +50 |
| Married | 1.2 | 1.6 | -200 | -250 | -300 | Nil |
| Non-aged:- | | | | | | |
| Single | 7.8 | 6.7 | -650 | Nil | -200 | +150 |
| Married, wife not working | | | | | | |
| with children | 3.0 | 4.3 | +350 | -550 | -150 | -550 |
| without children | 1.7 | 2.5 | +200 | -300 | -100 | +400 |
| Married, wife working | | | | | | |
| with children | 3.3 | 5.4 | +250 | +500 | +400 | -350 |
| without children | 3.1 | 5.1 | +150 | +600 | +400 | +800 |
| Total | 21.3 | 26.7 | - | - | - | +500* |

*The various increases and reductions under Scheme 4 would not cancel one another out, because some of the benefit from increased child benefit would be given to non-taxpayers - a group who are not covered in this table.

## Conclusion

5.1 The illustrative figures do no more than indicate in very broad terms the financial effects of moving the present system for taxing husband and wife to independent taxation. Nonetheless, the figures quoted serve to underline the points about the distributional effects of the independent taxation options which have been referred to in the text of the Green Paper:-

- independent non-transferable allowances would benefit no group of married couples, except those where the wife has substantial investment income;

- transferable allowances would benefit couples where the wife is not working compared with those where she is;

- couples where the wife is working and where there are no children would lose substantially from most options;

- single persons generally would benefit from the change (except where the yield from changes goes to increase child benefit);

- the married aged would benefit from the separate taxation of the Category B pension;

- couples with substantial investment income and where the wife is not working would benefit from all the options;

- "breadwinning" wives would lose in all the options.

APPENDIX 7

INTERNATIONAL COMPARISONS

Introduction

1. The grid below gives a summary of the basic treatment of the family for taxation purposes in the EEC countries, Australia, Canada, Japan, New Zealand, Sweden and the USA.

2. These fifteen countries have systems of taxation (and cash benefits for children etc) which differ considerably in law and in practice: no format such as the grid used here can cover every detail or every option of such diverse systems. Accordingly, it should only be regarded as giving a broad outline for comparative purposes: the answers may be capable of change in unusual circumstances, or if various options are exercised. For more detailed information, the individual countries section which follows this note should be consulted.

Basic unit of taxation

3. The possible units are individual; husband and wife; and family. Ten of the fifteen countries regard the individual - whether married or not - as the basic unit, and four the husband and wife combined. The French quotient system, under which the family is the basic unit, is explained in the country section. Of the four in which the husband and wife combined are the basic unit, options for separate taxation of either the spouses' total income, or their earnings only, are available in Belgium, Germany and the United Kingdom.

4. Four of the ten countries which treat husband and wife as separate individuals for earned income nevertheless aggregate their investment incomes. In the USA and Ireland couples would generally exercise the option of aggregating their total income from all sources as in most cases this would reduce their overall tax bill.

5. In recent years there has been a general trend away from compulsory joint or family taxation towards the choice of the individual as the tax unit for earned income or, at least, the provision of an <u>option</u> for individual taxation. In particular there have been the following changes:

1970 <u>Denmark</u> moved from joint to individual taxation of earned income.

1971 <u>Sweden</u> moved from joint to individual taxation of earned income.

1973 <u>Netherlands</u> moved from joint to individual taxation of earned income.

[1974 <u>Italy</u>, in reforming its schedular system of taxation, moved from individual taxation to compulsory family taxation for couples whose joint income exceeded 5 million lire (but see 1977 below).]

1976 <u>Belgium</u> moved from family to compulsory individual taxation, except where joint income exceeded 350,000 Belgian Francs.

1977 <u>Italy</u> moved from joint to individual taxation.

1980 <u>Ireland</u> is moving from joint to individual taxation, but giving married couples the option of being taxed jointly under income splitting rules.

<u>Treatment of married couples</u>

6. All the countries considered here give some extra tax relief where there is a financially dependent spouse, whether by deduction from total income, tax credit, or some form of quotient system. In Germany and the United States, spouses may choose between joint and

separate assessment. Under the joint taxation rules in both of these countries a husband and wife are taxed as if their total income were split equally between them. So for most married couples, opting for joint taxation reduces their total tax bill. (The new Irish system contains a similar option; and again it is expected that most husbands and wives will choose joint taxation).

7. Where there is a financially dependent spouse, eleven of the fifteen countries give allowances at least equal to two single allowances against the one income. (In Sweden there is a combination of allowance and tax credit for marriage which makes it impossible to generalise on the value of the couple's allowances). The United Kingdom is in the minority here in giving less.

8. Where both spouses work, tax relief for the financially dependent spouse is normally subsumed in the separate allowances, and the couple are left with two single allowances. The United Kingdom, together with Belgium, is unusual in giving the two income married couple more than two single allowances: none of the countries gives less than two single allowances.

Treatment of children

9. Eight of the countries give a tax allowance and all countries except the USA provide a cash benefit for a dependent child. Only in Canada is this cash benefit taxable. As in the UK, the general trend in recent years has been to move from tax allowances to cash benefits.

Lone parents

10. Twelve countries give extra tax allowances to one parent families. Apart from those countries, Belgium gives extra allowances to such families where the parent

is a widow or widower and Denmark does so where there is a dependent child of 17 or over who is undergoing education.

11. Many of the 15 countries also provide extra help for lone parents through the social security system. In some instances, as in the UK, there is some provision for all lone parents. Elsewhere there are different types of provisions for different types of lone parents. Often there is a special family allowance where one parent has died: in Denmark and France, this is paid in addition to an ordinary family allowance; in Germany and Luxembourg it is similar to a pension. In addition various countries have schemes for other one-parent families, those of France, Ireland, Australia and New Zealand are means tested.

| | Belgium | Denmark | France | Germany | Ireland | Italy | Luxembourg | Netherlands | United Kingdom | Australia | Canada | Japan | New Zealand | Sweden | USA |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1. What is the legal unit of taxation? | Husband and wife [1a] | Individual [3] | Family | Husband and wife [1b] | Individual [2] | Individual | Husband and wife | Individual [3] | Husband and wife [1a] | Individual | Individual [4] | Individual [3] | Individual | Individual [3] | Individual [2] |
| 2. Is there tax relief in respect of a financially dependent spouse? | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| 3. Does a one income married couple receive the same total tax allowances as 2 single persons each with an income? | More | Same | Same | Same | Same | More | Same | Less | Less | More | Less | Same | More | Variable | Same |
| 4. If both husband and wife work, do they receive higher total tax allowances than 2 single persons in work? | Yes [5] | No | No | No | No | No | No | No | Yes | No | No | No | No | No | No |
| 5. Is there tax relief for a dependent child? | Yes | No | Yes | No | Yes | Yes | Yes | No | No | No | Yes | Yes | No | No | Yes |
| 6. Is there a cash benefit for a dependent child? | Yes | Yes | Yes [6] | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes [6] | Yes | Yes | No |
| 7. Is there an extra tax deduction for child care costs? | No | No | No [7] | Yes [8] | No | No | Yes | No [7] | No | No | Yes | No | No | Yes | Yes |
| 8. Is there an additional tax allowance for one-parent families? | No [9] | No [10] | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | No | Yes | Yes | Yes |

1. Option for individual taxation:
   (1a) of each spouse's earned income only
   (1b) of each spouse's total income.
2. Option for joint taxation of husband and wife.
3. Compulsory aggregation of a husband and wife's investment income in certain circumstances.
4. Husband and wife are taxed jointly where the wife's income is below $2,990.
5. Providing they are jointly assessed.
6. Not for all children in a family.
7. Except for lone parents.
8. For 1980/81 only.
9. Except for lone parents who are widows/widowers.
10. Except where there is a child aged 17 or over who is being educated.

RESTRICTED
RESTRICTED

BELGIUM (62.90 B Frs = £1)*

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. Husband and wife are taxed jointly.<br><br>2. If beneficial, there is separate taxation of earned income of husband and wife if combined earned income does not exceed 390,000 B Frs.<br><br>Investment incomes are still aggregated. | 1. Taxable income of employees and professional people is reduced by a minimum deduction for professional expenses. The amount of the minimum deduction varies with income, and the maximum flat-rate deduction is 75,000 B Frs.<br><br>2. There is a further deduction against net earned income of 10,000 B Frs. | 1. Married taxpayers who are jointly assessed on the whole of their income receive a tax credit equal to 5 per cent of the tax payable on the first 390,000 B Frs of income.<br><br>2. If husband and wife are jointly assessed and both have earned income, that of the wife is reduced by 56,000 B Frs.<br><br>3. Where both husband and wife earn, each receives the expenses deduction. The deduction of 10,000 B Frs is a combined deduction, which is apportioned in the case of separate assessment. | 1. Tax credits are granted for dependants, including the wife (see previous column, 1). The <u>cumulative</u> credits are<br>1 dependant - 5 per cent of tax on first 390,000<br>2 dependants - 10 per cent of tax on first 390,000<br>3 dependants - 20 per cent of tax on first 390,000<br><br>2. There are cash benefits (not taxable) for dependent children amounting to:<br>1st child - 1,524.00 B Frs per month<br>2nd child - 2,417.00 B Frs per month<br>3rd child - 3,310.00 B Frs per month<br>4th child - 3,376.00 B Frs per month<br>each subsequent child - 3,400.00 B Frs per month<br>plus 'age addition' for children over 6.<br><br>3. LONE PARENTS - there is relief only for widows/widowers who have not remarried: the deceased spouse is regarded as a dependent for tax purposes. |

RESTRICTED

*Exchange Rates throughout as at 7 January 1980

DENMARK (12.08 Kr = £1)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. Spouses are taxed individually for earned income, but investment incomes are added to the husband's earned income. | 1. There is a personal allowance of 14,800 Kr. The allowance is converted at the lowest income tax rate for deduction from the tax due.<br>2. There is a wage-earner's standard deduction of 2,000 Kr. | 1. Two personal deductions are given to a married couple with only one income.<br>2. If a spouse has insufficient income to make full use of the personal allowances, the balance is deducted from the taxable income of the other spouse. | 1. There are no tax allowances for dependent children.<br>2. There are cash benefits (not taxable) for dependent children of 161 Kr per month for each child.<br>3. LONE PARENTS - a double personal allowance (29,600 Kr) at the lowest income tax rate is received by a single parent with a dependent child of 17 or over who is being educated. |

RESTRICTED

FRANCE (9.065 frs = £1)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. The joint income of the family, including children who are in the care of the family. Investment incomes are aggregated.<br><br>2. The spouses are always taxed jointly, but children over 18 may opt for separate taxation. | 1. There is a minimum expenses deduction for employees of 10 per cent of net salary (minimum 1,800 frs, maximum 40,000 frs). There is an additional deduction for employees of 20 per cent of earnings less social security contributions and the minimum expenses deduction, up to 360,000 frs. | 1. Under the "quotient familial" system, net total income is divided into a number of parts according to the tax-payer's status and number of dependants (one part for each spouse, half a part for each child). The tax attributable to a single part is multiplied by the total number of parts to give the total amount payable. | 1. Allowances are normally given by the quotient system, but there are limits to allowances for children over the age of 18.<br><br>2. There are cash benefits (not taxable) for the second and subsequent children in a family amounting to:<br>2nd child - 218.27 frs per month<br>3rd child - 389.09 frs per month<br>4th child - 351.13 frs per month<br>each subsequent child - 332.15 frs per month<br>plus 'age addition' for children over 10.<br><br>3. LONE PARENTS -<br>(a) a widow with dependent children of the marriage is treated like a married person. Other lone parents (single/divorced/separated) are accorded more than the usual child part (½) in addition to the adult part (1). For example:<br>a widow with 1 child = 2½ parts<br>2 children = 3 parts<br>a divorced/separated/single person with<br>1 child = 2 parts<br>2 children = 2½ parts<br>(b) lone parents are also entitled to a deduction for child care costs of up to 3,000 frs per year per child if they have earned income of less than 114,850 frs. |

RESTRICTED

GERMANY (FEDERAL REPUBLIC) (3.865 DM = £1)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. Spouses are normally assessed jointly on earnings and investment income, but have the option of being separately assessed. | 1. There is a basic allowance of DM 3,719 (at the 22 per cent rate only) granted to all taxpayers.<br><br>2. There is a personal allowance of DM 510.<br><br>3. There are standard deductions for employees of DM 1,444; there is also a minimum deduction of DM 240 for certain special expenses. | 1. In the case of joint assessment, the basic allowance, personal allowance, and lump sum of DM 240 are doubled.<br><br>2. Total income of spouses is divided by two; the tax applicable to this sum is calculated, and doubled to give the joint liability.<br><br>3. If both husband and wife are employed each receives the standard deduction of DM 1,444. | 1. There are no tax allowances for dependent children [at present, but see 3 below].<br><br>2. There are cash benefits (not taxable) for dependent children amounting to:<br>1st child - DM 50 per month<br>2nd child - DM 100 per month<br>each subsequent child - DM 200 per month<br><br>3. [For 1980 there is a deduction of up to DM 600 per child (up to DM 1,200 where couple jointly assessed), with no requirement that both spouses should be working, for expenses incurred in the education, care, or professional (etc) training of a taxpayer's child. But] from 1981 it is proposed instead to reintroduce an ordinary tax allowance for children of DM 800 (DM 1,600 where couple jointly assessed) given at the starting rate of 22 per cent.<br><br>4. LONE PARENTS - an additional allowance of DM 3,000 is availabe where there are dependent children. |

RESTRICTED

IRELAND (£IR 1.048 = £1)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1.* Spouses are assessed on their separate incomes, but may opt jointly for joint assessment.<br><br>The tax rate scale bands of income are doubled for a married couple jointly assessed, eg:<br><br>separate assessment: first £IR 1,000 of income @ 25%<br><br>joint assessment: first £IR 2,000 of income @ 25% | 1. The single person's allowance is £IR 1,115 per year.<br><br>2.* There is an additional allowance for each individual with income taxed under PAYE. | 1. The married person's allowance is £IR 2,230 (£IR 1,115 each if separately assessed) per year. | 1. There is a tax allowance of £IR 195* per year for a dependent child.<br><br>2. There are cash benefits (not taxable) for dependent children amounting to:<br><br>1st child - £IR 3.50 per month<br>each subsequent child - £IR 5.50 per month<br><br>3. LONE PARENTS - there is an additional personal allowance of £IR 1,500 for lone parents with dependent children. |

*Subject to final approval of 1980 Finance Bill by Irish Parliament

RESTRICTED

ITALY (1,811.25 lire = £1)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. Spouses are assessed individually on earnings and investment income. They may opt for joint assessment, which does not alter the tax payable as this is still calculated on an individual basis. | 1. There is no basic allowance, but there is a tax credit (deducted from the tax bill) for all taxpayers of 36,000 lire.<br><br>2. All employees receive a deductible tax credit of 160,000 lire.<br><br>3. Individuals with incomes from employment/ pension of less than 2,500,000 lire receive an additional credit of 52,000 lire. | 1. A tax credit of 108,000 lire is given.<br><br>2. The working wife receives the same credits as the husband. Where the wife's income exceeds 960,000 lire, the credit of 108,000 lire for marriage is lost. | 1. A married person receives tax credits of 24,000 lire for one child, 40,000 lire for two children etc. Where the spouse's income exceeds 960,000 lire, half the credit is given to each spouse.<br><br>2. There are cash benefits (not taxable) for dependent children of about 10,000 lire per month for each child.<br><br>3. LONE PARENTS - a lone parent receives the <u>spouse</u> credit for one child, and the appropriate child credit for the total of the other children, less 24,000 lire. |

RESTRICTED

LUXEMBOURG (62.90 Frs = £1)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. Spouses are taxed jointly on earnings and investment income. | 1. There is a minimum flat-rate deduction of 15,000 Frs for special expenses from total net income.<br><br>2. There is a minimum expenses deduction of 12,000 Frs from net employment income. There is also a deduction of 18,000 Frs from taxable income in respect of employment income. | 1. There are no allowances or tax credits for marriage. However, the tax payable by a married couple is derived by halving their taxable income, calculating the tax due on this part, and then doubling the resulting tax.<br><br>2. Where both spouses work the allowances and deductions in the previous column are doubled. | 1. Where taxable income does not exceed 505,200 Frs and there are up to 3 dependent children the income is divided into parts: the tax due on one part is multiplied by the number of parts to give the tax liability. The number of parts into which income is divided is:<br>for 1 dependent child, 2.6;<br>for 2 dependent children, 3.4;<br>for 3 dependent children, 4.6.<br><br>2. Where there are more than 3 dependent children, or for other levels of income, there are tax credits of varying amounts in respect of the children.<br><br>3. There are cash benefits (not taxable) for dependent children amounting to:<br>1st child - 1,244.00 Frs per month<br>2nd child - 1,555.00 Frs per month<br>each subsequent child - 3,203.00 Frs per month<br>plus 'age addition' for children over 6.<br><br>4. Married couples (there is no requirement for both spouses to be working) and lone parents with at least 3 children under 14 in the household, are entitled to a deduction of up to 18,000 Frs if they employ someone to help in the house and pay that person.<br><br>5. LONE PARENTS -<br>(a) a lone parent with children is treated as a married person for tax purposes ie he/she is at least entitled to have income divided by 2, the tax calculated on the |

RESTRICTED

(continued)

(Luxembourg)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| | | | divided sum and then remultiplied by 2 (quotients of 2.6, 3.4 or 4.6 will apply where income is below 505,200 Frs and there are up to 3 dependent children, as for a married person).<br>(b) See also 4 above. |

RESTRICTED

## NETHERLANDS (4.275 fl = £1)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. Spouses are taxed separately on earned income, but jointly on investment income. | 1. A single taxpayer receives an allowance of 6,087 fl (for those who are divorced or over 35, the allowance is 8,183 fl).<br><br>2. There is an expense allowance of 4 per cent of employment income (minimum 200 fl, maximum 800 fl) plus a minimum allowance of 200 fl for the cost of travelling to work. | 1. A married man receives a personal deduction of 10,489 fl.<br><br>2. There is a wife's earned income allowance of 2,101 fl. | 1. There are no tax allowances for dependent children.<br><br>2. There are cash benefits (not taxable) for dependent children amounting to:<br><br>1st child - 86.33 fl per month<br>1st child (if born after 1.1.79) - 43.33 fl per month<br>2nd child - 140.00 fl per month<br>3rd child - 141.00 fl per month<br>4th child, 5th child - 170.34 fl per month<br>6th child, 7th child - 188.00 fl per month<br>each subsequent child - 207.00 fl per month<br><br>3. LONE PARENTS -<br><br>(a) a lone parent under 35 with a child entitled to a cash benefit is entitled to an additional personal allowance of 4,402 fl; in similar circumstances a lone parent over 35 is entitled to an additional allowance of 2,306 fl. If the lone parent works outside the home, there is a further additional allowance of one-quarter of earned income up to a maximum of 3,361 fl;<br><br>(b) lone parents of children under 16 are also entitled to a deduction for "extraordinary burdens relief" in respect of the expense of employing a household help, within certain limits. |

RESTRICTED

UNITED KINGDOM

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. Husband and wife are taxed jointly.<br>2. A couple may elect to have wife's earnings taxed separately, but investment incomes have to be aggregated.<br>3. They may also opt for separate assessment, which apportions rates and allowances between the spouses, but does not alter the total joint tax liability. | 1. There is a single person's allowance of £1,375. | 1. A married man receives an allowance of £2,145.<br>2. A working wife receives an allowance of £1,375, or the amount of her earnings if less. | 1. Tax allowances for dependent children have now ceased [in most cases].<br>2. There are cash benefits (not taxable) for dependent children of £17.33 per month for each child.<br>3. LONE PARENTS -<br>where a person has single-handed responsibility for at least one child who is under 16, or if over 16 in full-time education, and living with him/her the additional personal allowance of £770 per annum is also available. |

RESTRICTED

AUSTRALIA ($2.027 = £1)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. Individuals are taxed separately. | 1. There is a general rebate of 33.07 per cent of qualifying personal expenditure (eg medical expenses, superannuation contributions, rates in excess of $1,590) which is set off against tax payable. | 1. A rebate for a spouse of $597 is allowable provided that the spouse's income does not exceed $203. The rebate is reduced by $1 for every $4 by which the spouse's separate net income exceeds $203. | 1. There are no tax allowances for dependent children.<br><br>2. There are cash benefits (not taxable) for dependent children amounting to:<br>1st child - $15.20 per month<br>2nd child - $21.70 per month<br>3rd child )<br>4th child ) - $26.00 per month<br>each subsequent child - $30.35 per month<br><br>3. LONE PARENTS - a lone parent is entitled to a rebate of $417 where there is a dependent child under 16 or a student in the household. |

RESTRICTED

CANADA ($2.644 = £1)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. Spouses are taxed individually; however, where the income of a wife is below $2,990 she is required to file a joint return. | 1. There is a basic personal exemption of $2,890 plus a minimum standard deduction in respect of medical expenses and charitable contributions of $100.<br><br>2. There is also a general tax deduction of 9 per cent of federal tax otherwise payable, with a minimum of $200 and a maximum of $500. | 1. Where a wife's income is below $2,990 the husband receives a tax allowance in respect of his wife (maximum $2,530) which is reduced by the excess of the wife's income over $460.<br><br>2. If the wife's income is greater than $2,990 both husband and wife must file as separate individuals and each receives the basic allowance of $2,890 and the 9 per cent tax reduction. | 1. There is an exemption of $540 for each dependent child under the age of 18 whose incom is less than $1,910. If the child's income is more than $1,910 but less than $2,990, the exemption is reduced by one-half of the child's income above $1,910. For dependent children aged 18 and over, the exemption is $990. The exemption is reduced by the amount of the dependent child's income over $2,000.<br><br>2. There is a child tax credit of $238 for eac child under 18 given where the income of the claimant and spouse (if any) does not exceed $21,380. The total credit is reduced by 5 per cent of the income in excess of $21,380. In the case of a married couple, the credit would normally be claimed by the wife, any excess of the credit over her tax liability being refunded.<br><br>3. There are cash benefits (<u>taxable</u>) for dependent children of $21.80 per month for each child (this rate does not apply in Quebec).<br><br>4. A deduction for child-care expenses is allowed in respect of children under 14 (or over 14 in cases of mental or physical handicap). This is limited to the least of: $4,000; $1,000 per child; two-thirds of the claimant's earned income in the tax year.<br><br>5. LONE PARENTS -<br><br>(a) a lone parent may claim the additional personal allowance for a spouse ($2,530) in respect of one dependent child, reduce by the child's income in excess of $460, as for a spouse. The ordinary child allowances are claimed for any other dependent children;<br><br>(b) see also 3 and 4 above. |

RESTRICTED

JAPAN (523.50 yen = £1)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. Individuals are taxed separately on their earned income.<br>2. Where members of a family (including parents, grandparents) live together and aggregate income exceeds 10 million yen all investment income of the family is added to the total income of the member of the household with the largest income (apart from investment income). The tax due on the investment income is then apportioned pro rata among the relevant members of the family. | 1. There is a basic allowance of 40 per cent of employment income up to a salary of 1,500,000 yen per year. The rate of relief varies with income: on salaries over 10,000,000 yen per year it is 2,050,000 yen + 5 per cent of the excess of earned income over 10,000,000 yen.<br>2. There is a personal allownace of 290,000 yen. | 1. An allowance of 290,000 yen per year is given, if the spouse's earned income does not exceed 200,000 yen (100,000 yen for investment income). | 1. There is an allowance of 290,000 yen per year for each dependent child.<br>2. There are cash benefits (not taxable) for the third and subsequent children in a family of 5,000 yen per month for each child. (This allowance is means-tested.) |

RESTRICTED

NEW ZEALAND ($2.2785 = £1)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. Individuals are taxed separately. | 1. There is a basic allowance of $52 on employment income, for expenses. | 1. There is a rebate for a spouse of $156 provided the spouse's income does not exceed $520. The rebate is reduced by 20 cents for every $1 earned by spouse over $520 and ceases when spouse's earnings reach $1,300 per annum.<br><br>2. See also 2 in next column. | 1. There are no tax allowances for dependent children, except that a rebate of $468 per annum is allowed (in the case of a married couple, to the spouse with the higher income level) provided that:<br><br>(a) the family includes a child under five during the income year;<br><br>(b) the income level does not exceed $9,360 per annum.<br><br>The rebate is reduced by 10 cents for every $1 income over $9,360 and ceases when income reaches $14,040.<br><br>2. <u>Single income family rebate</u> - this is given where there is a child under 12 in the family and where there is only a single income or the income of the other person having care of the child is $1,300 or less. The rebate is $260, reduced by 20 cents for every $1 of the other person's income in excess of $1,300, so that it ceases when income reaches $2,600.<br><br>3. There are cash benefits (not taxable) for dependent children of $6 per week for each child.<br><br>4. LONE PARENTS - are also eligible for the rebates outlined in 1 and 2 above. |

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SWEDEN (9.34 Kr = £1)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. Spouses are taxed separately, but wife's total investment income is aggregated if it exceeds 2,000 Kr. | 1. There is a basic lump-sum deduction of 6,000 Kr for every tax-payer (local income tax only).<br>2. Each separately assessed taxpayer also receives a tax credit of 320 Kr. | 1. There is a tax credit of 1,800 Kr where a spouse has no income.<br>2. Where the spouse has income, the credit is reduced: it is withdrawn when spouse's income reaches 6,000 Kr. | 1. A deduction of 2,000 Kr is given to families with children under 16 years of age, when both parents are in employment.<br>2. Theare are cash benefits (not taxable) for dependent children of 2,800 Kr for each child.<br>3. LONE PARENTS -<br>(a) a lone parent with a child under 16 is also entitled to the deduction at 1 above;<br>(b) a lone parent with a child at home under 18 is entitled to a tax credit of 1,800 Kr. |

RESTRICTED

UNITED STATES ($2.262 = £1)

| TAX UNIT | BASIC TAX ALLOWANCES AND CREDITS | MARRIED COUPLE: ONE-EARNER/TWO-EARNERS | CHILDREN/LONE PARENTS |
|---|---|---|---|
| 1. The basic principle is individual taxation.<br><br>2. In practice, however, most married couples exercise the option to be taxed jointly. In this case their tax bill is calculated as if their joint income was split equally between them. A special scale of tax rules, with rate bands wider than (but not double) the single person's rate scales, applies to married couple's joint returns. | 1. There is a zero bracket amount of $2,300 ($1,700 for a spouse filing a separate return).<br><br>2. There is a personal exemption of $1,000. | 1. For a married couple filing jointly, there is a zero bracket amount of $3,400.<br><br>2. There is an exemption of $1,000 for a spouse. | 1. There is an exemption of $1,000 for each dependent child under 19, or full-time student<br><br>2. A taxpayer with a dependent child under 19 in his household is entitled to an earned income credit of the lesser of either 10 per cent of earned income, or, $500 reduced by 12½ per cent of earned income over $6,000. If the credit exceeds liability after all other credits have been given, the excess is refunded.<br><br>3. A taxpayer who maintains a household may receive a tax credit for 20 per cent of child-care expenses, where they were paid to enable the taxpayer to be employed; subject to a maximum of $400 for one qualifying child and $800 for two or more.<br><br>4. There are no cash benefits for dependent children.<br><br>5. LONE PARENTS - a special scale of tax rates applies to "heads of households" which would include lone parents with dependent children whose principal place of abode is with the parent. The rate scale is more favourable than that for a single person although the zero bracket amount ($2,300) is the same as for a single person. |

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JS
cc CO
Econ PS

10 DOWNING STREET

*From the Private Secretary*

MR. IBBS

TAX AND HOUSING

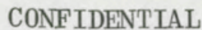
Thank you for your minute of 19 September. The Prime Minister rejected some of the proposals in the Chancellor's minute of 7 August, not as a matter of principle, but I think on the grounds that they would involve a reduction in mortgage relief. Her impression was, I believe, that the "universal option mortgage" scheme would involve a reduction in relief.

I think that, rather than showing your minute to the Prime Minister, the best way forward would be for you to take up your suggestion directly with the Treasury. If a scheme on the lines you propose could be worked out, I believe the Prime Minister would be prepared to consider it.

I am sending a copy of this minute to Sir Robert Armstrong. (I am also sending him a copy of the Chancellor's minute of 7 August and my reply of 8 August: I assume you received copies of these from the Treasury.)

T. P. LANKESTER

30 September 1980



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Qa 05131

To: MR LANKESTER

From: J R IBBS

Tax and Housing

1. We saw a copy of your note of 8 August to the Chancellor's Private Secretary about tax and housing. You will know better than we do whether the Prime Minister rejected the alternatives on principle or because of their assumed effect on mortgage relief. Assuming the latter, however, I would offer one comment.

2. One option listed by the Chancellor - the so-called "universal option mortgage" scheme - would offer substantial staff savings in the Inland Revenue (estimated for the Layfield Report at 4,500 staff). It might be worth considering whether it could be adapted in some way to obtain the staff savings while leaving everyone with the same amount of tax relief as at present. An outline of such a scheme is as follows:

(i) Individuals would pay their mortgage repayments to building societies after deduction of the equivalent of tax relief at the basic rate on the interest.

(ii) Building societies would be compensated either by an adjustment to the "composite" tax rate they pay on their income or by a global tax repayment for mortgage interest received.

(iii) Individuals paying tax at the higher rates would claim tax relief against their income as at present but only for the excess over basic rate tax.

3. In this way everyone would receive the same amount of tax relief as now. But since for most people it would be paid in a single repayment to the building societies rather than in individual tax adjustments there would be administrative savings in the Inland Revenue which we understand are currently put at around 1,000 staff, although it might be worth



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exploring why the reduction from the Layfield estimate is so large. Such a change might also have beneficial effects on inflationary expectations since the perceived rate of interest on mortgages would fall even though net payments were unchanged.

4. If the Prime Minister sees any merit in the idea she might like to ask the Chancellor for his views.

5. I am sending a copy of this minute to Sir Robert Armstrong.

JH

19 September 1980

20 SEP 1980

Civil Service Department,
Whitehall,
London, SW1A 2AZ

✓ MJS

*With the Compliments*

*of the*

*Lord President of the Council*

NBPM yet
MJS
19/8

Econ Pol

**Civil Service Department**
Whitehall London SW1A 2AZ
01-273 4400

18 August 1980

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1P 3AG

Dear Geoffrey,

GREEN PAPER ON TAXATION OF HUSBAND AND WIFE

I have seen your minute of 8 August to the Prime Minister, and the reply of 11 August from her Private Secretary.

I agree both with the thrust of the Green Paper and with your desire to publish it. But I think more should be said in general terms about the drawbacks in terms of manpower costs.

There can plainly be no question of spelling out the precise staff costs of the various options, if only because they must depend to some extent on choices made by individual taxpayers. On the other hand the public debate should take place with some indication of the extra manpower involved in each of the options which you have given in your minute, again if only to make people aware that Government is aware of the importance of this in the present climate. From the Green Paper itself it is impossible to know that mandatory independent taxation would involve a staff cost ten times that of extending existing options; and amounting to some 5,000 civil servants. Given our policy of reducing the size of the Civil Service, this is clearly a relevant and important consideration.

Our officials are already in touch about the wording and I think it would be helpful to see a revised draft before deciding whether the issue should be discussed at E Committee.

The basic manpower question we shall have to answer when we reach a decision is this. We are committed to a Civil Service no more than 630,000 strong by 1 April 1984; and we must surely plan to maintain this figure, if not to reduce it still further in later years, when the bulk of the 5,000 will be needed. Is it clear that if we are to add 5,000, the maximum advantage is gained by devoting them to this purpose? Or, if you prefer, will colleagues be ready

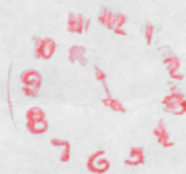
to get down to 625,000 to make room for these particular proposals?

I am copying this to the Prime Minister, other members of E Committee, the Secretary of State for Social Services, Sir Robert Armstrong and Mr Ibbs.

Yours ever
Christopher

SOAMES

19 AUG 1980



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Caxton House Tothill Street London SW1H 9NA

Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury
Great George Street
LONDON SW1P 3AG

18 August 1980

Dear Geoffrey

GREEN PAPER ON TAXATION OF HUSBAND AND WIFE

Your minute of 8 August to the Prime Minister invited the agreement of members of E Committee to the issue of a Green Paper on the Taxation of Husband and Wife later this year in the form of the draft which you enclosed.

My Department will of course be studying the draft from the point of view of the likely effect on women at work of the different taxation options which it identifies and my officials will no doubt be in touch with yours about points of detail; but in general I am content that the Green Paper should be published along the lines you propose.

I am sending copies of this letter to the recipients of yours.

Yours
Jim

18 AUG 1980

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RH

cc:- E Cttee

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| HO | MAFF |
| FCO | Trade |
| C.Exch | Energy |
| Ind | Chief Sec |
| L.Pres | |
| Emp | |

11 August, 1980

Green Paper on Taxation of Husband and Wife

The Prime Minister has seen the Chancellor's minute of 8 August.

Subject to the view of colleagues, she is content with the proposals in paragraph 4 of that minute. She agrees that there is no need for a meeting to discuss the draft , subject once again to the agreement of colleagues.

I am sending copies of this letter to the Private Secretaries of E Committee, Don Brereton (DHSS), David Wright (Cabinet Office) and Gerry Spence (CPRS).

N. J. SANDERS

A J Wiggins, Esq
HM Treasury

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

GREEN PAPER ON TAXATION OF HUSBAND AND WIFE

In my Budget Speech I announced our intention to publish later this year a Green Paper dealing with the treatment for tax purposes of husband and wife.

2. Attached to this minute is a draft of the Green Paper and also a short summary of its contents. I suggest that you need not look beyond the summary and, if time possibly permits, the opening and closing chapters of the draft: they give a pretty clear picture of what the Green Paper is about. If you did have time to read more, I think you will find that the Green Paper does deal in what I trust is a constructive way with an important issue which affects the majority of the population and has provoked a good deal of comment and criticism.

3. The Green Paper deals mainly with income tax as it applies to married couples (and does not, for example, touch on child benefit, for the reason given in the first paragraph of the Summary); but you will see that, in recognition of proposals put forward by bodies such as the Equal Opportunities Commission, it also deals with the possibility of social security provision as an alternative, in particular, to meet the case of the

/married couple where one

married couple where one partner is financially dependent on the other. Patrick Jenkin has seen the draft and agrees with the line which it takes, namely, that a tax allowance is to be preferred for this purpose to a cash benefit.

Agreed

4. The purpose of this minute is to seek your agreement, first, to the publication of a Green Paper on these lines before the end of this year (probably in October or November), and secondly, to the broad coverage of the Green Paper and the presentation of the issues which it examines. I am also copying this minute to other members of E Committee, although I recognise that only a minority will have a departmental, as distinct from personal, interest in the subject. I suggest that there is no need for a meeting of the Committee to discuss the Green Paper, unless you or others should wish it; but I should welcome comments, which we can then pursue as necessary in correspondence.

5. With regard to the substance of the Green Paper and the likely course of events following its publication, I should draw the following points to your attention:-

(i) General line of the Green Paper

The greater part of the Green Paper is devoted to consideration of the case for treating husband and wife as individual units for tax purposes, instead of treating the wife's income as her husband's. Independent taxation is what most of the pressure groups favour; but it has its drawbacks in terms of the shifts in the relative burdens of taxation between different

/groups, the revenue

groups, the revenue cost of ensuring that at the time of change working couples (who would inevitably be relatively disadvantaged by independent taxation) would not be absolutely worse off, and the manpower costs of a system under which, with independent taxation, a transferable tax allowance would be provided to meet the case of the married couple where one partner is financially dependent on the other. (The first two of these aspects are dealt with in Appendix 6 and Chapters 6 and 8 - where the revenue cost in current terms is estimated to range between £2¾ and 3¾b. - and the third immediately below.) The case for change and its drawbacks need to be exposed fully for public debate through a Green Paper.

(ii) Manpower

Chapter 10 of the draft deals in broad terms with the administrative implications; but the effect on the workload is not quantified, since staff figures could only be speculative, especially for changes which could not take place until the end of the decade, and there is always a risk that such figures in a Green Paper would be taken as indicating a prospective net increase of this amount in total Inland Revenue manpower without allowing for the possibility of achieving offsetting savings. But, to give you some idea of the work involved, the continuing staff requirement in the Revenue which would result from a change to independent taxation, with a transferable tax allowance where

one partner is financially dependent on the other, could at worst amount to something of the order of 5,000 units.

(iii) Implementation of changes discussed in the Green Paper

Mandatory independent taxation could not be carried out until PAYE is fully computerised, that is, about the end of this decade. But an extension of the existing options for independent taxation, along the lines examined in Chapter 4, could be brought into effect earlier than that. Subject to the revenue cost (of allowing a couple to claim that the wife's investment income - as well as her earnings - should be separately taxed, estimated at some £m300) and the manpower costs (which, depending on the numbers electing, could amount to some 500 staff) "optional independent taxation", as the Green Paper calls it, could be legislated for within the next two years. The timetable for such legislation will, of course, depend on the handling of the Green Paper, eg by the Select Committee on the Treasury and Civil Service, who will almost certainly wish to examine it (or set up a sub-committee to do so). If their work is completed by the Summer of 1981, legislation could be contemplated in 1982, to take effect from 1983/84.

6. Conclusion

I should be glad to have your agreement and that of other members of E Committee -

(i) to the issue of a Green Paper on the Taxation

of Husband and Wife later this year; and

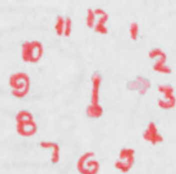
(ii) to its coverage and presentation along the lines of the attached draft.

7. I am sending copies of this minute to other members of E Committee, the Secretary of State for Social Services, Sir Robert Armstrong and Mr Ibbs.

G.H.

8 August 1980

- 8 AUG 1980



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cc Mr. Hoskyns
Mr. Wolfson

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copied to HMT
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10 DOWNING STREET

*From the Private Secretary*

8 August 1980

The Prime Minister has read the Chancellor's minute of 7 August about tax reliefs for housing. She would be prepared to discuss with the Chancellor some of the ideas in this minute after the holidays; but you should know that she is not prepared to countenance any reduction in mortgage relief, and that therefore it would be a waste of time commissioning further work on proposals which would have this effect. You should also be aware that the Prime Minister is not disposed to the idea of increasing the ceiling on mortgage relief while restricting the value of the relief to the basic rate, nor to the possibility of a universal option mortgage scheme, nor to the approach favoured by Peter Bottomley.

T. P. LANKESTER

Martin Hall, Esq., M.V.O.,
HM Treasury.

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

cc Mr Hoskyns
Mr Wolfson

Prime Minister

I suggest you discuss the ideas for further work at the end of this minute with the Chancellor after the holiday. (Peter Bottomley's idea - para 17 - looks interesting).

PRIME MINISTER

TAX RELIEFS FOR HOUSING

Since the Budget, I have pressed ahead with preparations to involve a few experienced people outside Whitehall in the work on taxation and savings which you endorsed earlier in the year (your Private Secretary's letter of 31 March to mine). The involvement of the outsiders was made public in a Written Answer on 14 July. I am also asking officials (but not the outsiders) to consider the tax treatment of gilts and chattels as you suggested.

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Background

2. You also mentioned the present bias towards housing. I have been thinking carefully about the scope for doing more work on this. This is a difficult area, and I thought it might be useful to set out some of the considerations which we would need to take into account in deciding what work to put in hand. There are a number of conflicting issues.

3. I have not concerned myself with rented housing - either in the public or private sectors - but have concentrated on owner-occupation, where the tax reliefs are given. What we decide on owner-occupation, however, will need to be viewed alongside our policy in the public rented sector, where our aim is to increase rents and reduce subsidies, and in the private rented sector where one of our aims is to improve the working of the market by reducing the extent of rent controls.

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The Reliefs Available

4. The main tax provisions from which owner-occupiers can be said to benefit (apart from general help for housing) are:-

(a) mortgage interest relief on loans up to £25,000 for the purchase or improvement of one's main or only residence;

(b) exemption from capital gains tax on disposal of one's main or only residence;

(c) exemption from stamp duty on the transfer of residential property not exceeding £20,000, and reduced rates up to £35,000; and

(d) (included for the sake of theoretical completeness) the absence since 1963 of tax on the "imputed" income from owner-occupation - the old Schedule A tax.

5. The cost of these provisions cannot be calculated with any degree of certainty. It would be misleading simply to aggregate the various costs in calculating the total tax subsidy to owner-occupation. But the cost in 1979-80 of mortgage interest relief was around £1.4 billion (and is estimated this year to be around £2 billion), and the cost of the stamp duty relief some £230million. The tax "forgone" in giving CGT relief and from the absence of Schedule A is likely to be more than £1 billion in each case.

6. The value of these reliefs has continued to increase rapidly in recent years with the growth in the size of mortgages (due to inflation) and the increase in mortgage rates. In 1973-74, for example, the cost of mortgage interest relief was only £500 million - equivalent to about £1.2 billion at 1979-80 prices.

7. On the other hand, domestic rates, which yielded last year nearly £3 billion, work in the opposite direction to these reliefs. They are a tax on the occupation of property, and assessed on its annual value. As such they are paid by those who rent their house as well as by owner-occupiers; but even so they represent something of an offset to the fiscal concessions outlined above (though domestic ratepayers are still better treated than industrial and commercial ratepayers because of domestic rate relief).

The issues

8. The reliefs for owner-occupation are now very generous - arguably too generous, at least in the extent to which they are particularly concentrated on those who already own, in contrast with those wishing to buy for the first time. Indeed, from an economic, social and fiscal point of view, a case can certainly be made for re-examining them. They are not a very cost-effective way of increasing owner-occupation; the fiscal incentives push up house prices so that much of the benefit goes to existing owners, rather than first-time buyers. By diverting savings flows away from the capital market, they raise the cost of money to industry and commerce and may crowd out productive investment. Some reduction in the tax concessions would go some way to widen the income tax base. And it should reduce the overall level of interest rates at which the monetary target can be met. (Tax relief damps the price sensitivity of demand for housing credit and so raises total credit for any given level of interest rates generally, except insofar as housing finance is directly rationed.)

9. On the other hand, as a Government, we are committed to a property-owning democracy and it is right that we should retain a range of generous incentives in this area. I would not, therefore, want to make a ~~substantial~~ any reduction in the total scale or scope of reliefs - at least while mortgage rates remain relatively high. If at any stage the pattern of reliefs was changed, that would need to happen gradually to avoid hardship.

I am not prepared to make any changes which diminish mortgage relief. On the ceiling. i.e. £25,000 limit - needs increasing, not.

10. Certainly this does not mean that we should rule out making changes at all. But in considering what might be done, the points I would wish to stress are these:-

(i) the need for tax simplification. We must try to reduce the administrative complications of the present arrangements. Mortgage interest relief is costly in manpower - requiring some 1400 Inland Revenue staff, and even more when PAYE codes have to be changed mid-year to take account of alterations in the mortgage rate;

(ii) the effect of labour mobility. As part of our policy of improving the supply side of the economy, we should aim to make changes that will encourage labour mobility. I have little doubt, for example, that the present burden of stamp duty on house transfers is harmful in this respect;

(iii) the possible need for greater competition among the building societies. We have up to now acquiesced in exempting the building society cartel from restrictive trade practices legislation because it helps to ration mortgage finance and so keeps down mortgage rates. But there can be little doubt that the building society cartel creates inefficiency. It restricts price competition between the societies, ensuring that the least efficient can survive. One conspicuous consequence of the cartel has been the recent increase in the number of high street building society branch offices.

Possible developments

11. If we were thinking of making changes, I would suggest the following broad approach:

12. Schedule A. I cannot believe that we could or would wish to turn back the clock and re-introduce Schedule A. It would be costly to administer, and cause enormous trouble with our supporters.

13. Capital gains tax. Nor could we contemplate taking away the exemption from capital gains tax for owner-occupied houses. It would be absurd to impose a heavy CGT charge on owner-occupiers, with the most damaging effects on labour mobility, at a time when we are still giving thought to reducing the burden of this tax generally.

14. Stamp duty. Clearly there is a good case for reducing or even abolishing stamp duty on house sales. A change here would encourage labour mobility, and abolition would represent a useful simplification of the tax system. But stamp duty is now a big revenue-raiser and changes would be expensive.

15. Mortgage interest relief. There are a number of possibilities here. We could reconsider the £25,000 ceiling, and the rate of tax at which relief is given. The ceiling has remained unchanged since 1974 and there are strong pressures within the party to increase it. One possibility which has been suggested would be to increase (or even abolish) the ceiling whilst restricting the value of the tax relief to the basic rate. (We should need to examine the distributional consequences of this and other possibilities.)

16. A second possibility would be introduction of a universal option mortgage scheme - replacing the present tax relief with a direct

No

subsidy paid by the Government to the building societies, who would then pass it on to the mortgagee in the form of a lower mortgage rate. The Government could then choose to set the subsidy at whatever rate it wished. Such a scheme would produce staff savings in the Inland Revenue, though these would be partly offset by the extra staff needed by the DOE for a wider option mortgage scheme.

17. A more radical approach, of which Peter Bottomley is a persistent advocate, might be to do away with mortgage interest relief as such, replacing it with a general relief covering life assurance premiums, mortgage interest and possibly other forms of contractual or medium-term savings. Supporters of this scheme see it as a way of limiting relief for owner-occupiers, whilst removing some of the existing distortions in the tax field. Though it would raise difficult problems, it is certainly an interesting longer-term idea.

No

18. Lastly, there is a rather separate point on the building societies. The Wilson Committee recommended a number of changes in the tax treatment of the societies which are not far removed from this general area and I am arranging for these to be looked at in the Tax and Savings Group.

Conclusions

19. There can be little doubt that the tax treatment of those already established in owner-occupation is generous. This reflects the priority we give to encouraging home ownership. Whether we want to make any changes is as much a matter of politics as of economics, and is something which you will no doubt want to consider very carefully. I would rule out any thought of re-introducing Schedule A or removing the CGT exemption. But it might be worth commissioning some work on the various suggestions for mortgage

No

interest relief, along with reducing or even abolishing stamp duty on house sales. There could be a useful package here which would make better use of the revenue involved and save staff, whilst simultaneously reinforcing the forces of competition and encouraging and assisting labour mobility.

20. If you wanted to proceed, I would ask officials in the Tax and Savings Group (without outsiders for this purpose) to embark on a study. But perhaps we should first discuss.

It will be a waste of time to commission any work that will have the effect of reducing mortgage relief. I am not prepared to agree to any such reduction. M.T.

(G.H.)

7 August 1980

- 7 AUG 1980

Extract from Hansard, Vol 987, Col 711,

Dated 4 July 1980,

## Housing Market

**Mr. Durant** asked the Secretary of State for the Environment what consideration has been given to the workings of the owner-occupied housing market and in particular to the factors which may determine the rate of house price changes.

**Mr. Stanley**: A review has been undertaken jointly by officials and representatives of the Building Societies Association. A copy of the report subsequently prepared for the Joint Advisory Committee on Building Society Mortgage Finance, and broadly endorsed by that committee, has been placed in the library.

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CONFIDENTIAL

Econ Pol. JS

10 DOWNING STREET

*From the Private Secretary* 31 March 1980

Dear John,

INTERIM REPORT OF THE WORKING GROUP ON TAX AND SAVINGS

The Prime Minister has now had an opportunity to read the Chancellor's letter of 14 March and the officials' report which he enclosed with it. She has also seen the letter of 24 March from the Secretary of State for the Environment and the letter of 25 March from the Secretary of State for Industry.

The Prime Minister thinks the idea of a further study involving outside experts is a good one. She feels, however, that it is important to get the terms of reference right and that it would not be appropriate for such a group to cover the whole area within the scope of the existing Working Group.

The Prime Minister suggests that the new group with outsiders should consider the case for tax changes to encourage personal investment direct in equities rather than through the institutions. It should look in greater depth than the Interim Report both at the case for reducing existing tax reliefs for institutions and at the possibility of new reliefs for individuals on the lines of the Loi Monory.

At the same time, the Interim Report touches on - but does not examine in any depth - the question of whether the present tax relief biasses savings away from investment in productive assets towards investment in assets like gilts, chattels and housing. Further consideration of these sensitive issues would not be appropriate for a group involving outsiders. But the issues are of great importance if the regeneration of British industry is to be given top priority. The Prime Minister suggests that a parallel official group should examine the contents of any biasses in the existing system and consider what could be done to remove them over a period of years. This group would include the Department of the Environment as well as the Departments mentioned by the Chancellor.

I am sending copies of this letter to the Private Secretaries to members of E Committee, Sir Kenneth Berrill and Sir Robert Armstrong, and to John Hoskyns.

Yours ever,

Tim Lankester.

A.J. Wiggins, Esq.,
HM Treasury.

CONFIDENTIAL

Qa 04986

To: MR LANKESTER
From: SIR KENNETH BERRILL

Interim Report of the Working Group on Tax and Savings

1. On 14 March the Chancellor of the Exchequer circulated to members of E Committee the Interim Report of the Working Group on Tax and Savings. He suggested that the issues should be considered further by an enlarged group including officials from Departments of Industry and Trade and also outside experts, as well as Treasury departments. The CPRS would support this recommendation. But we feel it is important to get the terms of reference right and at present the Treasury proposals are rather unspecific.

2. The interim report stems from two concerns of Ministers - first, that the present tax reliefs for savings might be biassed against investment in productive assets and, second, that they might encourage investment via institutional intermediaries rather than by individuals in companies directly. These two aspects are linked but distinct; neither is covered comprehensively in the interim report; and there is a case for continuing the study as two separate exercises.

Direct Investment -v- Investment via Institutions

3. In the case of encouraging direct investment by individuals rather than through institutions the issues to be determined are:

(i) what are the effects of institutional preponderance on the quantity, sectoral distribution and quality of investment?

(ii) what part do tax considerations play in determining the balance between direct and institutional investment?

(iii) should the balance be changed and, if so, should it be by removing existing tax reliefs for institutions or by introducing new reliefs for individuals?

It would be helpful to have the benefit of outside expert advice while not trampling again over all the ground being covered by the Wilson Committee.

CONFIDENTIAL

Bias against Investment in Productive Areas

4. In the case of the possible bias against productive areas, the issues to be covered are:

(i) do existing tax reliefs encourage investment in assets such as gilts, housing and chattels, rather than equities?

(ii) How strong are the economic and social arguments for retaining the existing preferences?

(iii) If a change is justified should it be by reducing existing tax reliefs for gilts and housing or by introducing new reliefs for equities?

A study on these lines could be very valuable. It can be argued, for example, that partly as a result of distortions caused by tax, Britain is among the best housed nations in Europe while having one of the worst records for investment in industry. The case is set out in greater detail in the Annex. Such a study would, however, be extremely sensitive politically and we assume Ministers would not wish to consult outsiders, at least in the first instance. We therefore suggest that any review by officials of the bias against productive assets had best be conducted separately.

5. If the Prime Minister agrees with this approach ~~she~~ you might like to write to the Chancellor of the Exchequer on the lines of the attached draft.

6. I am sending a copy of this minute and the attachment to Sir Robert Armstrong.

KB

27 March 1980



CONFIDENTIAL

DRAFT MINUTE FROM MR LANKESTER TO THE PRIVATE SECRETARY TO THE CHANCELLOR OF THE EXCHEQUER

INTERIM REPORT OF THE WORKING GROUP ON TAX AND SAVINGS

1. The Prime Minister has seen the Chancellor's letter of 14 March to the Secretary of State for Industry. She thinks the idea of a further study involving outside experts is a good one. She feels, however, that it is important to get the terms of reference right and that it would not be appropriate for such a group to cover the whole area within the scope of the existing Working Group.

2. She suggests that the new group with outsiders should consider the case for tax changes to encourage personal investment direct in equities rather than through the institutions. It should look in greater depth than the Interim Report both at the case for reducing existing tax reliefs for institutions and at the possibility of new reliefs for individuals on the lines of the Loi Monory.

3. At the same time, the Interim Report touches on - but does not examine in any depth - the question of whether the present tax relief biasses savings away from investment in productive assets towards investment in assets like gilts, chattels and housing. Further consideration of these sensitive issues would not be appropriate for a group involving outsiders. But the issues are of great importance if the regeneration of British industry is to be given top priority. The Prime Minister suggests that a parallel official group should examine the contents of any biasses in the existing system and consider what could be done to remove them over a period of

years. This group would include the Department of the Environment as well as the departments mentioned by the Chancellor.

27 March 1980

Att'd: Annex

ANNEX

## TAX PREFERENCES FOR GILTS AND HOUSING

### GILTS

1. Gilt-edged securities are exempt from capital gains tax provided they are held for more than twelve months. The Exchequer cost of this exemption is not known but is likely to be considerable. However it can be argued that if tax relief were not given the government would have to sell the same amount of stock but at a higher coupon. This might be just as costly. There is nevertheless a case for studying the balance of advantage. If the exemption does have a net public expenditure cost then the implication is that private firms have to offer a more generous return than otherwise in order to compete, thus discouraging investment in equities.

### HOUSING

2. Income tax relief on mortgage interest costs the government about £1.5 billion a year and the capital gains tax exemption on principal private residences an amount of similar magnitude. There can be little doubt that these reliefs encourage investment in housing rather than productive assets. No other form of savings can offer tax free capital gains, growth in value at a faster rate than inflation, cheap building society finance subsidised by tax relief, and an asset offering visible social status and rent free living accommodation. This may be one reason why Britain is among the best housed nations in Europe while having one of the worst records for investment in industry. Moreover, the tax preferences distort the housing market. Demand is artificially stimulated

and there is little inducement to use resources economically, for example, by moving to smaller accommodation when children leave home. Excess demand has caused high prices which create barriers for first-time buyers while giving windfall gains to existing owners.

3. On the other hand, the implications for the government's policy of encouraging owner-occupation and the serious political difficulties of adding burdens on the owner-occupier at a time of record interest rates both need to be considered. However, if tax reliefs on owner-occupiers were reduced it might be possible to move faster on removing subsidies for council tenants, thus keeping the relative attractiveness of the two forms of tenure unchanged. And even if immediate action is ruled out, changes might become feasible in a year or so's time if interest rates come down.

27 March 1980

27 MAR 1980

JU

2pps cc AD

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
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*Secretary of State for Industry*

25 March 1980

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1P 3AG

Dear Geoffrey.

Thank you for your letter of 14 March attaching the Interim Report of a Working Group of officials on tax and savings. As you say, my officials were consulted at a late stage before completion of this report.

I assume from your letter that you do not propose to take action in the forthcoming Budget on any of the specific points discussed in the report. Although some are of relatively minor importance, others are not, and I think the issues need more fundamental study before we embark on anything of structural nature. For this reason I welcome your proposal for further work in a wider forum. It will be particularly important to ensure that the group focusses on the problems associated with the undesirable preponderance of pension funds as vehicles for savings. Attention will need to be paid to the libertarian and decentralisation arguments, about which both you and I are convinced, for encouraging wider direct share ownership.

I should certainly wish the Department of Industry to be associated with the further work of the group; Ivor Lightman will be our representative. For outside experts, we need a strong advocate of the non-institutional approach to savings; Harold Rose might be a suitable candidate. I imagine you will also want to ensure that the broad interests and expertise of industry, the City and academic economists are also covered. For the first, Alan Lord might either be suitable himself or be able, in his CBI capacity, to suggest suitable names of people in industry with experience of the problems of raising finance from various sources. From the City, you might like to consider the names of Mr Artus of the Prudential and Mr Quartano of the Post Office Superannuation Fund, both of whom are knowledgeable and thoughtful on these questions. I imagine you would find suitable academics among the membership of the Institute of Fiscal Studies, such as Mr Kay and Mr King.

I am sending copies of this letter to other members of the E Committee, to John Hoskyns and to Sir Kenneth Berrill.

Yours ever
Keith.

OW

cc AD

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

24 March 1980

Dear Geoffrey

INTERIM REPORT OF THE WORKING GROUP ON TAX AND SAVINGS

request y. required

I read with interest your letter to Keith Joseph about the interim report of the Working Group on Tax and Savings.

You know my views that we are being too unadventurous in the introduction of accelerator schemes to stimulate small industrial activity and new investment and I therefore welcome your proposal that John Nott and Keith should be involved in taking a closer look at this area.

May I illustrate my concern by drawing to your attention the approach of the report to the Loi Monory Scheme. Paragraphs

38-44 depict the scheme in about as unenthusiastic a way as possible.

The emphasis is on the problems, extra staff, administrative differences between the two countries, high ratio of subsidy in new investment (asserted not demonstrated).

Perhaps I can reproduce the facts of the above paragraphs.

850,000 taxpayers have taken advantage of the scheme. Half are newcomers to the stock exchange. So 425,000 new investors have appeared in this sector of the market.

The maximum allowable amount is £500 per annum. Over 4 years that would be £2,000 for each but assume the average is only half the allowable total (ie £1,000). £425 million investment from new investors in this area. This puts the 1,200 staff at £6,000 each for 4 years at £29 million in perspective.

If the figures assumed in paragraph 42 are taken then the investment of £500 per annum for 1 million people over 4 years is £2 billion. That sort of money invested in areas of the

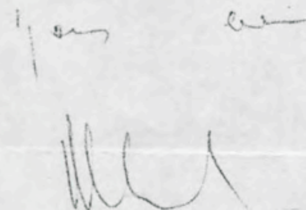
British economy selected by industrial classification should be compared with a total investment in manufacturing industry over the past 4 years of £25 billion in the same prices.

It is asserted that much of the investment would have taken place any way. I would be interested to see the evidence for that.

I also understand that investment in equities often means cash passing from one existing owner to another without new investment in physical assets. The sophistication of the stock exchange in Britain may bring into question the need for a scheme of this sort here.

But I am writing as I have because every time a new approach to stimulating small industrial activity is considered it is dealt with in the same parsimonious and suspicious way. We are experts at saying "No" and even when reluctantly and late we venture into the water it is only to the extent of the most reluctant toe.

I am copying this letter to other members of E Committee and to Sir Kenneth Berrill.



MICHAEL HESELTINE

The Rt Hon Sir Geoffrey Howe MP

25 MAR 1980

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

14 March, 1980

Dear Keith

INTERIM REPORT OF THE WORKING GROUP
ON TAX AND SAVINGS

As you know, a Working Group of officials has been looking at various tax reliefs in the savings field. The Departments represented on the group, apart from the Treasury, were the Inland Revenue, the CPRS and the Bank of England. They have produced an interim report which I attach. Before completion it was discussed with a wider group including the Departments of Industry, Trade, Health and Social Security and the Civil Service Department.

The report considers in particular the existing tax reliefs for institutional investment (savings through life assurance and superannuation funds), along with the case for introducing new reliefs to encourage direct personal investment in equities.

I have been thinking about how the issues discussed in the report should be taken forward. First, I should like to expand the membership of the group to include officials from your Department and the Department of Trade. Second, it seems to me that there are some issues, for example how we might encourage direct personal investment in equities, on which it would be desirable to associate outside experts with the work of the group. In that way we should inject some first hand experience of the workings of the capital markets.

If you agree with this approach, perhaps you and I and John Nott could consider who should be invited to join the group. I am copying this letter plus attachments to the other members of E Committee and to Sir Kenneth Berrill.

Yours ever
Geoffrey

(GEOFFREY HOWE)

The Rt. Hon. Sir Keith Joseph, MP

CONFIDENTIAL

INTERIM REPORT OF THE WORKING GROUP ON TAXATION AND SAVINGS

This is an interim report of a Working Group under the chairmanship of Mr Littler (latterly Mr Middleton) which has been examining possible changes to the taxation of different forms of savings. The Group has included representatives from the Inland Revenue, Bank of England and CPRS. A draft of the report has also been seen by the CSD, and the Departments of Trade, Industry and Health and Social Security.

2. The report is referred to as an "interim" report because it does not deal with various issues that might be appropriate for a fuller report. These include general questions about the level of total savings (what has been happening to savings? is the level of savings excessive?), a number of conceptual arguments about the tax base (should this be consumption or income?), as well as the examination of certain specific topics -including the taxation of public sector debt, tax relief on interest on borrowing, and the taxation of owner-occupied housing. The Group hopes to consider at least some of these issues in the future.

3. The Group thought that the best way to go about its work was to look at various existing and proposed tax reliefs in the savings field. Priority was given to specific suggestions raised by Ministers (including some proposals put forward in the Hoskyn's exercise) and matters that might be legislated on this year. This report records the Group's preliminary conclusions on

I <u>Institutional Investment</u>

i. the tax treatment of life assurance premiums and companies;

ii. the tax treatment of superannuation contributions, funds and payments.

II <u>Personal Investment in Equities</u>

i. a Loi Monory scheme for encouraging direct equity investment by individuals;

ii. stamp duty on equities;

iii. a small savings tax exemption.

4. The Group has also looked at a proposal for changing the tax treatment of the unfranked income of authorised unit trusts. This is the subject of a separate submission.

5. A summary of conclusions is contained at the end of the report. The Group recommends that the rate of tax relief on life assurance premiums should be reduced. On superannuation it suggests that one of the main questions for consideration is whether lump sum superannuation payments should be brought into tax. None of the proposals for encouraging personal investment in equities seemed particularly attractive - though if Ministers favour in principle the idea of a Loi Monory scheme, the Group will be happy to consider it in more detail.

6. A list of papers so far taken by the Group is annexed. Copies of the papers may be obtained from the Secretary on request.

## I INSTITUTIONAL INVESTMENT

7. The institutions - primarily the life assurance and superannuation companies - play a major role in the working of the financial markets. They handle savings equivalent to about 5% of GDP (split evenly between life assurance and superannuation business). They are substantial net investors in both company securities (with purchases of around £2½ billion in 1978) and in government stock (with purchases of some £3 billion in 1978). They provide a valuable service to millions of small investors - allowing them to benefit in particular from expert portfolio management, risk spreading and the minimisation of transaction costs.

8. The dominance of the institution in the financial markets depends to some extent at least on the existence of generous tax reliefs for life assurance and superannuation purposes. These reliefs have come under a certain amount of attack in recent years. The general arguments for limiting the reliefs are:

i. the cost. Tax reliefs for life assurance and superannuation are expensive. The cost of life assurance premium relief is expected to be some £425m in 1979/80, while the cost of superannuation reliefs is estimated at £m500 (in the forthcoming Public Expenditure White Paper). This costing rests on the view that, although the combined cost of relief for employees' superannuation contributions and of the exemption for the income of superannuation funds themselves is £m1670 in 1979/80 it would not be possible, if these reliefs were withdrawn, to tax the full amount of the emerging pensions as income. The current yield from tax on pensions is over £1 billion;

ii. fiscal neutrality. It is often argued that, because of the availability of generous tax reliefs, investment in life assurance and superannuation funds constitutes - along with investment in public sector debt and owner-occupied housing - one of the "privileged" forms of savings, in contrast with other types of savings - including investment in equities, bank accounts and building society share accounts - for which no tax reliefs are available. It has been suggested that there is very little justification for the existing pattern of tax reliefs in the savings field, and that there is a need for greater "fiscal neutrality". This could be achieved, in principle, either by "levelling up" (giving new tax reliefs for, say, investment in equities) or "levelling down" (withdrawing tax reliefs for, say, life assurance and superannuation purposes);

iii. reducing the cost of funds for industry. For a given PSBR and monetary target, the total funds available for industry are constrained. The terms on which they are available, however, may depend on institutional channels. It is often argued, for example, that the institutions have a relative preference for gilts, thus making it more difficult and/or more expensive for industry to raise equity finance. It is also argued that they contribute to the small firms equity gap since much of their equity investment is in large "blue chip" companies;

iv. encouraging personal investment in equities. The argument here is that there is a need to increase direct investment by individuals in equities as a way of encouraging a more personal involvement by the investor in the working of industry. The problem is that the institutions now so dominate the equity and money markets that the part played by the individual who invests directly in equities is rapidly becoming overshadowed.

Bearing in mind these points, the Group considered each of the main tax reliefs for life assurance and superannuation purposes to to see whether they could still be justified on their own merits.

The tax treatment of life assurance premiums

9. At present, tax relief is allowable in respect of premiums paid by an individual on a qualifying life assurance policy or deferred annuity contract. There is an overriding limit to the relief of the greater of £1,500 or one-sixth of the individual's total income.

Until 1979, the rate of relief was one-half of basic rate. Since 1979, the rate of relief has been fixed at 17½ per cent. The cost of tax relief on life assurance premiums in 1979-80 is estimated to be £425 million.

10. The historical justification for life assurance relief is that it encourages the individual to save and therefore to make proper provision for dependents in the case of his death. As the Royal Commission on Income Tax, 1920, observed:

> "The distinguishing feature of life assurance, which probably accounts for what would otherwise seem to be an unfair preference /in the allowance of tax relief/, is that by no other means can the less wealthy taxpayer, who has no accumulated capital in his earlier years of productive effort, secure a proper provision for his dependents."

11. It is not clear, however, whether the case for retaining the relief remains good:

i. much of the life assurance business has little to do with genuine life assurance, but is aimed at securing tax relief for short to medium term savings with only a small life assurance element. For example, a typical scheme for a unit linked life assurance fund provides for only 6 to 7 per cent of the gross premiums to be used to provide life assurance for a man aged 40, and for the balance to be used for the purchase of units. In this case, the 17½ per cent tax relief given to the premiums is substantially greater than the total cost of life assurance being purchased;

ii. it is questionable whether it is any longer right to provide a "tax subsidy" for savings for life assurance purposes. These days, dependents are often adequately protected against the death of the breadwinner in the family by the breadwinner's own superannuation arrangements and by the social security system in general;

iii. life assurance is an inefficient way of saving. One reason for this is that the companies are required by law to adopt conservative actuarial practices. A second reason is that the life assurance companies have large expenses (in 1978, for example, expenses and commissions paid by the life companies were £1,400m). One 1978 study suggested that, but for tax relief, investment in building society share accounts had, in recent years, normally been more profitable than saving through a life assurance scheme.

12. There were differences of view with in the Group on the weight that should be attached to those arguments. While a number of members felt that the tax relief should be completely abandoned, it was accepted that it would be difficult to withdraw the relief at one go. The withdrawal of relief would hit those who had recently taken out medium to long term life assurance contracts on the expectation that the availability of relief would continue for at least some years to come. Many of these would be new housebuyers with "endowment-linked" mortgages (at present, about 25% of all new mortgages are endowment mortgages). In the meantime, however, the Group was unanimous in its view that the rate of relief should not be maintained above its traditional level - of one half basic rate. Whether, as a first step, the rate should be reduced to, say, 15% or something less was essentially a Budget matter, and would need to be considered in a Budget context.

13. The Group noted that the life companies would like good notice of any change in the rate of life assurance relief and would object to frequent changes in the rate. There were, for example, 83 million industrial life policies, and each policy would have to be amended manually if the rate of relief were altered.

14. Cutting relief for life assurance premiums to, say, 15% would save about £70m in a full year, while cutting it to 12½ per cent would raise around £140 million. This would probably have some effect on the volume of new business. However, although the life assurance companies are large purchasers of Government debt, it was not thought that reductions in the rate of relief of this magnitude would have a significant effect on the sales of public sector debt.

The taxation of life assurance companies

15. The profits allocated to the shareholders of life assurance companies are taxed at the full rate of 52 per cent. The profits allocated to policyholders, on the other hand, are taxed at a special "pegged rate" of 37½ per cent. Although only a small proportion of the life companies total profits is taxed at 37½%, it has been suggested that this special pegged rate confers an unfair advantage on life assurance companies and therefore gives them an unfair competitive advantage in the market for personal sector savings.

16. The pegged rate of tax was introduced in 1940 to meet the claim of life offices that they had made many long-term contracts on the assumption that pre-war rates of tax on their investment income would continue, and that they could be put in financial difficulties by the burden of wartime tax rates.

17. The Group recognised that there were arguments of principle for both increasing the pegged rate of tax to 52 per cent, and reducing it to, say, 30 per cent. The case for increasing the pegged rate is that such a change would bring the tax treatment of life assurance funds into line with the tax treatment of company profits in general.

18. The case for reducing the pegged rate rests on comparing the position of the man who invests directly in financial assets with the man who invests through a life assurance company. The person investing directly would have to pay income tax (at 30 per cent if he is a basic rate taxpayer) on his income, and capital gains tax on any profit, whereas the person investing through a life assurance company has tax at 37½ per cent paid on the income, while the proceeds of his policy are generally free of tax. Neutrality would demand that they both paid the same rate of tax - 30 per cent - though it would be impossible to fix any single rate of tax on the profits of the life companies which would equate with the varying marginal tax rates of policyholders in general. An argument in favour of a special rate of tax is that life assurance companies are quite different from other companies paying corporation tax, so it is by no means clear that policyholders profits should be taxed at the normal rate of corporation tax. We noted that certain other financial intermediaries (eg building societies and industrial and provident societies) also pay a special concessionary rate of corporation tax.

19. The Group concluded that the arguments of principle did not point clearly either to increasing or to reducing the pegged rate of corporation tax. They noted, however, that the revenue effect of the change either way would be small (probably less than £20 million), and thought that the effects of a change in the pegged rate on life assurance business would be minimal. The conclusion was that there was no good argument for making any changes, so the pegged rate should be left at its present 37½ per cent.

Superannuation arrangements: general

20. Superannuation arrangements enjoy a number of tax reliefs. Both employers' and employees' contributions to approved schemes are (within limits) deductible for both corporation tax and income tax purposes (at a revenue cost, in 1979-80, of around £1860m); the investment income of the superannuation funds is free of tax (at a revenue cost of around £960 million); while (again within limits) lump sum payments to beneficiaries from the superannuation funds are free of tax (at a revenue cost of something less than £200 million). It was explained in para. 8(i) that the cost of each of these reliefs cannot simply be added together to estimate the total cost of relief for superannuation arrangements. Pension payments to beneficiaries are, of course, taxed as earned income.

21. No one in the Group has questioned the deductibility of employers' superannuation contributions for tax purposes. Contributions to approved schemes were regarded as allowable deductions under ordinary profit computational rules.

22. The treatment in the hands of the employee of both employers and employees contributions to approved superannuation schemes is more open to debate. On the one hand, it can be argued that the absence of tax on such contributions is justified and should not be regarded as a "tax subsidy" - that the contributions should be regarded as the "deferred income" of the employee, with the implication that they should not be taxed at the time they are paid in, but only later when the pension is actually received by the beneficiary. This is in line with the treatment of superannuation contributions in nearly all overseas countries. Moreover, it is pointed out that the benefit of belonging to a superannuation scheme is quite different from the benefit received from other types of savings. The employee may have little choice about whether to be a member of the superannuation scheme, and may never receive any benefits. Why tax him, therefore, on his superannuation contributions?

23. On the other hand, it can be argued that income tax relief for superannuation contributions is generous and should properly be regarded as a "tax subsidy". Just because superannuation contributions can be described as deferred income does not, of itself, justify giving tax relief. However, no member of the Group went as far as to suggest that tax relief for superannuation contributions should be withdrawn. It was thought that this particular tax relief was so much a part of people's expectations of the tax system and of their financial planning that to withdraw it would be both disruptive and controversial.

24. The Group thought that, so long as superannuation contributions were exempt from tax, it was right that pension payments to beneficiaries should be taxed as earned income. The Group did not come to any conclusion on how the superannuation funds should be taxed - this was a matter to which they would like to give more thought.

Lump sum superannuation payments

25. In principle the absence of tax on lump sum superannuation payments is an anomaly so long as the contributions financing the payments are relieved. If the payments are to be exempted as being of a capital rather than an income nature, then it is questionable whether tax relief should also be given on the superannuation contributions.

26. One way of restricting relief for lump sum payments would be to deny tax relief to the contributions which finance those payments. One disadvantage with this approach, however, is that it would be difficult to identify the appropriate contributions. A second problem is that it would hit contributory superannuation schemes, but would not affect non-contributory (generally public sector) schemes.

27. Another way of restricting relief for lump sum payments would be to levy some sort of tax on the superannuation funds. But this would leave non-funded schemes at a relative advantage.

28. The more obvious way of restricting relief would be to tax the lump sum payments directly. It is not immediately clear what rate of tax would be appropriate, nor whether there should be a tax threshold below which no tax would be levied. If all the lump sum was taxed at 30 per cent, the revenue gain would be around £200m in a full year.

29. One objection to taxing lump sum payments, however, arises regardless of the way the tax is levied. This is the objection that any change would have a selective effect. The problem arises because about two thirds of all lump sum payments go to those who were previously employed in the public sector - so it would be former public sector employees who would be hit most by any change. This is partly because whereas the right to commute part of a pension into a lump sum is frequently optional in private sector schemes, it is generally obligatory in the public sector. If lump sum payments were brought into tax, there would be strong demands from public sector unions for changes in public sector pension arrangements to bring them into line with arrangements in the private sector (so as to enable beneficiaries to opt for either the lump sum payment or a higher pension). The cost of giving public sector employees the option of retiring on a two thirds pension could rise to around £100 million a year -cutting a large slice in the revenue yield from taxing the lump sum payments.

30. Taxing lump sum payments would be controversial. It would need to be preceeded by widespread consultations both within Whitehall and outside. It would not be a matter for the 1980 Finance Bill. The Group believes it is an issue which might merit further study.

## II PERSONAL INVESTMENT IN EQUITIES

31. The arguments for encouraging personal investment in equities are similar to some of those for restricting the scope of tax reliefs for life assurance and superannuation purposes. Tax concessions for personal investment in equities would, for example, promote "fiscal neutrality" (by conferring a tax advantage on one of the "under-privileged" forms of saving), possibly help reduce the cost of funds going to industry, and could well divert funds away from the big institutions. It was argued within the Group, however, that the main reason for encouraging personal investment in equities concerns the merits of involvement - involvement by the population at large in the prosperity of the economy generally, involvement in the prosperity of individual companies, and involvement in the firm for which each individual works.

32. The Group recognised that the most effective way of encouraging more personal investment in equities was by reducing the burden of the investment income surcharge, capital gains tax and capital transfer tax. Possible changes here have been considered in the capital tax review and were not examined by the Group. In considering what equity investment schemes to consider, the Group took note of other work going on in this area. The FASE Group has already looked at two sets of proposals. The first set was designed to encourage greater employee share ownership. They involved extending the 1978 profit-sharing provisions and re-introducing the 1972/73 legislation to give incentives for certain types of share option schemes. The second set of proposals was designed to encourage individuals to invest substantial amounts of money - up to £10,000 or £20,000 - in the equity of small firms. One scheme was designed to give income tax relief on capital losses in equity investment in unquoted trading companies. A second scheme was designed to give income tax relief on funds actually invested in new, small firms. No final decisions on whether these proposals will be implemented have been taken.

33. These proposals are designed to encourage, on the one hand, equity investment in small firms and, on the other hand, equity investment by individuals in their employing company. The Group thought that the next step to consider was some sort of scheme or tax relief which would provide a modest encouragement for individuals generally to purchase shares. The main candidates here are a small savings tax exemption, the introduction in the UK of a Loi Monory scheme, and a cut in the rate of stamp duty on equity transfers. Although the small savings tax exemption would be an incentive for all types of savings - not just investment in equities - it was thought convenient to consider it along with the other schemes for encouraging equity investment.

A small savings tax exemption

34. A small savings tax exemption would give relief, within limits, on the income from a wide range of investments - including, presumably, the income from equities, unit and investment trusts, gilts, building society interest, deposit account interest, NEB ordinary account interest, income from foreign investments, rents etc. A scheme along these lines was suggested by the Financial Secretary at a meeting within the Treasury some time ago. The idea of the scheme would be to give tax relief for, say, the first £250 of investment income as a way of encouraging personal savings and investment. It would not be possible to have both a small savings tax exemption and a Loi Monory Scheme.

35. It is possible that a relief of this nature would encourage some additional savings. Moreover, there would be an administrative saving from not having to assess for tax small incomes from certain types of asset (such as bank accounts) which have to be assessed at present.

36. On the other hand:

i. the cost of an exemption would be high - around £450 million if relief was given on investment income up to £250;

ii. much of the benefit would go to those with investment income above £250. In these cases, the relief would not constitute an incentive for further saving;

iii. there would be a large administrative cost from having to take account for tax purposes of certain types of income which are not assessed for tax at present, or are assessed only to higher rate tax and/or investment income surcharge. This includes income from shares and building society deposits. For example, if, as a result of the scheme, building society interest was paid gross, something like 3 million additional tax returns would have to be issued. This would entail a staff cost of more than 2,000.

37. The Group accepted that the disadvantages of introducing a small savings tax exemption were considerable. They recommend no further action on it.

A Loi Monory scheme

38. The Loi Monory is a French scheme designed to strengthen the Paris Bourse (a much smaller market than the London stock exchange), encourage investment in equities and unit trusts, and improve the gearing of French companies. Under the scheme, income tax relief is given on additional net investment of up to £500 per year in French equities and in French unit trusts provided that a large proportion of their assets comprises French equities. In order to prevent abuse, all qualifying investments (including those held before the relief was introduced) have to be lodged with a bank or other approved intermediary. The relief is clawed back to the extent that there is a net reduction in the individual's equity holdings (assuming the reduction takes place while the Loi Monory provisions are in effect - they were introduced for a period of four years, and so far as is known no decision about extending this has been taken).

39. It is difficult to reach a firm conclusion on the effectiveness of the Loi Monory, but since the scheme was introduced new equity issues in France have quadrupled. Some 850,000 taxpayers have now taken advantage of the relief, of whom possibly one-half are newcomers to the stock exchange. Share values on the Bourse have increased significantly. Nearly 90 per cent of the additional investment has been in unit trusts.

40. There is no doubt that the introduction of a Loi Monory scheme in the UK would help stimulate stock exchange activity. But is is not clear to what extent it would stimulate new equity investment by individuals. If the French experience was repeated here, much of the new money would go into unit trusts, thus strengthening rather than weakening the position of the institutions. Moreover, there must be considerable doubt about both the administrative feasibility of a Loi Monory scheme as well as it cost effectiveness.

41. The problem about the administrative feasibility of the scheme is that it would be very laborious to acquire the appropriate information on each individual's transactions in shares. One possibility would be to get the banks to operate like the French banks and handle the equity portfolios of all those participating in the scheme. The problem here, however, is that the British banks are not really used to operating in this way, and their charges for handling the portfolios of participants could well offset the tax advantages. An alternative way of administering the scheme would be to get the Revenue to keep track of each individual's transactions in shares. But the staff cost of this alternative would be considerable. Some 1200 extra staff would be required if there were 1 million participants in the scheme. This reflects the difficulty of introducing the scheme with the UK tax system as opposed to the French tax system.

42. The cost of introducing a Loi Monory scheme - on the assumption of one million participants, and the maximum take-up of £500 per year - would probably be in the region of £150-200 million per year, equivalent to around 30-40 per cent of the gross qualifying investment. Given much of this qualifying investment would have taken place anyway, the Exchequer subsidy as a proportion of genuine additional investment could well be 50 per cent or more.

43. It is interesting to note that there has been no pressure for the introduction of a Loi Monory scheme from the unit trusts.

44. In the view of these doubts about the administrative feasibility and the cost effectiveness of a Loi Monory scheme in the UK, the Group was not able to advocate its early introduction. If, however, Ministers favour in principle a scheme on these lines, the Group will examine it in more detail.

Stamp duty on share transfers

45. Stamp duty is payable on transfers of stocks and shares. The bulk of the duty - about £170 million in 1978-79 - arises from sales on the Stock Exchange. Since 1974, the rate of duty has been 2 per cent (previously 1 per cent). Transfers of British Government securities, local authority loan stocks, and certain other stocks are exempt.

46. The complaint is often made that the Stock Exchange is a particularly expensive market to buy equities, and that, as the largest contributor to transaction taxes, stamp duty constitutes a major brake on market activity. It is argued that a cut in duty - to, say, 1 per cent - would give a fillip to the market and increase the value of purchases. Other arguments for cutting stamp duty are that it would bring the rate closer to the EEC harmonisation objective (duty at a total of 0.6% on transactions in shares), and that it would largely abolish the stamp duty incentive for individuals to deal in shares overseas rather than at home.

47. In considering the possibility of a cut in the rate of stamp duty, the Group identified as two of the main issues the cost of any change and its effect on Stock Exchange turnover. It was aware that, with the abolition of exchange controls, a cut in stamp duty could also have important international ramifications - but these were not examined in any depth.

48. The Group thought that the cost of a cut in stamp duty would be substantial. A cut in the rate of duty to 1 per cent would cost (in 1979-80) around £70-80 million. However, although a distinction could be made in principle, it would be politically difficult to cut the rate of duty on share transfers to 1 per cent while leaving the rate of duty at 2 per cent on transfers of other kinds of property (including residential property). There would also be practical difficulties resulting from the encouragement of transfers of shares in land-owning companies (at the lower rate of stamp duty) rather than of the land itself (at the higher rate of duty). An across-the-board cut in stamp duty to 1 per cent would cost much more - in 1979-80, around £230 million.

49. The effect on Stock Exchange turnover of a cut in stamp duty is not likely to be large. On the basis of an examination of the effects of doubling the rate of duty in 1974, it has been estimated that a halving of the duty to 1 per cent would lead to an expansion of Stock Exchange transactions of only some 10-15 per cent. Most of these transactions would of course involve existing stock rather than new investment.

50. Taking account of both the cost of any change, and the effect on the Stock Exchange turnover, the Group thought that a cut in the rate of stamp duty to 1 per cent was not a cost effective way of stimulating wider share ownership and new investment in equities. On these grounds, the Group did not think a cut in duty should be given a high priority in the near future.

51. The Group noted a suggestion by the Financial Secretary that a cut in stamp duty might be traded against the introduction of some kind of stock market tax which did not impede share transfers. However, the Group have not so far identified any alternative way of raising revenue from the stock market which would not work its way back into transaction costs, and so restrict trade in stocks and shares.

Conclusions

52. These are:

i. the rate of tax relief on life assurance premiums should not be retained above its traditional level of one half of basic rate. Some of the Group would like this relief withdrawn altogether in the longer term;

done in the Budget

ii. there is no good reason for changing the pegged rate of tax paid by life assurance companies on the profits of their policyholders. An increase in the rate to 52 per cent would raise very little money (less than £20 million a year) and would have only a minimal effect on the life assurance business;

iii. some members of the Group thought that income tax relief for employees superannuation contributions was generous. But the relief is such an important part of most peoples expectations and financial planning that the withdrawal of the relief would be difficult;

iv. although the absence of tax on lump sum superannuation payments in addition to relief for superannuation contributions was regarded as an anomaly, the imposition of a tax charge would have a selective effect and would lead to demands for changes in public sector pension arrangements;

v. the introduction of a Loi Monory scheme in the UK would encourage some additional personal investment in unit trusts and equities, but would raise formidable administrative difficulties and would be quite costly (£150-200m a year). If Ministers feel in principle they would like a scheme of this nature, the Group will examine the possibilities further; — Yes

vi. a reduction in the rate of stamp duty on share transfers to 1 per cent would probably have only a small effect on Stock Exchange activity and on equity investment by individuals. A reduction in stamp duty on all transfers of property would cost around £230 million a year. The Group does not think that a change here would be a cost effective way of encouraging wider share ownership and new investment in equities;

vii. a small savings tax exemption would be costly (£450 million a year if the relief was on investment income of up to £250), and would raise difficult administrative problems. The Group does not think that the small savings exemption warrants further consideration.

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