PART TWO

MT

SECRET

CONFIDENTIAL FILING

Interim Report of the Working Group on Tax and Savings

Tax Reliefs for Housing

Green Paper of Taxation of Husband and Wife.

ECONOMIC POLICY

Pt 1: MARCH 1980

Pt 2: JANUARY 1984

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
5.10.84							
~~8.10.84~~							
~~25.10.84~~							
~~15.11.84~~							
~~Jan 1985~~							
~~15.1.85~~							
~~11.7.85~~							
~~30.9.85~~							
~~4.11.85~~							
~~20.11.85~~							
~~4.12.85~~							
~~6.1.86~~							
~~13.1.86~~							
~~15.1.86~~							
~~16.1.86~~							
~~28.1.86~~							
28.1.86							
ENDS							

PREM 19/1708

Dd 533270 5M 2/78 8362633 JET

Note: Draft Green Paper on Personal Taxation, Sept. 1985 in folder at rear of file.

See 27/9/85

Folder 2: HMT Background papers on Sir G. Howe's proposals for reform of personal taxation.

See 3/12/85

PART TWO ends:-

Rcd of Meeting 14 on
Wednesday 29 January 86

PART THREE begins:-

e

Board of Inland Revenue to Chan. Exchq
6.2.86

CABINET OFFICE

Mr Unwin suggests that this goes out

With the compliments of

to night to Ministers

GR's ~~CF~~ Please circulate immediately.

A. J. WIGGINS

DRW.

copied & circulated @ 1830.

70 Whitehall, London SW1A 2AS
Telephone 01 233 7029

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SECRET

REFORM OF PERSONAL TAXATION

Note of a further meeting
at 10 Downing Street on
Wednesday 29 January 1986
at 4:30pm

PRESENT

Rt Hon Margaret Thatcher
Prime Minister

Rt Hon Viscount Whitelaw
Lord President of the
Council.

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer.

Rt Hon Norman Fowler MP
Secretary of State for
Social Services.

Rt Hon Lord Young of Gratham
Secretary of State for
Employment.

Rt Hon John Wakeham MP
Parliamentary Secretary,
H M Treasury.

Rt Hon John Moore, MP
Financial Secretary,
H M Treasury.

Mr Anthony Newton MP
Minister of State, Department of
Health and Social Security (Minister
for Social Security).

SECRETARIAT

Mr J B Unwin

Mr A J Wiggins

The Meeting considered a minute of 28 January from the Chancellor of the Exchequer to the Prime Minister, to which was attached a note about methods of phasing in transferable allowances and a paper analysing the impact of the introduction of transferable allowances on a no cash losers basis,as described in the draft Green Paper, and on a revenue neutral basis.

2. The Chancellor of the Exchequer said that he was discussing separately with the Secretary of State for Social Services

Part III of the draft Green Paper about the longer term relationship between the income tax and social security systems and the system of national insurance contributions, and would provide a revised text for consideration by the Group in due course. He suggested that the present meeting should concentrate on the economic and distributional effects of the introduction of transferable allowances.

3. He remained convinced that the distributional effects of the change to transferable allowances should be illustrated on the 'no cash losers' basis. Because of the large number of substantial gainers and losers, no Conservative Chancellor of the Exchequer would ever wish to make the change on a revenue neutral basis. To propose the change on such a basis would be seen as admitting that the Government were unlikely to have room in the medium and longer term for real reductions in the burden of taxes; in other words, this would amount to a forecast of failure in the Government's objective to keep the growth of public expenditure below that of the Gross Domestic Product. There were both genuine and presentational problems of cost; these could best be overcome by making clear that the phasing-in period could be as long as economic circumstances required, and by giving the Government some freedom of manoeuvre in determining whether the restructuring of allowances was to be in addition to or in substitution for normal inflation-proofing increases. In practice most tax payers would see an increase in their cash thresholds each year during the phasing-in period, so there need be no cash losers whichever choice the Government made. The advantage of introducing transferable allowances on the no cash losers basis, rather than on the revenue neutral basis was that the change could be shown to be much more effective in giving the largest proportionate gains to the lowest paid and in reducing - by a half - the overlap between liability to tax and eligibility for benefit. The price of the social security changes now being implemented, which achieved substantial reductions in the marginal tax rates faced by people in the poverty and unemployment traps (achieved by determining entitlement to benefit on the basis of income net rather than gross of tax), was a substantial increase in

the number of people covered by the tax/benefit overlap; the introduction of transferable allowances would helpfully complement the social security changes by reversing this undesirable side effect. Responses to the latest Conservative Political Centre contact brief showed a substantial measure of support for the principle of transferable allowances; their presentation on the basis of an extended phase-in period, and without any prior Government commitment to any step in the phase-in process, should overcome any difficulty in the financial markets.

4. In discussion the following main points were made.

(a) Possible future simplifications of the personal tax system - self-assessment, non-cumulation within a financial year, etc - were separate issues not directly related to the introduction of transferable allowances. The computer system should be flexible enough to cope with adjustments to cumulative tax payments by husbands and wives as their incomes fluctuated within each financial year.

(b) Preparation would be needed, both in terms of legislation - to enable Inland Revenue to secure all the new information they needed, and to adapt the present provisions relating to the indexation of allowances - and in terms of the development of flexible computer systems, before any steps could be taken to begin the process of introducing transferable allowances. Depending on the response to the Green Paper, the necessary legislation could be included in the 1987 or 1988 Finance Bills.

(c) Transferable allowances as put forward by the Chancellor of the Exchequer would have a substantial beneficial impact on incentives to work in the cases of single earner families. Such families would receive a substantial increase in their post-tax incomes, and couples would no longer face the indefensible situation where their average tax rate increased when the wife gave up work. On the other hand, there would inevitably be complaints that married women restarting work would immediately face a marginal tax rate of 30 per cent or more (depending on their liability to pay national insurance contributions) on their first £ Sterling of income.

(d) Because relatively more of the advantage of tax allowances would be enjoyed by single earner households, any given real increases in tax thresholds once the change had been made would be more effective than at present in floating families out of the poverty trap.

(e) The basic inequity in the present personal tax system was the fact that working wives in effect received a single person's allowance while their husbands received the preferential marriage allowance. This produced the absurd situation that the family could face widely differing tax rates depending on the distribution of some total earned income as between the husband and the wife. This inequity, coupled with the aggregation of unearned income, was impossible to defend; under present arrangements married women were deprived of independence in their own financial affairs, and at the same time given an undesirable and unnecessary incentive to go out to work.

(f) To the extent that the objective of the change was to improve the relative position of families with children, the introduction of some kind of Family Tax Allowance could be a much more effective way of concentrating the benefit on the target group for any given Exchequer cost. Even if this possibility were not discussed in detail in the Green Paper, some mention should be made of it, and it should not be altogether dismissed.

(g) More work was needed to ensure that the presentation of the change in the structure of personal tax allowances was not inconsistent with that of the changes in social security benefits currently before Parliament. In the case of social security benefits, the Government had given illustrative figures in both cash and real terms, showing substantial numbers of losers in each case. This presentation in effect abstracted from normal price-indexation arrangements, and showed how benefit entitlements would change in real terms. To the extent that transferable allowances were introduced in substitution for normal indexation adjustments, there would be real losers as there were in the case of the social security changes; if transferable allowances were financed entirely out of the provision which would otherwise have been allocated to price-indexation, and there were no aggregate real reductions in taxation, the overall effect in real terms, and the impact on numbers in the poverty trap, would be exactly as set out in the revenue neutral case, even though there would be no cash losers. Conversely, the change would only have the impact on numbers in the poverty trap shown in the no cash losers case if it were actually made on a no real losers basis, given that entitlement to social security benefits would be uprated in line with inflation.

5. THE PRIME MINISTER, summing up the discussion, said that the Group endorsed the Chancellor of the Exchequer's intention, in presenting the possible change to a system of transferable allowances, to avoid any Government commitment on either the extent or the timing of the change; although it had major attractions, and would remove the serious inequities which disfigured the present system, it would not be appropriate to decide now that implementation of the change should necessarily have first claim on any room there might be for real reductions in the burden of personal taxation in the years after 1990. But the Group remained concerned about the presentation of the economic and distributional effects of the change; that presentation had to be reconcilable with the presentation of the social security changes the Government were now implementing, and had to avoid disturbing financial markets by holding out the prospect of tax reductions regardless of the conjunctural situation. On the other hand, to the extent that the case for a change was made by showing distributional effects

under which there were no losers, the full benefit of these effects could only be claimed if the change were made on a no real losers basis. Great care would be needed in the presentation to avoid accusations of inconsistency. The Chancellor of the Exchequer and the Secretary of State for Social Services should therefore reconsider the presentation of the change to transferable allowances in the light of the discussion, having regard also to the position taken by the Government in presenting the distributional effects of the current social security changes.

6. The Group -

1. Took note, with approval, of the Prime Minister's summing up of their discussion.

2. Invited the Chancellor of the Exchequer, in consultation with the Secretary of State for Social Services, to reconsider the presentation of the economic and distributional effects of the change to transferable allowances, in accordance with the Prime Minister's summing up of the discussion.

3. Noted that the Chancellor of the Exchequer would submit a revised text of the complete Green Paper, taking into account the points made at the Group's first two meetings, for consideration by the Group in mid-February 1986.

SRWANO

cc B'UP

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PRIME MINISTER

GREEN PAPER ON PERSONAL TAXATION

A further point on the use of money from indexation to finance transferable allowances.

Social Security payments are likely to continue to rise in line with inflation even if tax allowances do not. This would affect the distribution of gains and losses. In the limiting case, where transferable allowances were wholly financed from use of money which would otherwise have gone to finance indexation, it would be exactly as if they had been introduced on a revenue neutral basis. The full benefits of transferable allowances will not be achieved if they are financed in whole or in part by not indexing the allowances.

As I suggested in my other note to you, this problem can be avoided in drafting the Green Paper.

DLN

(DAVID NORGROVE)

29 January 1986

SECRET

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PRIME MINISTER

cc. Professor Griffiths

GREEN PAPER ON PERSONAL TAXATION

The worries expressed by Lord Young and others at the last meeting about the size of gains to high earners are not well founded. The maximum gain to any couple would be £25.44 a week.

The Chancellor's analysis depends heavily on the assumption of no cash losers. The examples shown in the paper circulated with his minute assume that the total allowances for a two-earner couple are frozen in cash terms, and that the married man's allowance would fall. In other words, two-earner married couples earning more than the tax thresholds would lose in real terms (if I have understood the argument correctly). This does not seem a good way to win a constituency for tax cuts.

Moreover, how would this fit with Rooker-Wise-Lawson? Would a resolution of the House of Commons be needed each year? If so, there would need to be strong support in the House for transferable allowances to allow the married man's allowance to be reduced in cash terms for several years in succession in a way which would leave the total of the couples' allowances unchanged in cash terms but reduce them in real terms.

The Chancellor aims to create a constituency for tax cuts. To get maximum value the Green Paper ought surely to be less precise about whether reductions in the real value of the married man's allowance are envisaged. It could be drafted to say that the speed of progress towards fully transferable allowances will depend on the size of the fiscal adjustment (though without using that term), but that less than full indexation of the married man's allowance would be an option if there were widespread agreement that a more rapid move towards fully transferable allowances was desirable.

Duty Clerk

PP David Norgrove

28 January 1986

SECRET

11

PRIME MINISTER 28 January 1986

mr

REFORM OF PERSONAL TAXATION

It is useful that the Chancellor now "accepts the need to make it absolutely clear that there is no Government commitment to provide resources on any given scale over a particular period of time". That helps to make the paper more green. It also reduces the risk that the Chancellor's Budget will be seen as imprudent when prudence must be the message.

But it is still not clear why the Green Paper needs to be pushed through for the coming Budget. Is the Chancellor afraid that otherwise his Budget will be boring? Or is he actually going to start taking practical steps, such as buying computer software very soon? Are we to assess his document as an academic analysis, a political exercise, or a set of measures which will soon start to be implemented?

DHScola

pp BRIAN GRIFFITHS

David Willetts

DAVID WILLETTS

cc B10 P

SECRET

P 01891

PRIME MINISTER

Green Paper on Personal Taxation
Meeting of Ministers at 4.30 pm on Wednesday, 29 January

BACKGROUND

At the meeting you held on 16 January the Chancellor of the Exchequer was asked to produce, in consultation with the Social Services and Employment Secretaries, further material on the distributional implications of his proposed reform. He was also asked to pursue bilaterally with the Social Services Secretary Part III of the proposed text about the longer term relationship between the income tax and social security and National Insurance systems; and you made it clear that, although the Group accepted that a Green Paper would need to be published with the Budget, the text would need to be much "greener" than the present draft.

Distributional Implications: Chancellor's minute of 28 January

2. The Chancellor's paper examines the distributional implications by occupational status, family type and income range, and the implications for the poverty and unemployment traps, of two options:-

(a) the "no losers" option described in the draft Green Paper, with a full year revenue cost of some £5 billion and a standard transferable allowance of £2830, representing one half of the the combined tax allowances currently available to a couple where both partners work;

(b) a revenue netural option giving a transferable allowance of £2215 (£10 per year higher than the current single person allowance).

3. The detailed effects are displayed in the tables attached to the

SECRET

paper, and described from paragraph 8 onwards. The calculations assume implementation of the new social security reform, and that the tax changes happens in one step. A working assumption is also made in the case of the revenue neutral option that age allowance would continue at its present level, but become transferable; and that the additional personal allowance (APA) would continue at its present level.

4. The Chancellor's covering minute contrasts the gainers among all family and income types who would (by definition) result from the "no losers" option, with the 5 million or so losers (almost entirely among two earner couples) resulting under the revenue neutral option. He also stresses the more beneficial effects of the "no losers" option on the poverty and unemployment traps, on the numbers in receipt of family credit and housing benefit, and on those who both pay tax and receive income related benefits. The main features may be summarised as follows.

Effects by Family Type

5. The main effects can conveniently be summarised in the following table:-

	"No losers" Option	Revenue Neutral Option
Family Type		
(a) husband only working	Nearly 3m gain over £10 a week (2m = families with children)	Small number of losers; 2.8m gain £5-10 a week (1.9m = families with children)
(b) both working	1.7m gainers (but majority no change)	few gainers; 3.6m lose £5-10 a week (1.6m with children)
(c) single working taxpayer	Majority gain £2-5 a week	No change
(d) pensioners	Majority (60%) do not pay tax and are unaffected. Given assumption that age allowance retained, both options show mostly gains, with some 0.75m gaining over £5 a week in each option.	

Effects by Income Range

6. On the "no losers" basis, one-third of those with gains over £10 a week have incomes of £5-10,000, and a further 40 per cent are in the £10-15,000 income band. Over 55 per cent of those with incomes over £20,000 also gain more than £10 a week. On the revenue neutral basis, no one earning less than £5,000 loses, but there are few gains either. In the £5-10,000 income band about half would have no income change, and 20 per cent would gain more than £5 a week. As income rises, there are more losers than gainers, reflecting the fact that two earner couples form an increasing proportion of the higher income groups.

Poverty and Unemployment Traps

7. The following table shows the numbers taken out of marginal withdrawal rates of over 70 per cent and replacement ratios of over 80 per cent.

	"No loser" Option	Revenue Neutral Option
Poverty Trap		
Numbers taken out of marginal withdrawal rates of over 70%	240,000	100,000
Unemployment Trap		
Numbers taken out of replacement ratios of over 80%	250,000	100,000

Numbers in receipt of benefit

8. Under the "no losers" option, the number of families entitled to Family Credit is reduced by over a quarter, and those entitled to Housing Benefit by 150,000. The numbers are much smaller for the revenue neutral option. Similarly, under the "no losers" option the numbers (about 1½ million) liable both to pay tax and receive income related benefits would be reduced by more than a half. The reduction would be about 200,000 under the revenue neutral option.

MAIN ISSUES

9. The main issue addressed by the Group at their last meeting was whether the estimated revenue cost of one step introduction of the "no losers" option - some £5 billion - justified the objectives that it would achieve. In presenting the proposal the Chancellor appeared to put equal stress on two aspects of the reform - the distributional effects, particularly for families with low incomes and high costs; and the removal of discrimination against married women in their tax affairs and the family (with more weight being put on the distributional effects than in previous presentations of this reform). The Group were not convinced that the predicted effects justified either in social or political terms the massive preemption of resources involved; and you were also concerned at the effect an apparent £5 billion "give away" might have on the markets.

10. The analysis in the Chancellor's further paper does not entirely allay these doubts. It would, for example, be difficult to justify spending £5 billion to achieve the relatively modest effects on the poverty and unemployment traps shown in the table in paragraph 7 above (only two and a half times the improvements achieved by the revenue neutral option). Nor is it clear that, given the nature of the reform (a change in the structure of personal taxation to remove present discrimination), some losses among two earner couples would not be tolerable on the basis of a less costly option. Even on the revenue neutral option there are very few losses among pensioners, and substantial gains (and few losses) among couples where the wife is not working. Again, although the possibility was raised at the last meeting, the paper does not consider the possibility of, say, some kind of family tax allowance as a more effective means of directing help towards families, without adding to public expenditure.

11. In his covering minute, however, the Chancellor has adopted a new approach. He acknowledges (bottom of page 3) the dangers of appearing to preempt £5 billion of resources and, while strongly sticking to the "no losers" option, points out that the cost could be cut (to no

revenue loss if necessary) by phasing in its introduction. The attachment to his covering minute shows that the speed of introduction could be varied (and if necessary halted) and that the change could be financed entirely out of the annual provision for revalorising tax allowances, with no claim on the fiscal adjustment at all (although this would result in real losses, if allowances were not adjusted). He therefore recommends that, while the reform should continue to be displayed on the basis that full transferability and no losers is the eventual aim, no decision on phasing in should be taken now, and it should be made quite clear that that judgement will be made nearer the date of introduction in the light of economic conditions at the time.

12. You will wish to take the views of the Group, and in particular the Social Services and Employment Secretaries, on whether they would be prepared to accept this new approach, or whether they still wish to advocate alternative means of achieving at least some of the Chancellor's distributional objectives. The Chancellor's proposal, with appropriate redrafting, would certainly leave the issue very much "greener" than before, and would go a long way to meet your own concern about the impact of a £5 billion "give away" and future pre-emption of resources. It would also leave genuinely open the precise pace at which the changes would be made, so that decisions could be made in the light of available resources and priorities at the time. But, however green the disclaimers, the fact is that the proposals would still create a very strong presumption that the Government were committed to the reforms on a no cash losers basis; and that its introduction as speedily as possible would have first claim on available resources. This would still be seen in contrast with the cost saving social security reform (one of Mr Fowler's main concerns) and would not make it easy to contemplate for some years any further major tax or social reform involving any substantial competing claim on resources. Very great care would also need to be taken in presenting the reform in the Green Paper on a "no losers" basis not to obscure the fact that, if it proved necessary to phase the reform over several years, using the revenue set aside for revalorisation,

real tax losses would occur. It would be unfortunate to repeat the mistakes of the social security Green Paper by presenting incomplete or misleading information on the effects of the reform. You may therefore wish to invite the Chancellor to say something about how he would propose to display the distributional effects on the new approach in the Green Paper.

Other aspects of the Green Paper

13. Part II of the Green Paper is concerned with the implications of transferable allowances for other allowances and taxes (eg age allowance, additional personal allowance etc). The detailed discussion and proposals, as well as lengthening the Green Paper, tend to make the central reform appear "whiter" and more set in concrete than the revised approach above would warrant. Although these problems must be acknowledged, the general "greenness" of the paper would be enhanced if this part of the text were considerably shortened, or the discussion relegated to a technical Annex. The Chancellor, to whom I have mentioned this, would accept the latter, and you may wish to put the suggestion to him.

14. Part III is concerned with the tax system in the longer term (relationship between the tax and social security systems etc). I do not think you need to discuss this at this meeting. I understand that discussions on the text between Treasury and DHSS officials are making good progress, and you can revert to it at a future meeting when a full revised text is available for consideration.

NEXT STEPS

15. Subject to discussion, it may be possible to make do with one more meeting of this Group to which the Chancellor should be invited to bring a complete revise of the Green Paper. This might be towards the middle or end of next week, after which the Chancellor would need to circulate the final text for clearance to the Cabinet. I under-

stand that the Treasury's final date for getting the text to the printers in time for publication with the Budget is 28 February, though there is no doubt a little leeway in this.

HANDLING

16. I suggest that you concentrate the discussion on Part I of the Green Paper, the basis of the Chancellor's paper, and only touch very briefly on Parts II and III as in paragraphs 13 & 14 above. You will want to ask the Chancellor of the Exchequer to introduce his paper, and the Social Services and Employment Secretaries to comment, before opening the discussion to the Group generally for wider comment.

CONCLUSIONS

17. You will wish the Group to decide:-

(i) whether the Chancellor's new approach (no cash losers but no commitment on phasing of introduction) is acceptable or whether alternative options or approaches should still be explored;

(ii) whether Part II of the draft Green Paper should be substantially reduced or relegated to a technical annex;

(iii) to invite the Chancellor to bring back a revised draft of the Green Paper for further consideration by the Group at their next meeting in a week or so's time.

J B UNWIN

28 January 1986
Cabinet Office

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

PRIME MINISTER

REFORM OF PERSONAL TAXATION

At our last meeting I was asked to prepare material on the distributional effects of the proposed reform of Personal Taxation. The attached paper, which has been agreed at official level with DHSS and Department of Employment, analyses, as requested, the effect of moving to transferable allowances on both a revenue neutral and a no cash losers basis.

As the paper shows, the revenue neutral option has major disadvantages:-

- While 3.7 million working couples, 2.6 million of them with children, would gain, there would be 5.2 million losers, mainly among two-earner couples.

- Hardly anyone earning less than £100 a week would gain. While half of those in the £100-£200 a week income range would have no change in income, 20 per cent would gain just over £5 a week. Those earning above £200 a week would lose on average, with the loss increasing with income.

- The effects on both the poverty and unemployment traps would be very small, providing little offset to the increased numbers of those who will be brought into high marginal rates as a result of the social security changes.

Perhaps more important, the assumption of revenue neutrality would be taken as a signal that we had implicitly abandoned our objective of reducing the overall burden of income tax.

The whole object of the Green Paper is to suggest how any scope for income tax reduction, as and when it arises, might sensibly be used. The question of introducing it on a revenue neutral basis would not, in practice, arise: if, contrary to our published hopes and intentions (see the Green Paper "The Next Ten Years: Public Expenditure and Taxation into the 1990s" - Cmnd 9189) we found ourselves unable to reduce income tax in the 1990s, then the proposed reform would simply have to be shelved. Thus public presentation on a revenue-neutral basis would be doubly mistaken: first, it would imply a retreat from our declared objectives amounting to a tacit admission of likely failure on the fiscal front (including, crucially, over the control of public expenditure) and, second, it would imply a readiness to introduce a reform in circumstances in which we would not in fact do so.

If, by contrast, we were to display the proposed reform on a no-cash-losers basis, then the following distributional consequences would emerge:

- By definition there would be no losers. 12½ million working families would be gainers, while the remaining 4 million have no change in their net income. Among pensioners, 2¼ million taxpayers would gain, and the remaining 3½ million would have no change in their net income.

- The most substantial gains would be among couples where the wife is not working, most of them with children. But nearly 7 million working single people (half of them under 25) would gain more than £2 a week.

- The biggest proportionate gains are among those with below average earnings.

- The numbers in the unemployment trap would fall substantially - by 250,000, for those with replacement ratios of more than 80 per cent. The number of families in the poverty trap would also fall - by almost a half for those with marginal rates of more than 80 per cent.

- The reduction in the numbers affected by high marginal rates broadly offsets the increase due to the social security changes. So the Green Paper proposals and the Social Security White Paper could be presented as a coherent package.

- The changes would make the low paid less dependent on the State. Those in receipt of Family Credit would be reduced by a quarter, and the numbers entitled to Housing Benefit would also fall.

- After the White Paper social security changes, about $1\frac{1}{2}$ million people will both pay tax and receive income-related benefits. Transferable allowances on a no loser basis would reduce this number by more than half.

Nevertheless, I accept that the presentation of this in the Green Paper as presently drafted is unsatisfactory. It could be held to pre-empt £5 billion of resources, which was not the intention and would clearly be unacceptable if it were; it might call into question our reputation for fiscal prudence, something we cannot allow.

The right answer to this difficulty is, I believe, to illustrate the possibilities of phasing the introduction of the scheme, while making it clear that full transferablity on a no losers basis is our eventual aim. As the attached annex illustrates, phasing can in principle cut the cost to any figure we choose. The change could even be financed entirely out of the annual provision for indexing allowances (in which case there would be no claim on the fiscal adjustment at all).

There is no need to take a decision now to phase in transferable allowances over a particular period. Indeed, it would be wrong to do so. That judgement can be made much nearer the date of introduction in the light of economic conditions, the room for manoeuvre and competing claims at the time. And we can also review the speed of the introduction of the new system as we go along. If necessary, the transition could stop before full transferability was achieved.

Conclusion

The no losers option would achieve, at a pace we can decide later in the light of circumstance at the time, the main objectives of reform:

- A well-targetted increase in tax thresholds, especially for those families with low incomes and high costs.

- A major improvement in the poverty and unemployment traps.

- The opportunity for married women to have the same privacy and independence in tax matters as their husbands.

- The removal of discrimination against the family and marriage.

I fully accept the need to make it absolutely clear that there is no Government commitment to provide resources on any given scale over a particular period of time. But I think this point can be most effectively made by demonstrating the scope for phasing, while underlining the possibility that the transition to full transferability can be arrested for as long as we choose at any stage. This approach would allow us to present our objectives for reforming the structure of personal taxation in a positive light, without appearing to make promises that no Government can guarantee to keep.

I am copying this to Willie Whitelaw, Norman Fowler, Norman Tebbit, David Young, John Wakeham and John Moore.

Rachel Lomax

N.L.
28 January 1986

(approved by the Chancellor
& signed in his absence)

circulated to those present + Prof Griffiths

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17/1/86

AO

REFORM OF PERSONAL TAXATION

Note of a Meeting at
10 Downing Street on
Thursday 16 January
1986 at 11:30 am.

PRESENT:

Rt Hon Margaret Thatcher MP
Prime Minister.

The Rt Hon Vicount Whitelaw
Lord President of the Council

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer

The Rt Hon Norman Fowler MP
Secretary of State for
Social Services.

The Rt Hon Lord Young of Graffham
Secretary of State for
Employment.

The Rt Hon John Wakeham MP
Parliamentary Secretary,
Treasury.

The Rt Hon John Moore MP
Financial Secretary,
Treasury.

Mr Antony Newton MP
Minister of State
Department of Health and Social Security
(Minister for Social Security)

SECRETARIAT

Mr J B Unwin
Mr A J Wiggins

The Meeting considered a memorandum by the Chancellor of the Exchequer covering a draft of his proposed Green Paper on the Reform of Personal Taxation. It also had before it a minute of 15 January to the Prime Minister from the Secretary of State for Social Services and a letter of 15 January to the Chancellor of the Exchequer from the Secretary of State for Employment.

JB

2. The CHANCELLOR OF THE EXCHEQUER said he had promised in his 1985 Budget Speech to issue a Green Paper on the Reform of Personal Taxation, which would specifically canvass the case for a change to fully transferable income tax personal allowances. He had made clear that the Green Paper would also cover longer term issues relating to possible integration of the systems of taxation and social security benefits, and the rationalisation of income tax payments and national insurance contributions. The Green Paper published by his predecessor had put forward transferable allowances among a number of other possibilities; although some of those who responded to that document had preferred other approaches, there was a substantial measure of support for transferable allowances. In particular, it had been clear that fully transferable allowances were strongly to be preferred to a system providing only for partially transferable allowances. The Government's policy was to reduce the burden of income tax, as economic circumstances permitted; he had concluded that such a reduction should be achieved, after the computerisation of the income tax system which would be complete by 1990, by the introduction of a system of fully transferable allowances on a no cash loser basis. This approach would serve a number of objectives: it would remove the present injustice in the tax treatment of married women and enable them to manage their own financial affairs separately from those of their husbands; it would remove the tax penalty currently attaching in some circumstances to marriage; it would improve the position of many families in the poverty and unemployment traps, which were generally dependent upon a single earner; and it would establish a system under which any given increase in personal allowances would be much more effective than under the present system in keeping poor people out of the tax net. The advantages of the proposed system could be clearly seen by considering the average tax rates paid by couples at different stages in their life; examples could be given under the present system where tax took a higher proportion of the total family income when a wife stopped work, despite the substantial reduction in that income, but under the proposed new system this effect would be removed, and it would not matter what proportion of total income is earned by either partner - the tax bill would be the same. The presentation of the Government's approach in the Green Paper would require great care; it would be made absolutely clear that

the changes would be introduced only as the position of the economy permitted, and there would be no commitment to any particular timescale within which the tax reductions would take effect. It would also be made clear that the revenue costs of the change would depend on the length of the transitional period and the rate of inflation at the time, and a range of figures would be presented on alternative assumptions rather than the single aggregate figure of £5.3 billion. (That figure could be further placed in context by pointing out that indexation in the last three Budgets had reduced personal tax payments during the current year by more than £6 billion.) Notwithstanding the proposals in the Green Paper, future Governments would still have complete freedom to decide how any available 'fiscal adjustment' should be allocated between public expenditure programmes and tax reductions; to the extent that the prospect held out of a reduction in the tax burden implied some 'tilt' of policy in that direction rather than towards higher public expenditure, that would be all to the good - all the other pressures faced by the Government were in favour of higher public expenditure. The Green Paper had been promised in the 1985 Budget, and its publication could not now be delayed beyond the 1986 Budget; this meant that work on its preparation would have to go ahead very rapidly, in order to produce a final text by the middle of February.

3. In discussion, the following main points were made.

(a) Although the cost and timing of the change could not be determined precisely at this stage, the implied prior commitment on the extent and shape of future tax relief would be a major issue at the next Election and throughout the period of the next Parliament. Given the possible conflicts of priorities, the presentation of the Chancellor's proposals would require the greatest care.

(b) It was essential that Ministers should understand fully the distributional implications of the Chancellor's proposals; studies should be made comparable with those made recently in the cases of the Review of Social Security and the Reform of Local Government Finance. Although a substantial part of the benefit would go to poor families, richer single earner couples would also be major beneficiaries. An analysis was needed of the proportion of the benefit going to people in different family circumstances and in different income brackets.

(c) The Green Paper would be published while the Social Security Bill was currently before the House. Attention would be focussed on the fact that the Reform of Social Security was being implemented on a broadly revenue neutral basis, with substantial numbers of cash losers including some poorer pensioners, but that personal taxation was to be reformed on a much more generous basis. Ministers should also have before them information about the impact of the introduction of fully transferable allowances on a revenue neutral basis.

(d) A substantial part of the case made by the Chancellor of the Exchequer rested on the benefits which would accrue to poorer families facing the poverty and unemployment traps. If the objective was to help families, and the Green Paper was to carry conviction, alternative approaches to this objective would need discussion. It would be argued that increases in child benefit would be a better way of directing help towards families, but it would also be possible to introduce some kind of family tax allowance which would have many of the same effects and avoid large increases in public expenditure.

(e) The Government's social security reforms removed the marginal tax rates of 100 per cent or more hitherto faced by some poor families. But because entitlement to family credit would depend on after tax income, tax reductions would in future be partially offset by reductions in entitlement to benefit. The overall effect of this was to lengthen the income range over which high marginal tax rates applied. The proposed new arrangements for transferable allowances would usefully complement the social security changes, since they would have the effect of shortening the range of income where poverty trap marginal tax rates applied.

(f) Although the change would be well received by married women who were not at work, they would resent the fact that when they returned to work either their husband would face an increase in tax or they would receive lower earnings net of tax than their colleagues - in practice the effect would be the former. Alternatively the proposed new arrangements might have the effect of inducing married women to join the black economy in order to avoid these tax effects. The result could be pressure for reinstatement of something like the present arrangements.

(g) Although transferable allowances would have a beneficial effect on the poverty and unemployment traps, the tax system should not be regarded as a precise instrument to direct additional resources to people in need - that was the task of social security benefits. On the other hand, it was argued that it was important for the Government to reduce the number of social security beneficiaries by increasing incentives to work; it might be that higher priority would need to be attached to measures which would have this effect on people at lower income levels than to general reductions in taxation which applied right up the income scale.

(h) The material about the future relationship between personal taxation, social security benefits and national insurance contributions should be discussed separately between Treasury and Department of Health and Social Security Ministers, who should report back to the present Group as soon as possible.

THE PRIME MINISTER, summing up the discussion, said that the Group recognised the advantages, equitable, practical and political of a system of transferable allowances. But they were concerned that the Government's approach might be seen as committing the Government to a particular form of tax reduction in preference to possible other social and economic priorities. Before Ministers could undertake any further commitment to an endorsement of the approach proposed by the Chancellor of the Exchequer, full information should be provided to the Group on the distribution of the benefit by income group and family type and on the impact of the change on people at different income levels and in different family circumstances. This latter analysis should be done on a basis comparable with the analyse made of the impact of the changes in social security and of the reform of local government finance. The Group accepted that a Green Paper would need to be published at the same time as the Chancellor of the Exchequer's 1986 Budget, but the text would need to be much 'greener' than the present draft; although it would not be possible to canvas a wide range of options, the change would need to be considered on a revenue neutral basis as well as on the basis of no cash losers, and a variety of options should be considered for the length of the transitional period. It should be made absolutely clear that there was no Government commitment to complete, or even to initiate, the process of introducing transferable allowances; and the possibility should be left open that only a partial transfer would be effected (ie the process would stop at some point during the transition); at the same time it should be made clear that fiscal relaxations, whether directed towards introducing transferable allowances or to increasing public expenditure, would only be made when economic circumstances permitted, and that there was no commitment to the future form of any such relaxation. The next step would be to consider further the distributional implications of the proposed change, on the basis of a paper prepared by the Treasury in consultation with the Department of Health and Social Security and the Department of Employment.

The Group -

1. Took note, with approval, of the Prime Minister's summing up of their discussion.

2. Invited the Chancellor of the Exchequer, in consultation with the Secretary of State for Social Services and the Secretary of State for Employment, to provide material about the distributional implications of the proposed change, on the lines indicated by the Prime Minister in her summing up.

3. Noted that the Chancellor of the Exchequer would discuss separately with the Secretary of State for Social Services the draft text about the longer term relationship between the income tax and social security systems and the system of National Insurance Contributions, and would prepare a revised text for consideration by the Group.

Agenda for Further Meetings

1st Meeting

	Paper by
(i) Distributional implications (including poverty and unemployment traps and alternative means of achieving same objectives)	Treasury and DHSS in consultation with Department of Employment.
(ii) Alternative approaches to achieving sex equality objectives (eg through partially transferable allowances) on different cost and/or phasing assumptions;	Treasury
(iii) Any detailed points on the proposals on other allowances, with particular reference to the implications for the social security reform;	DHSS

2nd Meeting

? longer-term issues (tax-social security integration etc)	DHSS

3rd Meeting

Consideration of revised draft and any outstanding issues.	Treasury

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

15th January 1986

Dear Nigel,

REFORM OF PERSONAL TAXATION

I would like to raise a couple of issues with you before we meet to discuss the Green Paper on Thursday.

I share your view that a system of transferable allowances would be desirable. It would remove distortions in the tax system which at present is biased against single earner families and discriminates against women. But I do have some doubts over the proposed implementation of the system.

The condition that there should be no losers in cash terms is not one we have applied in other areas, such as social security benefits. I am not myself convinced that it should be adopted for the reform of personal taxation.

I also share Norman Tebbit's doubts over revealing such a large potential tax giveaway. The ability of the Government to provide tax reductions on this scale should be specifically linked to responsible wage settlements and firm control of public spending. It would be helpful if the Green Paper could say more about the scope for actually making tax reductions.

At the same time, I particularly welcome the importance you attach to benefiting those groups most affected by the poverty and unemployment traps. As you know, I share your concern over incentives and unemployment. It would be helpful if you could indicate how much of the cost of the Green Paper goes towards helping those affected by the unemployment trap.

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Finally while I recognise that transferable allowances are a desirable step of fiscal reform, I would put much more emphasis on concentrating the benefits of reducing taxes on the low paid. We should be aiming to release the low paid from tax altogether and should look at radical ways to achieve that aim.

I am copying this to the Prime Minister, Willie Whitelaw, Norman Tebbit, Norman Fowler, John Wakeham and Sir Robert Armstrong.

Yours,
David

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PRIME MINISTER

Mo

GREEN PAPER ON PERSONAL TAXATION

You have seen most of these papers before and the Cabinet Office have provided their usual admirable brief. Minutes by Lord Young, Mr. Fowler, Mr. Tebbit and the Policy Unit are in the folder. Note that Mr. Tebbit favours partially transferable allowances.

It might help the progress of the discussion if you were to make a few points clear early on:

i) the Government is committed to publishing the Green Paper and it makes sense to bring it out on Budget Day;

ii) the Green Paper will need to focus primarily on transferable allowances;

iii) there is nothing inconsistent in making savings on social security whilst aiming for no losers on taxation: the Government is committed to reducing public expenditure and reducing taxation;

iv) but there must be doubts about whether the Government can put forward so firmly proposals which would rightly or wrongly be viewed as a massive give-away;

v) the Green Paper will in your view need to be greener and discuss more modest possibilities for transferable allowances; (it might be possible to make fully transferable allowances an objective to be reached as resources permit)

vi) the meeting is intended to be a second reading

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discusison followed by two or three further meetings to look in more detail at particular aspects.

The aim would be from the start to assure the Chancellor of your broad support on publishing a Green Paper which discusses transferable allowances, whilst making him and others aware that you are not prepared to go as far as he would like.

An aide memoire on the advantages of partially transferable allowances is attached to this minute.

DN

(David Norgrove)

15 January 1986

AIDE MEMOIRE

PARTIALLY TRANSFERABLE ALLOWANCES

The possibility of partially transferable allowances was discussed in paragraphs 69 to 75 of Chapter 6 of the 1980 Green Paper on The Taxation of Husband and Wife (Cmnd 8093).

2. In brief, under partial tranferability the transferable allowance would be limited to a proportion of the single allowance. Supported spouses income up to the difference between the single allowance and the amount of allowance transferable would be disregarded so that no tax liability would arise where the supported spouse had a small part-time earnings or income from savings amounting to less than the disregard limit. However, any income above the disregard limit would reduce the transferable allowance £1 for £1. The level of the transferable allowance (and its converse, the disregard) could be varied according to the view taken of the reduction in taxable capacity arising from the need to support two married persons on one income.

3. The following arguments in favour of partial transferability emerged in the Green Paper discussion:-

(i) there would be an in-built flexibility for the couple where one spouse stays at home. The size of the allowance given to the one-income couple could be varied to reflect the weight given at different times to different views about the appropriate relationship between married and single allowances;

(ii) a fully transferable allowance could discourage some married women from taking up work in the first place, since a wife's income up to the level of the single allowance would effectively be taxed at the husband's marginal rate (the married women herself would not pay any income tax but the husband would lose the transferable allowance from his PAYE code which he had enjoyed as a sole earner). On the other hand, with a partially transferable allowance the wife's earning's 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;

(iii) with partially transferable allowances there would be greater privacy for the supported spouse since the husband would only know of changes between the disregard limit and the single allowance. This would effectively give almost total privacy for wives with a small income;

(iv) administratively, a partially transferable allowance scheme would be cheaper than fully transferable allowances since every £ of one spouse's income would affect the quantum of allowances available to the other. Under partial transferability, no adjustments would be required where a spouse had only small part-time earnings below the "disregard limit";

(v) the revenue cost of full transferability would be greater than partial transferability.

14 January 1986

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MR NORGROVE

Green Paper on Personal Taxation

I am told by the Treasury that, with the further postponement of the Prime Minister's meeting on the draft Green Paper, the Chancellor is getting agitated about whether it would be possible to fit in a further three meetings (as suggested, after consultation with the Treasury, in paragraph 8 of my brief of 10 January) and still get the document out on time with the Budget.

2. I should still have thought myself that this was possible. But if necessary the programme could be shortened by omitting the proposed third meeting on the longer term development of the tax system. This could be remitted for bilateral consultation between the Chancellor and Mr Fowler, and then picked up again as necessary at the concluding meeting to consider a revised draft.

3. You may like to add this gloss to the Prime Minister's briefing.

J B UNWIN

15 January 1986
Cabinet Office

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15. I. PM 86

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PRIME MINISTER

REFORM OF PERSONAL TAXATION

I think it would be helpful to you and colleagues if I briefly set out my first reactions to Nigel's memorandum and Green Paper.

Carrying through these proposals will be a major element in the Government's programme over the next few years. We need to make sure that we get the details of these proposals right and that we are able to present them effectively. Clearly it will not be possible to complete this work in one discussion and I suggest that, as with the social security and local government finance proposals, there should be an opportunity for further meetings to enable us to go into the proposals in more detail.

There are one or two particular issues which we might cover. The Green Paper concentrates on the extra help going to families. We shall need to be able to demonstrate this and in particular the overall effect on family finances rather than just the effect of tax reductions. Now that we have a set of illustrative figures for the social security reform, we shall be able to look at the combined effect of the tax and benefit changes. This will enable us to see how the tax reforms affect poorer families as well as families in general. Similarly, we ought now to be able to show the effect on the poverty and unemployment traps of the tax reforms, on which Nigel rightly places so much importance. At the same time, we need to be able to explain why we have chosen transferable allowances rather than other ways of reforming the tax system e.g. by specifically recognising children again in some way.

We shall also have to consider the "no cash loser" basis in Nigel's proposals, as compared with the social security proposals. The presentation will not be easy.

There are two other social security aspects. First, I agree with Norman Tebbit that the Green Paper should deal in more detail with the case against full integration of tax and social security. My Green and White Papers have relied on Nigel's Green Paper to cover this issue. In developing this, we need to recognise the support amongst our own people as well as outside commentators for greater integration. We must therefore make the most of our moves to partial integration, as with family credit. Second, we need to consider very carefully before we convert another tax allowance - in this case the additional personal allowance for lone parents - into a cash benefit. As with the earlier conversion of child tax allowance into child benefit we shall be lowering the tax threshold. It would also add complications to social security at a time when we are trying to simplify it.

Finally, the presentation of the tax changes to married women will not be easy. Providing opportunities for tax privacy and equal treatment in investment income will be good news. But for women not in work, the picture would be different. Unlike now, they will have to declare every pound they earn on their return to work. And they will have no extra tax allowance, compared with women at home, to meet for example the costs of caring for children. We shall therefore have to convince people that the changes are not intended in any way to dissuade married women from returning to work.

I am copying this minute to Willie Whitelaw, Nigel Lawson, Norman Tebbit, David Young, John Wakeham and Sir Robert Armstrong.

NF

15 JANUARY 1986

15. I. AM 86

PRIME MINISTER

15 January 1986

PERSONAL TAX GREEN PAPER: SOME QUESTIONS

1. Is the Green Paper about tax reform or tax cutting? A tax reform Green Paper should give various illustrative costings of fully transferable allowances, ranging from a large cost to zero.
The Budget should be prudent, so as to strengthen City confidence. Is a Green Paper promising tax cuts in the medium term compatible with this?

2. Can the Green Paper be made genuinely Green? Why not discuss alternative ways forward such as cutting the basic rate of tax, raising existing thresholds, or introducing a family tax allowance like the old child tax allowance?

3. How many low-paid single people and one-earner couples would be taken out of tax? What could be the effect on unemployment?

4. What is the woman's angle? The Green Paper would give more generous tax treatment to couples with young children when the wife may wish to stay at home. Women would also get complete independence in their tax affairs if they wish. But the tax treatment of working wives would be relatively less generous.

5. What are the overall effects on two-earner couples? Some gain - if the woman's earnings are below the tax threshold, if they

have already elected for separate assessment, if the wife has an investment income that can now be treated separately. Others do not gain from the overall reduction in the tax burden.

6. <u>What are the implications for the next two Budgets</u>?

7. <u>What are the administrative savings</u> for tax collectors and taxpayers if the Chancellor simplifies income tax?

Brian Griffiths David Willetts

<u>BRIAN GRIFFITHS</u> <u>DAVID WILLETTS</u>

DCAAYI

PRIME MINISTER

GREEN PAPER ON PERSONAL TAXATION

Mr. Fowler has asked whether Mr. Newton can attend the meeting on personal taxation tomorrow. DHSS argue that the Financial Secretary will be there and Mr. Newton will be working on some of the more detailed aspects later and it would be good for him to be involved from the beginning.

This is a little sensitive because the Financial Secretary was not allowed into the early discussions of MISC 111 and invitations to your meeting tomorrow were issued on a personal basis. The meeting with the Chancellor may be difficult anyway and I suggest refusing Mr. Newton at this stage on the grounds that the discussion will be general, but invite him to the later meetings. Content?

Yes mt

Duty Clerk

(David Norgrove)

15 January 1986

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CC D.W.

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NBPM at this stage

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Chancellor of the Duchy of Lancaster

PRIME MINISTER

REFORM OF PERSONAL TAXATION

I regret that I shall be unable to attend the re-arranged discussion of the Green Paper on personal taxation, circulated under cover of Nigel's memorandum of 23 December.

I support Nigel's view that we should adopt a system of transferable allowances. It reinforces and supplements measures which Norman Fowler is presenting in the Social Security White Paper. It reflects fully our wish to allow individuals to keep more of the money they earn, and to spend it as they wish. It provides further support to families and removes a distortion in the tax system, one which is widely regarded as discriminating against women.

More than most issues, this is one which can be presented at a number of levels. While the green paper is a well-written document, we must be careful not to be too caught up with exploring the technicalities, and forget to argue the points of principle involved. We cannot afford for this to be widely interpreted as a gift to the haves, at the expense of the have-nots.

The most careful advance preparation of commentators is needed for a subject of this kind. There are many aspects which can be attractively presented:

- that people wish to keep the money they earn; that people do not wish to see an ever-increasing proportion of their income come from state benefits;

- that this measure, taken together with social security represents a major reform, ending 40 years of increasing anomaly and bureaucratic interference;

- that these measures will further reduce the employment trap;

- that families with young children are often at their most financially vulnerable when, having dropped to one income, they are at the same time owner occupiers with growing financial responsibilities. Every penny counts for them and many would accept that the tax burden on them should be lessened.

It would, however, be most unfortunate if the figure of £5.3 billion mentioned in the Green Paper as a possible cost, in terms of lost revenue, of implementing these reforms were to gain currency as an amount the Chancellor was ready to "give away". I wonder, therefore, if it might be expedient to widen and make more diffuse such estimates by giving consideration to a half-way stage of reform, in which not the whole of the personal allowance would be transferable.

There would be some sense in this, as some part of the allowance against earnings might be represented as being in respect of the costs of going to work.

Finally, I am concerned that chapter six of the paper should make as strong a case as possible against the full integration of the tax and social security systems, making it clear that most individuals view very differently the money they earn, from whatever benefits they receive, also that blurring the distinction between the two would devalue people's own earnings, and that a full integration of the two systems would either be costly and wasteful or an administrative nightmare. The SDP, in particular, view the integration of tax and benefits systems as a major plank of their policy, and the superficial appeal of such a proposal has to be strongly rebutted.

I am copying this minute to Willie Whitelaw, Nigel Lawson, Norman Fowler, David Young, John Wakeham and to Sir Robert Armstrong.

pp NORMAN TEBBIT

[Approved by the Chancellor of the Duchy and signed in his absence]

13 January 1986

10 DOWNING STREET

From the Private Secretary

Prime Minister

I have discussed this extensively with Brian Unwin, and have also had some discussion of it with Rachel Lomax. If all goes well it should lead to a Green Paper which is satisfactorily green, whilst protecting the Chancellor's position. But there are still uncertainties about how the Chancellor will react to these ideas.

DRN

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P.S. If you find the brief helpful, would it also help if the Lord President and Chief Whip saw copies?

– Yes – but has the Chancellor also been able to digest these arguments?

OD

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SECRET

PRIME MINISTER

Green Paper on Personal Taxation:
Meeting of Ministers at 11.30 am on Tuesday 14 January

I suggest that the main purpose of this meeting should be to take at least a preliminary decision on whether the Chancellor should publish with or after the Budget a Green Paper on Personal Taxation on the lines he has proposed; and to make arrangements for further work and consideration.

BACKGROUND

2. You are familiar with the background. The Government first canvassed options for the reform of personal allowances in the Green Paper (The Taxation of Husband and Wife, Cmnd 8093) published in 1980 by Sir Geoffrey Howe as Chancellor. In the response to this there was widespread agreement on the need to change the present system, but no agreement on the means. No specific follow-up action was therefore taken. The present Chancellor reaffirmed the Government's intention to proceed with a major reform of personal income tax in his 1985 Budget statement. The relevant passage is at Annex 1. You will see that this promised Green Paper "later this year"; and made it clear that the Chancellor strongly favoured a system of transferrable allowances of the kind now proposed. The statement also said that the Green Paper would "discuss a range of options opened up by computerisation, from non-cumulation to closer integration between the tax and benefits systems"; and indicated that, after an appropriate period for consultation, "it would be possible to legislate in 1987 and have a system on these lines in place by the end of the decade".

3. The Chancellor has also trailed these proposals publicly on other occasions. For example, in a speech to the Equipment Leasing Association on 28 May 1985 he outlined the likely contents of the Green Paper in some detail, making clear his own preference for a system of independent taxation with transferrable allowances, and his scepticism

about the scope for integration of the income tax and social security systems (while also asserting that he did not wish "to prejudge the matter one way or the other"). In addition, at the last Conservative Party Conference he said that proposals in the Green Paper would enable the Government to "do far more to deal with unemployment and poverty traps which damage incentive for those on low incomes ... they will also once and for all remove the discrimination against married women which so disfigures our present tax system."

4. There is, therefore, strong public commitment to, and widespread expectation of, the Green Paper and its likely contents. While it would not be impossible to shelve the idea, or to postpone publication further, it would be difficult to do so. Publication is already overdue.

CONTENTS OF GREEN PAPER

5. The Green Paper will represent a major statement of the Government's medium term taxation strategy, and, despite the caveats, in effect amount to a major pre emption by the Chancellor of the scope for tax cuts in several budgets to come. The central proposal is to replace the present structure of allowances for husbands and wives with a simpler system of transferrable allowances. The various consequentials include replacing the additional personal allowance for single parents with a higher One Parent Benefit (OPD) and the end of age allowances for pensioners. Significantly, these structural changes are to be achieved on a no-cash-loser basis, costing between £2.5 and £5.25 billion, depending on assumptions about inflation and the prevailing rate of tax. The Chancellor's intention is that legislation would be introduced in 1987 and the new structure implemented by stages from April 1990.

6. Part I (Chapters 1-3) of the draft paper deals with the reform of personal allowances and the tax treatment of husband and wife; Part II (Chapters 4 and 5) considers the treatment of particular groups (eg the elderly and single parents); and Part III (Chapters 6-8) discusses

possible longer term options for the development of the tax system. Chapter 6 rejects the possibility of full integration of the tax and social security systems and is less than enthusiastic about "partial integration"; Chapter 7 rejects the notion of merging the national insurance contribution and tax systems; and Chapter 8 discusses positively, but without commitment, the possibility of moving from cumulation to non-cumulation. The Chancellor stresses throughout the opportunity for radical reform that computerisation of PAYE, which is well under way, now presents.

MAIN ISSUES

7. You will not at this meeting want to get into detailed discussion of the contents of the Green paper. The immediate question is whether the political case for publication with the budget or later is a good one; and if so, what further work needs to be done, and how it should be organised. In reaching conclusions on these issues you may wish to concentrate on the following points:-

(i) General case for publication: in view of the expectations aroused by the 1985 Budget statement, and the other statements referred to in paragraph 3 above, it would now be very difficult not to publish a Green Paper. You will, however, wish to pause to consider likely reactions. The financial markets are looking with some nervousness for signs of fiscal laxity. Subject to the rest of the Budget package, there could be some concern at the prospect of a £5 billion "give away"; or alternatively, at the price that might have to be paid to achieve this (eg indirect tax increases or forgoing revalorisation). Nor is it clear that the proposals on sex equality will universally be welcomed, particularly since it may be argued that they would introduce a disincentive for married women to go out to work. This point has already been made in the press and by a report by the House of Lords Select Committee on the EC. On the other hand, the proposals for simplifying the present system of allowances and taxing married women on the same basis as their husbands are bound to be welcomed, and by making the Paper a good deal "greener" than at present, it would be possible to make it clear that the changes would only fully be introduced if they could prudently be afforded.

(ii) Substance of the transferrable allowances and related proposals: You may want to have a 'second reading' discussion of these, without going into great detail. The Chancellor now appears to be justifying the proposals more through their distributional effects than the sex equality arguments. The reform is presented as being primarily aimed at helping families in the poverty and unemployment traps. The supporting analysis, however, is far from complete. For example, it compares the effects in terms of changes in tax liability rather than in terms of net income. It largely ignores the inter-relationship between the tax and benefit systems, which will mean that under the new social security system some of the benefit from reduced tax for the lower paid will be offset by reduced entitlement to income-related benefits. This must mean that low income families, especially those with children, gain less from the changes than the better off. Similarly, there is little analysis to support the claimed improvements in the poverty and unemployment traps. Nor is there any discussion of alternative tax strategies which might achieve the Chancellor's objectives more effectively and perhaps at less cost. For example, it could be argued that a family tax allowance (or improved family credit) would be a better targetted way of tackling incentives and of helping families with children. On these and other points, and bearing in mind the exhaustive analysis that underlay the decisions on social security and rates reform, Ministers may feel that they should be provided with some further supporting analysis before a virtual commitment to preemption of resources on such a large scale is entered into.

(iii) Relationship with the Social Security White Paper: As the Chancellor argues, there seems to be no major conflict between the tax and social security proposals. However, there is a substantial difference in the thrust of the two documents. The Social Security White Paper is designed to make large public expenditure and PSBR savings, and to target transfer payments on those who most need them. There are in consequence many losers. By contrast, the Chancellor's proposals are on a no-cash-loser basis, and necessarily only a relatively small part of the additional cost will benefit the poor. The contrast between the two approaches is bound to be drawn, particularly as the Social Security Bill will be in the House at the time of publication of the tax Green Paper. The answer, of course, is that the Government are committed to reducing the burden of personal taxation, and the very reason for reducing social security and other public expenditure is to make way for tax cuts. But there could be presentational problems over the contrast between the promise of several £ billion for tax reforms, which will not be universally popular, so soon after the issue of the social security White Paper showing several million losers. The Social Services Secretary will no doubt refer to this.

(iv) Integration of tax and benefit systems: The Chancellor notes in his covering paper that there has been considerable public interest in the longer-term relationship between the tax and social security systems. The somewhat dismissive treatment in Part III of the paper may, however, disappoint expectations and risk criticism for appearing unduly negative in tone and content. There is a good deal of support for greater integration among the Government's own supporters, as well as the Opposition parties. If, therefore, this material must be published in the Green Paper, Ministers may wish to consider whether a more positive gloss could be given to the discussion and the options left more genuinely open. For example, Chapter 7, on integration of national insurance and income tax, does not discuss the possibility of devising an integrated tax/NIC on earnings, with separate machinery to deal with taxation of unearned income and pensions. There may be major disadvantages in this; but if so, perhaps they should be aired and explained. More could probably also be said about what the Government already are doing (especially through the proposed family credit) to bring the two systems together, to reduce "churning", and (in effect) to let recipients keep more of their own money. Again, the Social Services Secretary will no doubt have views on those issues.

NEXT STEPS

8. If you decide, even only provisionally, that the Green Paper should be published with the Budget, there is another six weeks or so for further work and consideration. The Treasury would want to put the draft to bed by about the end of February. On the basis of discussion with the Treasury (who believe the Chancellor would go along with something like this) I suggest that you might think in terms of two or three further meetings of this group under your chairmanship with the following possible agenda:-

2nd Meeting:

(i) Fuller consideration of the distributional implications of the proposals (notably the effects on the poverty and unemployment traps) and alternative means of securing the same objectives - on the basis (preferably) of a joint paper by the Treasury and DHSS, in consultation with the Department of Employment.

(ii) consideration of alternative options for achieving the sex equality objectives (eg through partially transferrable allowances), on different assumptions about cost and/ or phasing in period (eg revenue neutral basis and phasing in over 3 or 4 years rather than 2) - on the basis of a Treasury paper;

(iii) consideration of any outstanding points on the proposals (in Chapters 4 and 5) on other allowances and implications for the tax system - perhaps on the basis of a paper by Mr Fowler on the implications for the new social security system.

3rd Meeting:

Fuller consideration of Part III of the paper on the longer-term development of the tax system, particularly the relationship between the tax and social security systems - perhaps, again, on the basis of a paper by Mr Fowler.

4th Meeting:

Consideration of revised draft in the light of the above discussions.

9. A work programme on these lines would give Ministers a much better opportunity to consider the proposals in a measured and informed way before final decisions are taken. It should also help to eliminate the bugs in the present draft, expose those passages which ought to be greener than at present, and make it possible to launch the proposals with less risk of an adverse reaction. It would also, by confining discussion to this Group, not trespass too far on the Chancellor's traditional prerogative in tax matters.

HANDLING

10. You will wish to invite the Chancellor of the Exchequer to speak to his proposals. You might then ask the Social Services Secretary for his comments; and then invite the other Ministers present, beginning with the Lord President, to comment generally on whether they think it would be right to publish a Green Paper of this kind at or after the Budget.

CONCLUSIONS

11. You will wish the meeting to decide:-

(i) whether the Chancellor should publish a Green Paper on the lines he has proposed;

(ii) if so, whether it should be published with the Budget, or later;

(iii) whether further work should be done before final decisions are taken, and if so how it should be organised (eg on the lines of the programme in paragraph 8 above).

J B UNWIN

10 January 1986
Cabinet Office

ANNEX I

EXTRACT FROM HANSARD, TUESDAY 19 MARCH, Vol 75, Col 794 - 795

TAX REFORM

Mr. Lawson: I now turn to taxation.

This Budget carries forward the theme of tax reform I set out last year. Reform designed to make life a little simpler for the taxpayer. And above all reform designed to improve our economic performance over the longer term, on which the jobs of the future will depend.

In my Budget last year I announced a radical reform of the corporation tax system. This had been preceded by the Green Paper on corporation tax issued by my predecessor in 1982.

I am satisfied that the right way to proceed with major tax reform is to issue a Green Paper first, as a basis for full and informed discussion, followed by legislation when the results of that discussion have been fully digested.

I therefore propose to issue a Green Paper later this year on the reform of personal income tax.

The computerisation of PAYE makes this the right time to review the system of personal taxation. Most of the work will be complete by the end of 1987 and the full range of facilities will be available by 1989. The Green Paper will therefore discuss a range of options opened up by computerisation, from non-cumulation to closer integration between the tax and benefit systems, and including in particular a reform of the present system of personal allowances.

It is the Government's firm policy to reduce the burden of income tax, but we need to make sure that the reliefs we can afford are concentrated where they will do most good.

The present structure of personal income tax is far from satisfactory. Too many young people start paying tax at too low a level, and too many families find themselves in the poverty and unemployment traps. The system discriminates against the family in which the wife stays at home to look after the children. It denies to the partners in a marriage the independence and privacy in their tax affairs which they have a right to expect.

There is therefore a strong case for changing to a new system of personal allowances more suited to today's economic and social needs. Under this, everyone, man or woman, married or single, would have the same standard allowance; but if either a wife or a husband were unable to make full use of their allowance, the unused portion could be transferred, if they so wished, to their partner.

This reform would produce a more logical and straightforward system. Far more people could be taken out of the poverty and unemployment traps, and indeed taken out of tax altogether, for a given sum of overall tax relief than is possible under the present system. It would end the present discrimination against the family where the wife feels it right to stay at home, which increasingly nowadays means discrimination against the family with young children.

Husbands and wives would each be taxed separately on their own income irrespective of the income of the other. The aggregation for tax purposes of a wife's earned income and investment income with her husband's would end, thus removing what has become an increasing source of resentment among women.

The Green Paper will set out full details of the proposals I have just outlined, as a basis for public discussion. After an appropriate period for consultation, it would be possible to legislate in 1987 and have a system on these lines in place by the end of the decade.

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PRIME MINISTER

6 January 1986

HOW CAN £5.25 BN OF TAX RELIEF BE BEST SPENT?

The Chancellor's proposals have some good elements. The separate taxation of husband and wife for capital gains and investment income is not a costly move, and would be a welcome step towards greater equality of tax treatment between single people and married couples. Raising the threshold to reduce the number of lower paid single people in tax, and to reduce the favoured treatment which is accorded to two-earner couples, also have some merit.

However, the proposals will be seen as an attempt to discourage married women from going out to work - as it raises ? not necessarily. their marginal rate of tax; and will be administratively very complex, given the need to calculate the amount of allowance being transferred between husband and wife for each tax year. Promising tax changes after the next Election is feeble: people expect tax reform and reduction in this Parliament.

£5.25 billion of tax relief is a large sum of money. The Chancellor did well out of reform of Corporation Tax. He has not been so successful with the promised reform of capital taxation. Only Development Land Tax has gone; the worst elements of Capital Transfer Tax have been removed; and Stamp Duties have been halved, but there has been no dramatic reform. For £1.6 billion more (March 1985 Treasury Estimate of 1984-5 revenues) Capital Gains Tax could be abolished entirely, and Stamp Duty removed. This would simplify the tax system greatly, and remove an impediment to house mobility and to the purchase of shares.

The proposal to scrap Capital Gains Tax would be attacked as favouring the rich and the speculator. In its place, gains made in under one year from time of purchase - whether of real estate or shares - could be taxed as income for both companies and individuals.

If a net £1.25 billion were spent on removing Stamp Duties and Capital Gains Tax in this way, any other money available can be spent on reforming income tax. £4 billion, for example, would allow a reduction in the standard rate of income tax to 26%. Alternatively, thresholds could be raised by around 20%, taking the single allowance to around £2,600 and the married man's allowance to around £4,150. This would leave everyone better off in direct proportion to the amount of tax relief on offer, rather than skewing the advantages against the two-earner married couple towards the single-earner married couple, as the Chancellor's scheme proposes.

Conclusion

A way forward would be:

1. To accept the separate Capital Gains and investment income taxation for husband and wife - a long overdue reform.

2. To criticise the Chancellor's proposals for transferrable allowances, on the grounds that they penalise married women returning to work and they are administratively very cumbersome.

3. Suggest that capital tax reform be pursued as vigorously as Corporation Tax reform was pursued, by abolishing Stamp Duties and Capital Gains Tax, but taxing as income capital gains made in under one year.

This money is not on offer in this Parliament.

4. Using up to £4,000 million, either to cut the standard rate of tax by four percentage points, or to up thresholds by around 20%.

If this could be done in the next two Budgets (it depends on controlling public spending) this would enable the Government to go to the country on the platform that it had scrapped four taxes outright - Development Land Tax, National Insurance Surcharge, Stamp Duty and Capital Gains Tax - and had brought the standard rate of income tax down from 30% to 26% following the reduction from 33% to 30% in the previous Parliament. This would represent a significant achievement of tax reduction and reform, a programme which the country has been expecting ever since 1979.

JR

JOHN REDWOOD

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bc. BG

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10 DOWNING STREET

From the Private Secretary

12 December, 1985.

GREEN PAPER ON PERSONAL TAXATION

The Prime Minister has decided to convene a small group to discuss the proposed Green Paper on Personal Taxation which was announced in the Budget Speech. She would like to invite the Lord President and the Ministers to whose Private Secretaries I am copying this letter.

BF

A meeting has been arranged for 9 January, and the Treasury will aim to circulate before Christmas a paper for discussion then.

I am sending copies of this letter to Rachel Lomax (HM Treasury), Leigh Lewis (Department of Employment), Tony Laurance (Department of Health and Social Security), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office), Vivian Life (Office of the Financial Secretary, HM Treasury), and Murdo Maclean (Chief Whip's Office).

(David Norgrove)

Miss Joan MacNaughton,
Lord President's Office.

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SUBJECT
cc Master

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bc. B.G

10 DOWNING STREET

From the Private Secretary

4 December, 1985.

PROPOSED GREEN PAPER ON PERSONAL TAXATION

The Prime Minister and the Chancellor today discussed the proposed Green Paper on personal taxation.

The Prime Minister's main concern in the discussion was a fear that married working women would react against it: they would not gain financially and it would be seen as pushing women back into the home. The Chancellor explained the advantages of transferable allowances, speaking along the lines of his minute of yesterday. He recognised that there could at the margin be some effect on the incentives to women to go out to work.

The Prime Minister said she continued to have some doubts about the proposal, but that she was prepared to agree that the Green Paper should be discussed with a wider group of colleagues.

The Chancellor undertook to consider further who the members of this group should be.

David Norgrove

Mrs. Rachel Lomax,
HM Treasury.

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CHANCELLOR OF THE EXCHEQUER

In following piece - PREM 19/1709 (folder at back) J. Gray 4/11/14

David

I attach two historic papers on the fate of Geoffrey Howe's proposals, plus some snippets of more up to date thinking on points thought to be of particular concern to the Prime Minister.

Could you please keep them strictly to yourself for the time being? Rachel. 3/12

014/SP

SECRET AND PERSONAL

cc B'CP

CC B.G

Discussed at bilateral 4/12/85.

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DCW 4/12

PRIME MINISTER

TAX CUTS: STRATEGY

A month or so ago we discussed the need to rebuild the shrinking constituency of those who want to see substantial cuts in personal taxes. I believe that we have made some headway here in recent weeks, but it has been particularly disturbing to sense these doubts amongst some of our own supporters, who should be the main proponents of the argument that without lower taxes we will never get an enterprising, vigorous and flexible economy; and that voters rightly want to keep more of their own money to spend themselves.

It is ironic, but we need to continually to advocate the case for lower taxes - not just with our colleagues in Cabinet, whose interest in lower taxes may conflict with their Department's pressures for higher public spending, but even with supporters inside and outside the House whose interest in tax cuts one might expect to be much more straightforward. I believe that we now have to step up our effort, to prevent erosion of our position, and to go on the offensive, with new arguments and fresh approaches.

Since our 1979 reduction in the basic rate of income tax we have put very large sums of money into threshold increases, taking people at the bottom end out of income tax altogether, reducing the numbers of people facing very high marginal tax/benefit withdrawal rates, and improving the rewards for those who work in relation to those who do not.

But the sheer cost of raising allowances with the present tax structure means that year by year we appear to be making painfully slow progress. This is, perhaps, a reason why our supporters lose enthusiasm for tax cuts. We need to think of imaginative ways of restoring their appeal.

For the man presumably.

This has been a major driving-force behind my personal tax Green Paper. Its proposals would distribute threshold increases more cost-effectively. From a given amount of tax relief more would go to one-earner couples where the wife is at home with the children - the group most affected by the why-work syndrome, and where the disincentive effect of taxation and benefit withdrawal is strongest. There would also be a step-increase in the single person's allowance - which, by taking many young people out of tax altogether, should help to reduce the numbers of young unemployed. The result would also be a fairer distribution in the tax burden on married couples at different points in their lives. Most women nowadays have paid jobs for a good part of their working lives. But the present tax system is hardest on married couples at just that time when they have the responsibilities of a young family and the wife is least able to work outside the home.

I believe that the Green Paper proposals would be attractive to a wide range of political opinion, both within and outside the Party - and especially to women voters. The various tax penalties on marriage - all of which spring from the anachronistic rule that for tax purposes a married woman's income is treated as her husband's - arouse resentment among women right across the political spectrum, as I am sure you know from your own correspondence. All of them would go if the Green Paper proposals were adopted. You will recall that the Women's National Advisory Committee, in responding to Geoffrey Howe's earlier Green Paper, unequivocally supported the principle of mandatory independent taxation with a transferable option, arguing that the present system is anomalous, discriminatory against the family and inequitable as between husband and wife. Since I outlined my proposals in my Budget Speech there has been sustained and favourable interest both in the press and in the Party.

The high-tax, high-spending lobby would, of course, add up all the threshold increases and label the total the 'cost' of the Green Paper - ignoring the fundamental difference between tax reductions and expenditure increases. What we have to get over is that these are not 'costs' in the public expenditure sense, nor do they represent a new or additional commitment to cutting taxes. There is a world of difference between higher spending and allowing people to keep more of their own money. And we have already made it very clear that we intend to reduce personal taxes anyway, over a period of years. In last year's Green Paper, 'The Next Ten Years', we set out the scale of tax reductions which could be achieved if public expenditure is kept in check, up to 1993. These reductions would bring the (non-North Sea) tax burden down from its current 37½ per cent of GDP to as much as 6 percentage points below this level. By comparison, the illustrative figure given in the personal tax Green Paper is equivalent to only about 1½-2 per cent of GDP, assuming the proposals were introduced on a no-cash-loser basis. And a tax reduction of this size would still leave us above the tax burden we inherited in 1978/79.

If we can settle on, and publish, a strategy for substantial increases in thresholds along these lines we can then use the period between now and 1990, the earliest date on which any new system of thresholds could be implemented, to reduce the basic rate. Fiscal prudence must continue to constrain the pace at which we can move, but I believe our ultimate target should be the 25 per cent basic rate first advanced by Geoffrey Howe in 1979. Such reductions would be fully justifiable against the background of the raised and restructured thresholds in prospect. They would also help significantly to reduce the cost of the restructuring. And they would help all taxpayers - including those two-earner couples who do not stand to gain immediately from the Green Paper proposals themselves.

I believe that we should go for a two-pronged strategy on these lines. Without a clear prospectus for threshold increases we would be unable to build up support for reductions in the basic rate; and without basic rate reductions we risk losing the political initiative on our whole tax-cutting policy. Everyone knows what the basic rate of tax is: very few can tell you what their threshold is.

The essential first step is that you and I should together settle on a broad strategy - for both thresholds and the basic rate - on which we are agreed. Given the key political importance of all this and the substantial interactions between the tax structure and our social security and employment policies we will need next to secure the agreement of key colleagues - in particular Willie Whitelaw, Norman Fowler, Norman Tebbit and David Young - to what we have in mind, before Budget security considerations supervene. My aim would then be to publish the Green Paper itself on Budget Day - in the context of a fresh look at our overall economic strategy, and well clear of the publication of Norman Fowler's White Paper and Kenneth Baker's Green Paper on Local Government finance.

I hope we will be able to have a further talk about this at our meeting on Wednesday.

NL

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cc B/UP

PRIME MINISTER 3 December 1985

PERSONAL TAX GREEN PAPER: SOME QUESTIONS

1. What is the cost of introducing fully transferable allowances? Can the Chancellor find the money if North Sea oil taxes are falling? Is there a risk that commitments made now will be difficult to escape and we will end up with a higher PSBR?

2. What are the objections to alternative ways forward such as cutting the basic rate of tax, raising existing thresholds, or introducing a family tax allowance like the old child tax allowance?

3. What are the labour market effects? How many low-paid single people and one-earner couples will be taken out of taxout of tax. How many people will be affected? How big will be the effect on unemployment?

4. What is the woman's angle? The Chancellor is giving more generous tax treatment to couples with younger children when the wife may wish to stay at home. Women will also get complete independence in their tax affairs if they wish. But the tax treatment of working wives will be relatively less generous.

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5. <u>What will be the effects on two-earner couples</u>? Some will gain - if the woman's earnings are below the tax threshold, if they have already elected for separate assessment, if the wife has an investment income that can now be treated separately. Others will not gain from the overall reduction in the tax burden.

6. <u>Why publish</u> now as the proposals can only be implemented in 1990? Are there implications for the next two Budgets?

7. <u>Will the Chancellor be able to simplify the tax system</u> without having to buy out the twiddly bits, such as the age allowance, at great expense?

You may wish to ask for a note on some of these points at your meeting tomorrow.

David Willetts

<u>DAVID WILLETTS</u>

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10 DOWNING STREET

From the Private Secretary 20 November 1985

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TAXPAYERS' CHARTER

The Prime Minister and Chancellor today discussed briefly the proposal which had been made by the Policy Unit for a taxpayers' charter. It was agreed that this should be considered separately from the further work on implementation of the Keith Report.

(David Norgrove)

Tony Kuczys, Esq.,
HM Treasury.

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cc BG

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

David Norgrove Esq
10, Downing Street
LONDON
SW1

4 November 1985

pa

Dear David

TAXATION AND CHARITABLE DONATIONS

We spoke on the telephone about Andrew Turnbull's letter of 11 July to Rachal Lomax.

The Chancellor would of course be glad to discuss the tax treatment of charitable donations with the Prime Minister. As you will have seen, the Home Secretary wrote to him recently asking him to consider for the Budget various proposals in a detailed paper by Adam Ridley. The Chancellor would like to have time to consider these carefully before his discussion with the Prime Minister, and we shall then be in touch with you again.

Yours ever,

Tony

A W KUCZYS

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For
Bahamas.

10 DOWNING STREET

Prime Minister

The Treasury say you agreed with the Chancellor on Sunday that you would read this again while you are travelling.

DBW
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PERSONAL AND CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

30 September 1985

GREEN PAPER ON PERSONAL TAXATION

The Prime Minister has seen the Chancellor's minute to her of 27 September, and the draft Green Paper on Personal Taxation.

In view of the importance and the cost of the Chancellor's proposals she has said the Green Paper must be discussed in a Cabinet E Committee and in Cabinet itself. The Prime Minister would not want to press the proposals at a time when the Treasury is seeking economies from colleagues. She would in any case not be willing to agree the Green Paper in its present form.

You told me the Chancellor would probably wish to discuss this further with the Prime Minister at their next Bilateral.

(DAVID NORGROVE)

Mrs. Rachel Lomax,
H.M. Treasury.

LW

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PRIME MINISTER

27 September 1985

GREEN PAPER ON PERSONAL TAXATION

This is an extremely important document because:

- It aims to set out a possible tax strategy on which to fight the next Election.

- The Chancellor's approach to tax cuts in his next two Budgets will be influenced by his long-term objectives for 1990.

- Of course this Government must cut taxes, but any commitment must be credible. How will the Chancellor find the £5 billion his reforms will cost?

This Green Paper also needs to be set beside the rates and benefits reforms. For all these reasons, you will want to discuss it fully with the Chancellor, and maybe also with colleagues such as Mr Tebbit and Mr Fowler. I wonder if your diary would permit a Tax Policy Seminar at Chequers one weekend?

Two-earner couples

There are 5.3 million two-earner couples, many of whom no doubt vote Conservative. The Chancellor's message is that

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they will not enjoy any of the benefits of over £5 billion of tax cuts in the Conservatives' third term. This doesn't look like good politics, though the Chancellor would reply that:

- The Why Work? problem is concentrated on single-earner families. Getting these people out of tax encourages them to get work.

- Most of us are one-earner and two-earner couples at different stages of our adult lives. It is rather perverse for the tax system to act as a sort of negative Child Benefit - you get more generous reliefs when your children have grown up and you are both working than when the mother is at home looking after the children, and only the husband is earning.

Women

There is widespread discontent amongst working women that their tax affairs in general, and their investment income in particular, are tied in with their husbands. Full and genuine separate assessment, including investment income, will be widely welcomed by them. The question is whether this more than offsets the political cost of improving the relative tax treatment of non-working women.

Alternative approaches

The Chancellor's Green Paper has turned out White. He eloquently argues for fully transferrable allowances. But the Green Paper does not consider any other options. At least two other courses should be given a fair run for their money.

First, **cutting the basic tax rate**. For £5 billion, you could bring the basic tax rate down to 25p. The political attractions are obvious. In addition, there would be a very powerful effect on incentives, as everybody's marginal tax rate would fall. Raising allowances does nothing for most people's marginal tax rate, yet it is what matters for incentives.

The second option, which I floated during the Benefit Reviews, would be to **reintroduce a tax allowance for children**. The Conservative Party is supposed to be the Party of the family; and yet the previous Labour Government changed the tax and benefit system so that the only way of helping families is to increase public expenditure on Child Benefit. The option of helping them by easing the tax burden - the Conservative approach - has been taken away. The Treasury don't like a child or family tax allowance, because they see them as complicated and expensive to administer. But helping families through the tax system would be politically attractive. Moreover, if tax computers can speak unto benefit computers, it might be possible to use the existing information held on Child Benefit computers.

Tax strategy over the next 2 years

The Chancellor's long-term objectives also have important implications for his next Budget. It is time for a new look at the conventional policy of putting all our money into increasing tax allowances. Reducing the tax rate for everybody may be politically more attractive and have a better effect on incentives. Moreover, the less that we increase tax allowances between now and 1990, the lower would be the eventual cost of introducing fully transferable allowances with no losers.

Conclusion

You cannot be expected to accept or reject the Green Paper at this stage. It needs proper consideration. Meanwhile, we recommend that you ask the Chancellor about alternative options which might also be included in the Green Paper.

David Willetts

DAVID WILLETTS

PRIME MINISTER

GREEN PAPER ON PERSONAL TAXATION

From this immense document I suggest you read Chapters 2 and 3, and glance through Chapters 4 and 5. Chapter 3 sets out the case for transferable allowances, and Chapters 4 and 5 discuss the proposals for other allowances, and other taxes (for example, capital taxes).

This is a very important piece of work, proposing the expenditure of £5.3 billion on transferable allowances. The changes in other allowances and taxes, though less important by comparison, are themselves also very important. The abolition of age allowance, the application of mortgage relief to the residence rather than to the individual taxpayer and separate charging for capital gains tax on husband and wife are all examples which themselves merit careful thought.

Nigel Wicks' minute discusses handling. This will be relevant to your bilateral with the Chancellor on Wednesday.

The Chancellor's proposals are immensely expensive. He is in a sense putting his bid on the table for years beyond the Public Expenditure Survey, before the spending Departments mop up the money with their bids. One has to sympathise with that.

But will his bid look credible? Commentators and the Opposition will point to the Government's failure so far to control public expenditure. They may accuse the Government of irresponsibility.

You will want to assure yourself that they would be wrong to do so. This cannot be done with certainty. But in the 1990s we may well face falling North Sea oil revenue. And we shall face falling Corporation Tax revenues as the value of capital allowances builds up again. But (by assumption) the Corporation Tax rate remains at 35 per cent. (The Chancellor's reforms in the 1984 Budget changed the timing of all capital allowances. But they did not change the total amount that would be given over the life of an asset. So the cost of the allowances will build up to what it was before.)

DRN

DAVID NORGROVE

27 September 1985

L03ALT

PRIME MINISTER

GREEN PAPER ON PERSONAL TAXATION

It is most unfair of the Chancellor to plonk on you, under cover of a one-page minute, this massive document, which has enormous political and macro-economic implications, and expect a quick reply.

The minutes of David Norgrove (Flag A) and David Willetts (Flag B) deal with the substance. This minute suggests the way forward on handling.

The Chancellor's tactic is clear. He wants your general endorsement of the draft so that he can then tackle Mr Fowler, who has some considerable interest on the poverty and unemployment trap aspects. Above all, the Chancellor wants to avoid discussion of the Green Paper in Cabinet Committee, reflecting the traditional Treasury (and to some extent justified) obsession of "putting tax matters into commission".

How then to proceed? I suggest that:

- you convey to the Chancellor your first reactions on the draft, but make it clear that you have not had, and will not have before CHOGM, time to consider it fully. You cannot therefore be committed as to substance;

- the politics of the Chancellor's approach are clearly very sensitive. He therefore should show the draft, on a bilateral basis, to say, Lord Whitelaw, Mr Tebbit and Mr Brittan, (in his capacity as a former Treasury minister) so that they (ie. not filtered through the Treasury) can let you have their advice on politics and presentation. At the same time he can pursue his discussions with Mr Fowler. All this should be done in time for further reports to you after CHOGM.

There can be no question of treating this Green Paper in such a cursory fashion. It must go first to a Cabinet committee (E) and then to Cabinet. The Chancellor cannot agree to present £5.3 billion of tax relief without wide consultation. I feel sure that Treasury colleagues will have a great deal to say & to object to in this paper. I could not agree it in its present form. Moreover I should not attempt to present at a time when the Treasury is seeking economies from colleagues

The Chancellor won't like this. But you should point out that the alternative is for the Green Paper to be considered in Cabinet Committee. He will like that even less.

Of course, if you are fundamentally opposed to the Green Paper's approach of transferable allowances between husband and wife (or more accurately between wife and husband) you should say so now so that the Chancellor can go back to his drawing board.

N.L.W.

N L WICKS

27 September 1985

SL3AMA

RR7.30

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

PRIME MINISTER

In following piece - PREM 19/1709
J. Gray 4/11/14

- in folder attached to file.

... I enclose a draft of the promised Green Paper on Personal Taxation. This is still rough at some of the edges (and I would like to think further about the charts), but it is virtually complete, save for a Foreword that I will write later.

As you will recall, I announced that we would be issuing the Green Paper later this year in my Budget speech in March. (I ... attach the relevant extract.) The announcement attracted a great deal of interest, which continues to persist, and most of the comments so far have been very favourable; at least so far as transferable allowances are concerned. There may be some disappointment that we do not propose to go further, and integrate either the tax and benefit systems or the tax and national insurance systems; but the Green Paper explains very clearly why we are not persuaded.

Thanks before its content was known

When you have read this draft, you will obviously wish to discuss it with me. I would then like to consult Norman Fowler on a bilateral basis. I very much hope it will be possible to publish this Autumn.

NL.

N.L.

27 September 1985

Reference..

EXTRACT FROM HANSARD, TUESDAY 19 MARCH, VOL 75, COL 794-795

TAX REFORM

Mr. Lawson: I now turn to taxation.

This Budget carries forward the theme of tax reform I set out last year. Reform designed to make life a little simpler for the taxpayer. And above all reform designed to improve our economic performance over the longer term, on which the jobs of the future will depend.

In my Budget last year I announced a radical reform of the corporation tax system. This had been preceded by the Green Paper on corporation tax issued by my predecessor in 1982.

I am satisfied that the right way to proceed with major tax reform is to issue a Green Paper first, as a basis for full and informed discussion, followed by legislation when the results of that discussion have been fully digested.

I therefore propose to issue a Green Paper later this year on the reform of personal income tax.

The computerisation of PAYE makes this the right time to review the system of personal taxation. Most of the work will be complete by the end of 1987 and the full range of facilities will be available by 1989. The Green Paper will therefore discuss a range of options opened up by computerisation, from non-cumulation to closer integration between the tax and benefit systems, and including in particular a reform of the present system of personal allowances.

It is the Government's firm policy to reduce the burden of income tax, but we need to make sure that the reliefs we can afford are concentrated where they will do most good.

The present structure of personal income tax is far from satisfactory. Too many young people start paying tax at too low a level, and too many families find themselves in the poverty and unemployment traps. The system discriminates against the family in which the wife stays at home to look after the children. It denies to the partners in a marriage the independence and privacy in their tax affairs which they have a right to expect.

There is therefore a strong case for changing to a new system of personal allowances more suited to today's economic and social needs. Under this, everyone, man or woman, married or single, would have the same standard allowance; but if either a wife or a husband were unable to make full use of their allowance, the unused portion could be transferred, if they so wished, to their partner.

This reform would produce a more logical and straightforward system. Far more people could be taken out of the poverty and unemployment traps, and indeed taken out of tax altogether, for a given sum of overall tax relief than is possible under the present system. It would end the present discrimination against the family where the wife feels it right to stay at home, which increasingly nowadays means discrimination against the family with young children.

Husbands and wives would each be taxed separately on their own income irrespective of the income of the other. The aggregation for tax purposes of a wife's earned income and investment income with her husband's would end, thus removing what has become an increasing source of resentment among women.

The Green Paper will set out full details of the proposals I have just outlined, as a basis for public discussion. After an appropriate period for consultation, it would be possible to legislate in 1987 and have a system on these lines in place by the end of the decade.

CODE 18-77
HP 4/83

cc BG
cc DW.
(cc B. Chain

REFORM OF PERSONAL TAXATION
NOTE BY THE CHANCELLOR OF THE EXCHEQUER

In my 1985 Budget speech I promised to publish a Green Paper on the reform of personal taxation, and outlined the approach I thought we should adopt (see annex 1). Since then a considerable amount of effort has gone into working out both the presentation and the details of this proposal. The result is incorporated in the attached draft Green Paper, which we are to discuss on 9 January.

The case for reform

2. Since 1979, we have made a lot of progress in reforming the tax system, with the aim of creating a simpler and fairer tax structure as well as one which will encourage enterprise and improve the prospects for growth and employment. But we have not yet tackled the personal tax system, which remains essentially as it emerged, forty years ago, after the war. I am convinced that the reform of personal income tax should be a major priority for the next Parliament. The computerisation of PAYE, now well under way, will provide an important opportunity for imaginative reform. And if we are to seize this opportunity, we must plan for it now. why?

3. I have benefited from the work done by Geoffrey Howe during his period as Chancellor. His Green Paper (The Taxation of Husband and Wife, Cmnd 8093) published in 1980, canvassed a number of options for the reform of personal allowances. Virtually everyone who responded to Geoffrey Howe's Green Paper - including the Conservative Women's National Committee, professional organisations such as the Law Society and the Chartered Accountants, as well as social and political commentators of all persuasions - agreed that the present system needs changing.

4. The response identified two main options: replacing the present married man's allowance by an increased level of cash benefits for those with children and other dependants, and a system of independent taxation with transferable allowances. Like my predecessor, I am convinced that the first approach, supported by

the Labour party and the SDP as well as the Child Poverty Action Group, would be quite wrong, economically and politically. It would mean a further large increase in social security benefits; and it would do nothing to raise tax thresholds, rightly identified as a priority by many of our own supporters. The alternative, independent taxation with transferable allowances, was supported by the WNAC and by the professional organisations. It would provide a system of personal allowances which would both recognise the independence of women, and the special status of marriage, bringing us much closer to best practice in other European and North American countries. It is an approach that is consistent with the importance which we as a party give to the family; as well as one that fits well with the philosophy of giving voters more freedom to spend their own money as they wish, and reducing, as far as prudently possible, the burden of taxation - especially on incomes.

Transferable Allowances

5. The case for adopting a system of transferable allowance is set out in detail in Chapter 3 of the Green Paper. I attach particular importance to the following points:-

(i) Since 1979 we have devoted considerable resources to raising tax thresholds, while leaving the existing structure intact. A move to transferable allowances would target future increases in tax thresholds where they will do most good. It would particularly benefit those groups who are most severely affected by the poverty and unemployment traps - married couples where the wife is either not earning at all, or earns very little (typically because she works part-time). And, by combining it with a step increase in the single person's allowance, it would take many young people out of tax altogether, thereby helping to reduce the problem of youth unemployment.

(ii) A system of transferable allowances would be better attuned to the needs of couples over their working lives. Most women nowadays take paid work for a good part of their working lives. But the present tax system is hardest on married couples at just that time when they have the responsibility of a young family and the wife is least able to take paid work. Transferable allowances would meet this problem, by giving everyone a tax allowance in their own right; and allowing them to transfer the balance to their spouse where they had insufficient income of their own to use it up.

(iii) My proposals would completely remove the many tax penalties on marriage, all of which spring from the anachronistic - and widely resented - rule that for tax purposes a married woman's income is treated as her husband's. They imply the independent taxation of investment as well as earned income.

6. Annex 2 of this note summarises the implications of my proposals for the different groups of taxpayers, highlighting in particular the effect on married couples at different points in their lives. Further detail is given in the annexes to the Green Paper itself.

7. I would also draw colleagues' attention to part II of the Green Paper which outlines the ways in which the proposed reform would allow us to simplify the host of minor personal allowances, including the highly complicated system of age allowance.

This question needs to be tested.

8. The move to transferable allowances will fit well with the major reform of social security outlined in Norman Fowler's White Paper - although some drafting changes will be required to bring the draft Green Paper fully into line both with the White Paper and, later, with whatever changes are made in the 1986 Budget.

The tax system in the longer term

9. Section III of the Green Paper discusses, without commitment, a number of other long term changes in the taxation system, such as a move towards self assessment and a non-cumulative system. It also fulfils my promise to examine the longer term relationship between the tax and social security systems - a subject of

considerable public interest. The draft rejects the idea of complete integration which, in my view, would mean a further and undesirable blurring in the distinction between the money people earn themselves, and the money they receive from the state. There is however a strong case for rationalising the two systems for reasons of efficiency and greater simplicity. Norman Fowler's proposed changes already go some of the way. While major progress must await computerisation in both the Inland Revenue and DHSS, we must show ourselves prepared to discuss the case for going further.

10. The remaining chapter in this Section considers the scope for integrating income tax and national insurance contributions. I see little practical merit in moving in this direction; it would destroy the contributory principle and create many losers, especially among the elderly.

Phasing in the new system

11. The Green Paper examines in some detail the practical consequences of moving to a system of transferable allowances. This is discussed both in Chapter 3 of the main text and in the annexes. The Green Paper figuring, which at this stage is purely illustrative, shows the implications of phasing in the reform over 2 years on a no cash losers basis.

Coil-?

12. I should stress that the Green Paper represents no new commitment to reduce taxation: it merely shows how part of the tax reduction programme outlined in the 1984 Green Paper ("The Next Ten Years: Public Expenditure and Taxation into the 1990s" - Cmnd 9189) might be put to best use. We have made it very clear that our policy is to reduce the overall burden of taxation in general, and of income tax in particular, as and when we have the scope prudently to do so. But colleagues will need no reminding that my proposals are contingent on there being scope for tax reductions.

13. It is difficult to estimate precisely what the tax reductions implicit in the Green Paper, on a no cash losers basis, would amount to. On the assumptions given in the Green Paper the figure comes out at £5.3 billion (or nearly £2¾ billion a year). This is

sensitive to a number of factors, in particular the level of inflation in the early 1990s (since "no cash losers" implies that the cost of statutory indexation would be appropriated towards the cost of the reform). Also important will be the level of the basic rate of tax by then. The following table indicates the sensitivity of the calculations to these assumptions.

Real loss of Revenue over a 2-year period

£ billions; total

		Basic Rate		
		25%	27%	30%
	0	4¾	5	5¼
Inflation	2½	3¾	4	4¼
(%p.a.)	5	2¾	3	3¼

14. As the table makes clear, the figure quoted in the Green Paper implicitly assumes zero inflation and a basic rate of 30 per cent. Other assumptions would result in a lower global figure.

15. Moving to transferable allowances will not necessarily imply a net reduction in the overall tax burden of the same magnitude; it would be in line with the policy we have consistently pursued since 1979 to finance income tax reductions in part by raising indirect taxation. Thus, despite the difficulties we have had in recent years, we have been able in the last three Budgets to reduce income tax by raising thresholds by £6½ billion, implying a real loss of revenue (ie. in excess of statutory indexation) of almost £3½ billion.

16. Of course the draft Green Paper represents no commitment to reduce even income tax by any particular amount by a particular date; implementation of these proposals would have to depend on overall economic constraints in the normal way, and would occur as and when the scope for it occurs. But - subject to these provisos - I see considerable political advantage in giving some indication of the Government's tax strategy for the medium term.

Conclusions

17. I believe that the proposals for personal income tax in this Green Paper will be attractive to a wide range of political opinion, both within and outside the party - and especially to women voters. The response to Geoffrey Howe's Green Paper showed that there is a substantial body of opinion in favour of radical reform of the personal tax system. Informed opinion is aware of the opportunities created by the computerisation of PAYE. Since I outlined my proposals in my Budget speech there has been sustained and favourable interest both in the press and in the party. I also hope that the Green Paper proposals will strengthen support for the reduction in the burden of taxation to which we are committed, by showing how the scope for tax reductions can be most effectively used to encourage enterprise and employment.

N.L.

ANNEX 1

EXTRACT FROM HANSARD, TUESDAY 19 MARCH, Vol 75, Col 794 - 795

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The Green Paper will set out full details of the proposals I have just outlined, as a basis for public discussion. After an appropriate period for consultation, it would be possible to legislate in 1987 and have a system on these lines in place by the end of the decade.

ANNEX 2

IMPLICATION OF PROPOSALS IN TAX GREEN PAPER FOR DIFFERENT GROUPS OF TAXPAYERS

This note summarises the implications of the proposals in the Personal Tax Green Paper for different groups of taxpayers.

2. The note looks at the following groups:

two earner couples;
one earner couples;
single people;
lone parents;
pensioners.

It considers the effect of transferable allowances on these groups, as well as the effect of the Green Paper proposals on disaggregation of investment income and capital gains.

TRANSFERABLE ALLOWANCES

3. Table 1 shows the effect of transferable allowances on various groups.

Two earner/one earner couples

No - these can't be considered together

4. These groups can be considered together because it is common for the same couple to move from being a two earner couple to a one earner couple, and back again. This reflects the growing number of married women in work who cease work on having children, but increasingly return to the labour force after a relatively short period of a few years.

5. In 1984, the latest year for which figures are available, married women represented 27 per cent of the labour force.

6. The proportion of married women in the labour force as a percentage of all married women rose from 38.1 per cent in 1966 to 49.4 per cent in 1983. The proportion of married women of working age in employment is higher, at 62.4 per cent.

7. Over 80 per cent of women leave the labour market shortly before the birth of their first child, but return to paid employment at some point. The average length of time they spend completely out of the labour force is now some 3-4 years. However, most women, when they return to work, take part time jobs and indeed most of them subsequently remain in part time work. The proportion of women working part time is now 46½ per cent, compared with 40 per cent in 1977; and as much as 60 per cent of working married women are part-time. Of these part-timers, roughly 60 per cent earn below the £2,205 tax threshold.

Regional variations

8. Table 2 shows regional variations on the proportion of married women of working age who are either employed or seeking employment. On the whole this shows little significant difference between the various regions of England, but a noticeably lower proportion in Scotland and Wales.

Effect of the proposed system of transferable allowances

9. As noted above, many couples move from being two earner couples to one earner couples with the arrival of children; and return to being two earner couples as the children grow up. Transferable allowances are designed to recognise this typical cycle by removing the additional tax burden currently imposed at a time when many couples face heavily family commitments on sharply reduced gross family incomes.

This will be more helpful selected table than conventional

10. As can be seen from Table 1, two-thirds of the 9.7 million married couples paying tax will be better off under transferable allowances. This is made up of all one earner couples and 40 per cent of two-earner couples. Two earner couples will be better off where the wife earns less than £2,205 pa (almost certainly because she is working part-time); or where the couple have elected for

separate taxation of earned income; or in the case of some higher rate taxpayers, where disaggregation leads to a lower rate of tax.

She will. worsen husband position

11. It can be seen from Table 1 that in no case will a working wife pay more tax as a result of transferable allowances. In fact, in all cases where earnings are above the tax threshold, a working wife as such could pay less tax than under the present system. This is because she will be entitled to an allowance some £635 above the present Wife's Earned Income Allowance. (But her husband will of course pay correspondingly more tax).

12. Because transferable allowances will improve the family's financial position either where the wife does not work at all, or where she earns very little, the relative financial advantage to the family of a married women taking a job will be less than it is now (because the couple's extra earnings would effectively be taxed at 30 per cent from the first pound). Although this would be a disincentive to some married women to go out to work it needs to be kept in perspective: for any wife contemplating earning above £2,205 a year the maginal rate of tax will normally be the same with transferable allowances as it is under the present system.

13. There are, moreover, many factors other than the present tax treatment which lead women to work outside the home and these are likely to remain important. Social attitudes are in practice crucial, and these have changed dramatically since the 1940s. This is suggested by experience in those countries (see Table 3) which have systems similar to transferable allowances - such as Scandinavia and Canada, where married women's propensity to take paid work has increased as fast as or even faster than in the UK, and where it is currently at an even higher level.

why?

14. All single people paying tax will be better off under transferable allowances. About one-third of single people are under 25. Lower tax bills for this group (some will be taken out of tax altogether) should improve their employment prospects.

Lone parents

15. Lone parents will have their tax allowance reduced under transferable allowances, but the difference will be made up by increased one-parent benefit of equal value. Overall their position will be unchanged.

Taxpaying pensioners

16. Single pensioners (the largest group) will all be better off under transferable allowances. why?

17. Couples where the wife does not work or have her own pension will all be better off.

18. Couples where the wife works or has her own pension will either be better off, or in the same position, depending on the size of the wife's earnings. why?

DISAGGREGATION OF INVESTMENT INCOME

19. At present the wife's unearned income is added to the income of her husband and taxed at his marginal rate. It is proposed that following the introduction of transferable allowances, a wife's earned income should be taxed at her marginal rate. Couples will benefit where the husband's marginal rate of tax is higher than that of his wife (see Table 1).

SEPARATE TREATMENT OF CAPITAL GAINS TAX

20. Under the present arrangements, the gains and losses of each spouse are aggregated, and the couple are entitled only to one annual amount of tax free capital gains (currently £5,900). The Green Paper proposes that after the introduction of transferable allowances, each spouse should be entitled to an annual exempt amount, the unused part of which would be transferable to the other spouse. The provisions which allow the losses of one spouse to be set against the gains of another would be withdrawn.

EFFECT OF TRANSFERABLE ALLOWANCES

TABLE 1

Category	No of taxpayers in category	Present Position	Position under Transferable allowance	Better off/ Worse off
(a) Two earner couples				
1. Wife earning less than £2,205 pa.	1.8 million	Wife pays no tax, but couple cannot benefit from any unused portion of total allowances of £5,660 to which they are entitled.	Wife need pay no tax. Couple get benefit of £5,660 of allowances between them.	Couple better off. Wife's position the same.
2. Wife earning more than £2,205 pa.	3.1 million	Wife makes full use of £2,205 allowance to which she is entitled	Wife entitled to higher allowance (£2,830), but husband's allowance reduced as a result.	Position of couple unchanged. Wife better off. Husband worse off.
3. Higher rate taxpayers * where couple have elected for separate taxation of earned income.	0.2 million	Wife and husband each have allowance of £2,205 pa.	Wife and husband each have allowance of £2,830 pa.	Both husband and wife better off off.
4. Higher rate tax payers * where couple have not elected for separate taxation.	0.2 million	Wife has allowance of £2,205, husband has allowance of £3,455	Wife and husband each entitled to allowance of £2,830.	Position of couple either unchanged or improved, if disaggregation leads to lower rate of tax. In either case, wife better off. ? Husband may be worse off.

* These couples include some where the wife has unearned income taxed at her husband's marginal rate. In such cases the couple will be better off if the wife's marginal rate is lower than her husband's since the investment income will be taxed separately.

TABLE 1

Category	No of taxpayers in category	Present Position	Position under Transferable allowance	Better off/ Worse off
(b) **One earner couples** *	4.4 million	Couple have only married man's allowance £3,455	Couple get benefit of £5,660 allowances between them.	Couple better off.
(c) **Single people**	7.4 million	Have single person's allowance of £2,205	Gain allowance of £2,830	Better off.
(d) **Lone parents**	0.4 million	Receive single allowance plus additional personal allowance so effectively have married man's allowance of £3,455	Lose additional personal allowance but replaced by increased one parent benefit of equal value. Tax allowance falls to £2,830.	Position unchanged.
(e) **Pensioners** **				
1. Single	1.2 million	Have age allowance of £2,690 which tapers out when income over £8,800 falls to single allowance at income of £9,527.	Age allowance abolished but replaced by higher allowance of £2,830	Better off
2. Couples where only one partner has income	0.8 million	Man has age allowance of £4,255 which tapers out when income over £8,800 - falls to £3,455 when income £9,990 or over.	Each partner has own allowance of£2,830 - combined £5,660	Better off.
3. Couple where wife's earned income below £1,405	0.2 million	Have age allowance of £4,255 which tapers out when income over £8,800 - falls to married man's allowance at income of £9,999. Also have wife's earned income allowance against all of wife's earned income giving total allowances of £5,660	Each partner has single allowance so combined allowance £5,660.	Better off or unchanged depending on wife's earned income.
4. Couples where wife's earned income above £1,405	0.3 million	Have age allowance of up to £4,255 plus wife's earned income allowance of £2,205 giving maximum of £6,460.	Allowances protected to ensure no losses.	Better off or unchanged.

** Only 40% of pensioners pay tax.

PROPORTION OF MARRIED WOMEN OF WORKING AGE EMPLOYED OR SEEKING WORK - GREAT BRITAIN 1984

	%
Great Britain	62.4
North	61.8
Yorks and Humberside	62.8
East Midlands	64.0
East Anglia	60.0
South East	64.1
South West	61.5
West Midlands	61.1
North West	64.7
Wales	58.0
Scotland	57.6

TABLE 3

Denmark

1. Basic system: Fully transferable allowances for earned income; aggregation of investment income with the income of the spouse with the highest earned income.

2. Trends:

	Married women's participation rate*(%)	All women's participation rate**(
1965	31.8	49.3
1970	49.0	58.0
1975	56.4	63.5
1979	60.9	69.9
1983	66.6	74.2

Sweden

1. Basic system: A married person whose spouse has little or no income is entitled to a tax credit which reduces as the spouse's income increases.

2. Trends:

	Married women's participation rate*(%)	All women's participation rate**
1965	42.8	54.1
1970	50:5	59.4
1975	57.6	67.6
1979	63.1	72.8
1983	66.9	76.6

Canada

1. Basic system: A married person supporting a spouse is entitled to a further allowance over and above that available to single taxpayers. This further allowance is reduced $ for $ if the spouse's income exceeds a set level.

---

* Married women in the labour force as a percentage of all married women.

** All women in the labour force as a percentage of all women of working age. (Exact comparisons not available.)

2. Trends:

	Married women's participation rate*(%)	All women's participation rate**(
1966	not available	39.7
1970	not available	43.2
1975	40.9	50.0
1979	45.7	55.5
1983	50.5	60.1

United Kingdom comparison

Trends:

	Married women's participation rate*(%)	All women's participation rate**(
1966	38.1	52.9
1971	42.3	54.8
1981	47.2	60.7
1983	49.4	63.3

FROM: A J WALKER

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

15 JULY 1985

Mr Savage
(Parliamentary Section)

SDP "GREEN PAPERS" Taxation

You asked for briefing to pass to the Prime Minister's office on the SDP "Green Paper" on tax reform. The DHSS will brief the Prime Minister's office separately on the "Green Paper" on benefit reform.

Today's "Guardian" and "Times" give some details of the SDP proposals. Press Releases were apparently issued over the weekend, but the SDP office have told us that the "Green Papers" themselves are not due to be published until the end of the week. We are trying to obtain advance copies, and will provide further or revised briefing as necessary.

General line to take

The Chancellor of the Exchequer in his Budget announced the Government's own forthcoming proposals on personal taxation to be published later in the year in a Green Paper. Do not want to pre-empt that.

---

cc PS/Chancellor
PS/Financial Secretary
Ms Holmans
Mr Halligan
Mr Cropper
Mr Culpin
Mr Isaac
Mr Battishill
Mr Painter
Mr Blythe
Mr Houghton
Mr Mace
Mr Morgan
Mr Martin
Mr Symons
Mr Walker
Press Office
PS/IR

As for the proposal for an "exemption of savings" tax (ie an expenditure tax as proposed in 1978 by Professor James Meade), the Government has considered that carefully on previous occasions, and, as we have made clear, concluded that it would be impractical.

Individual proposals

i. Income tax should become an "exemption of savings" tax: ie an expenditure tax of the type proposed by Professor James Meade in a 1978 report for the Institute of Fiscal Studies. Savings and investments would be free of tax, but the realisation of savings or investments would be taxed as income.

   Line to take:

   Government is constantly pressed for stability in the tax system. We are prepared to consider the case for sensible reform (eg transferable personal tax allowances). But introducing an expenditure tax would mean major cost, upheaval and uncertainty - for taxpayers, employers, their advisers and the Government. Our priority is to reduce the burden of income tax, and to improve its structure where this is necessary.

ii. Income tax and National Insurance Contributions should be integrated. The tax threshold would be reduced, and the NIC threshold increased.

   Line to take

   i. The Green Paper on Personal Taxation will examine integrating income tax and employee NICs, and other options stopping short of full integration but which will bring the two closer together.

ii. Any new system should preserve, in some form, the "contributory principle" for existing national insurance benefits.

iii. <u>Abolition of married man's allowance</u>

<u>Line to take</u>

The Government's proposals on personal taxation are to be published in a Green Paper later in the year. The SDP proposals would -

i. reduce tax thresholds for <u>all</u> married couples and bring many couples into the tax net;

ii. mean that the tax system would no longer take acccount of marriage nor recognise that often one partner is dependent on the other.

By contrast, the Government's proposals would substantially increase tax threshold for married couples where only one partner is in paid employment.

iv. <u>Perks, especially company cars, should be taxed at their full value</u>.

<u>Line to take</u>

Government policy is that employees should pay same tax, whether paid in cash or in kind. Although many believe company cars are still not taxed at full cost, policy of gradual but worthwhile progress better than one involving precipitate action.

v. <u>Capital Transfer Tax should be converted into an inheritance tax</u>.

Line to take

There are attractions in donee-based taxation. But a move to donee-based taxation would be very disruptive for donors, testators and their advisers. Even with penal tax rates, it would not stop many people leaving their money to their family, rather than spreading it more widely. And, for given tax rates, a donee-based tax would mean a lower yield and more bureaucracy.

... I attach annexes which give more details on each point.

J

A J WALKER

PS apologies for lateness. We were waiting for a contribution from DHSS which never, in the event, arrived.

PROPOSAL FOR AN EXPENDITURE TAX

Line to take

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Background

The Institute of Fiscal Studies set up a committee chaired by Professor James Meade to examine the structure and reform of direct taxation. This reported in 1978 and recommended the introduction of an expenditure tax.

Chancellor of the Exchequer said in 1984 Budget Speech:

> "Some commentators have suggested that our entire income-based tax system should be replaced with an expenditure-based system. Even if a root-and-branch change of this kind were desirable, it would, I believe, be wholly impractical and unrealistic. But I do not believe we can afford to opt for the quiet life and do nothing. So I have chosen the middle way: to introduce reforms, some of them far-reaching, within the framework of our existing income-based system. I shall also be proposing transitional arrangements where I believe it fair and appropriate to do so."

Would an expenditure tax help small business and enterprise? No. Perfectly possible to give encouragement to enterprise and business within scope of present income tax system. Government has introduced a whole raft of measures to do this - eg highly successful Business Expansion Scheme - and is following this up with a concerted drive to lift the burden of unnnecessary regulation from businesses.

INTEGRATION OF INCOME TAX AND NATIONAL INSURANCE CONTRIBUTIONS

Line to Take

(i) The Green Paper will include a chapter examining the consequences of integrating income tax and employee NICs. It will also consider options stopping short of full integration but which will bring the two closer together.

(ii) Any new system should preserve, in some form, the "contributory principle" for existing national insurance benefits.

Background

The SDP propose fusing income tax and employee NICS into one charge at a basic rate of 39% levied on all income. (NICS are only charged on earnings between the lower and upper earnings limits - £35.50p to £265 per week). The result would be a higher tax burden on income other than earnings and on earnings between the end of the UEL and the start of the 40% tax band. The SDP suggest keeping the 30% rate for pensioners. Integration will be considered in the Green Paper and the response can rest on this and the importance of maintaining the contributory principle, whatever system is adopted. The advantages of fusion are simplicity, reduced administrative cost for the Government, and reduced employer compliance costs. The disadvantages are the increased burden on income other than from earnings and on some earnings, and ending NICS as a separate charge means finding a new qualifying test for existing national insurance benefits.

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SDP TAX PROPOSALS: ABOLITION OF MARRIED MAN'S ALLOWANCE

Background

1. SDP have proposed abolition of married man's tax allowance (£3,455 for 1985-86 compared with single allowance of £2,205). Husband and wife would each be given their own non-transferable single allowance. Revenue saved from abolition of married man's allowance (about £4 billion at 1985-86 income levels) would be used to provide new income support benefits to the low paid and to increase child benefit.

2. Government's proposals for a system of fully transferable allowances for husband and wife to replace present married man's allowance will be set out in a Green Paper to be published later in the year. In contrast to SDP proposals, fully transferable allowances would lead to substantial increase in the tax threshold for married couples where only one partner is in paid employment. This is much the largest group affected by the problems of the poverty and unemployment traps.

Points to make

(i) SDP proposals would mean a large reduction in the tax threshold for all married couples (not just those where wife is in paid employment). As a result, several hundred thousand married couples would be brought into tax. All couples could find themselves paying up to £7.21 per week more in tax through the loss of the married man's allowance.

(ii) SDP proposals would mean that tax system would no longer take account of marriage nor reflect the very wide variety of reasons (including disability and caring for children or elderly relatives) why one partner in a marriage may be dependent on the other. It is not sensible or practicable to seek to provide for all these different circumstances through the social security system.

(iii) By contrast, Government's proposals for a system of fully transferable allowances would lead to a substantial increase in the tax threshold for couples where only one partner is in paid employment. This is the largest group affected by the problems of poverty and unemployment traps. And the new system would continue to recognise that, at different times and for different reasons, one partner may be dependent on the other.

'Company cars and other perks would be taxed at their full value'

Line to take

Government policy is that employees should pay same tax, whether remunerated in cash or in kind. Although many believe company cars are still not taxed at full cost, policy of gradual but worthwhile progress better than one involving precipitate action.

Points to make

Government's record excellent. Since 1979, car scales increased by over 100% (50% in real terms). Proposal to increase figures again from April 1986 by 10% - above rate of inflation.

Measuring benefits by value is difficult concept. Worth of facility to one person may be very different from worth to another.

Cost incurred by the provider has been the measure used in the tax system for many years. This represents extra payment provider could otherwise make in cash. In general, easy to establish.

Background

General principle that benefits in kind (perks) taxed on the higher-paid (those earning over £8,500, including expenses and benefits) and company directors on basis of cost to provider. This principle goes back to inception of taxation of benefits in kind in 1948.

In the case of provided cars, difficulties in establishing private and business mileage led to introduction of scale charge covering:

(i) availability of car for private use (April 1977 by the then Labour Government);

(ii) free fuel (April 1983).

Typically the car and car fuel charges for 1985/86 for a 1600cc car are:

		Tax at 30% Annual	Tax at 30% Monthly
Car scale charge	525	157.50	13.12
Car fuel scale charge	525	157.50	13.12
Total:	£1,050	£315.00	£26.24

where business mileages are between 2,500 and 18,000 a year.

SDP GREEN PAPER

Convert capital transfer tax into an inheritance tax.

Line to Take

There are attractions in donee-based taxation. But a move to donee-based taxation would be very disruptive for donors, testators and their advisers. Even with penal tax rates, it would not stop many people leaving their money to their family, rather than spreading it more widely. And, for given tax rates, a donee-based tax would mean a lower yield and more bureaucracy.

Background

The SDP proposal seemingly follows Liberal proposals discussed in recent Finance Bills. These would replace the present donor-based capital transfer tax with a tax cumulating gifts and inheritances received by each recipient in the whole of his or her lifetime. The aim would be to encourage donors to spread their wealth amongst many recipients.

If such a tax successfully encouraged redistribution, there would be more recipients, each with exemptions and a tax threshold, than there are donors. So there would be more record-keeping, unless exemptions were increased, and a lower yield, unless exemptions were cut and tax rates increased. In practice, most people could be expected to leave money to their families irrespective of the tax consequences.

Guardian 15 viii 84

Benefits changes would shift resources from rich to poor

SDP proposes tax-free savings to aid business

By John Carvel
Political Correspondent

The SDP yesterday published proposals to reform the taxation and benefits systems to shift resources from rich to poor and encourage savings, investment and the growth of small businesses.

A green paper on taxation, to be debated at the party's annual conference in Torquay, suggests that income tax should be transformed into an "exemption of savings tax". All savings and investments would be exempt from tax, but the sale or realisation of savings and investments would be taxable as income.

The idea, based on the idea of an expenditure tax proposed by the Meade Report, would allow for the eventual abolition of capital gains tax.

Investments in shares, savings schemes and small businesses would be tax deductible, just as mortgage interest and pensions schemes are now. But when these savings were drawn down and when houses, shares or other assets were sold, the proceeds would be regarded as income and would be taxed as earnings.

"Our reform will be a charter for enterprise," says the green paper, drawn up by an SDP working party chaired by Mr Dick Taverne, the former Lincoln MP who defected from Labour and is a founder of the Institute of Fiscal Studies.

"Most people will no doubt continue to make saving for a house and for a pension their top priorities. But that will be because these are good things to save for, not because of the tax advantages they attract." It was reasonable to expect that some savings now invested in houses or pensions would be put into more accessible forms, or into small businesses.

Other changes include the abolition of national insurance contributions, to be replaced by an integrated income tax with a standard rate of 39 per cent (equivalent to the combined current rates of income tax and national insurance). The tax threshold will be lower than the present income tax threshold but substantially higher than the present national insurance threshold, which the SDP regards as a big advantage for the lower paid.

Men and women would be taxed separately and the married man's allowance would be phased out. Company cars and other perks would be taxed at their full value. Capital Transfer Tax would be turned into a more effective tax on the transfer and inheritance of capital.

The tax proposals are accompanied by a separate paper on social security reform, which the SDP claims would abolish the poverty and unemployment traps. Supplementary benefit, housing benefit, free school meals and Family Income Supplement would be replaced by a new Basic Benefit, payable through an integrated tax/benefit system.

The new benefit would redistribute income in favour of the poorest people, and would be funded principally through the phasing out of the married man's additional tax allowance. There would also be an immediate 24 per cent real terms increase in child benefit, bringing the weekly value to £8.50.

The SDP accepts that there is a problem about the eventual cost of the State Earnings Related Pension Scheme. It proposes a compromise, to increase basic pensions by 25 per cent at a cost of £4.5 billion, with £3.5 billion extra revenue coming from the abolition of contracting out of the state scheme and the remaining £1 billion from savings on means-tested benefits.

Fairness and Enterprise: tax reform proposals. Policy on Social Security Reform. Both published by SDP, 4 Cowley Street, London SW1.

Communists expel Gill in Star purge

AMAZING FACES: Paul McCartney (left) at Wembley a[...] his performance. Joan Baez opens the American end of th[...]

Meacher plans Labo[...] with £3 billion boos[...]

By David Hencke,
Social Services Correspondent

A Labour government would freeze health spending in London and the South-east while injecting extra money into the relatively deprived health services in the North and West, Mr Michael Meacher, the health spokesman, said yesterday.

Mr Meacher was commenting on an unpublished report prepared by Department of Health officials for Mr Norman Fowler, the Social Services Secretary.

The report shows that widespread inequality...

Irish ... said: "I think it is evidence of a change of attitude and policy generally by comparison with what we have seen many times in the past."

He added: "The decisions taken by the Secretary of State based on police advice and the

in Portadown, at least 19 civilians were injured, and 37 arrested as police with riot equipment made baton charges into the scores of baying loyalist youths.

At least one policeman was seriously injured as the mob smashed plate glass windows

Battle of the Boyne 295 years ago.

The police yesterday reopened all entrances to Obins Street, where the Catholic population had been under siege for two days. Hundreds of troops were withdrawn and only a small police presence

has done it.

"What Douglas Hurd and the Chief Constable have done at the insistence of the Prime Minister means the police in Portadown are now going to find themselves the enemies of both loyalists and republicans."

SDP would lift tax burden on savings

TIMES 15vii85

By Philip Webster, Political Reporter

The Social Democratic Party yesterday proposed a radical restructuring of the income tax system under which all savings and investments would be free from tax but their sale or realization would be taxable as income.

The proposals, aimed at correcting the discrimination in the tax system against earners and taxing the owners of wealth more heavily, was in a package of reforms to the tax and benefit systems which also included the abolition of the present national insurance system, and the taxation of company perks, especially cars, at their full value.

The SDP's long-term new deal for savings would ultimately abolish the distinction between income and capital and make capital gains tax redundant.

Under a new "exemption of savings tax" small savers who invest in building societies, shares and their own businesses, would be treated in the same way as people who invest in pensions or the business expansion scheme who now get preferential treatment.

Spending from the sale of capital will be taxed as part of income, meaning that owners will no longer be treated more favourably than earners.

In its Green Paper *Fairness and enterprise: tax reform proposals* the SDP says that the present tax system is defective in the narrow and far from coherent definition of what is taxable income, and that exemptions have greatly eroded the tax base.

Tax rates would start at 39 per cent, the combined rate of income tax and insurance contributions. Men and women would be taxed separately.

It adds that the State Earnings-Related Pension scheme should be modified, to reduce its cost, rather than phased out

Sarah Hogg, page 13

Court deals speed sale of BA

Continued from page 1

he has personally been offered in compensation, his priority still being to re-enter the aviation business.

He said yesterday: "There certainly is no question of me accepting any sum of money at this moment in time to be put out to grass."

Sir Freddie added that he still wants the truth to be told about his claim that airline and aviation companies conspired to drive him out of business.

British Airways indicated that its offer would not be conditional on him staying out of the aviation business. But Sir Freddie would find it difficult to stage a comeback because he would require a licence from the Civil Aviation Authority, and the agreement of travel agents to handle ticket sales.

The Association of British Travel Agents failed to support his attempt to get back in business in partnership with Lonrho after the collapse of Skytrain.

The 2,300 former employees of Laker Airways are viewing settlement proposals to compensate them for the loss of their jobs with suspicion and caution.

Mr Alan Hellary, aged 61, Laker's flight operations manager, and a founder of the Association of Laker Employees, said he will be discussing the matter further with lawyers.

He said: "I wasn't terribly excited by the news. We want compensation, in many cases for loss of career and loss of way of life.

"We are not like the ticket holders who were stranded. We have lost a great deal more."

Asian arrivals at Heathrow 'degraded'

The treatment of Asian visitors arriving at Heathrow Airport was now a "scandal" according to Mr Denis Howell, Labour MP for Birmingham, Small Heath.

He wrote to Mr Leon Brittan, Home Secretary: "You must accept full personal responsibility for the degrading treatment of people who are detained although not interviewed."

Last weekend, Mr Howell said he had to deal with 12 separate cases of visitors being held without questioning for between 9 and 24 hours before his intervention allowed them temporary entry.

He continued: "Almost all had relations in distress outside, and there is no doubt that the system at Heathrow has broken down. That is the view of senior immigration officers, to whom I spoke.

"It is a scandal and is causing intense resentment in the Asian community. Here are British citizens waiting for visitors for hours on end at Terminal three and they rightly say 'we are being degraded'."

Thames denies franchise threat in Dallas dispute

Mr Hugh Dundas, chairman of Thames Television, last night denied that the Independent Broadcasting Authority had ever threatened to withdraw the company's franchise because of the dispute with the BBC over the serialization of *Dallas*.

He also said "large parts of the United Kingdom" might not have seen *Dallas* because other ITV companies boycotted the series after Thames conducted the negotiations for the series by itself.

Dundas's statement came two days after the resignation of Mr Bryan Cowgill, Thames's managing director, who left after a dispute about his purchase of the show's next series.

Mr Dundas said: "The contract to acquire *Dallas* for the whole of the UK was entered into on Thames's behalf without the knowledge or consent of the Thames board."

One of the key aspects of the contract was "the very onerous, open-ended commitment to go on buying the series indefinitely at substantially increased costs year by year, a matter which, in accordance with company practices, should have been subject to board agreement in advance."

The IBA had objected strongly to Thames's action.

private session ... policy and ca... committee of w... is chairman. ... committee has a... reports he was ... final approval ... to the event, ... September 1.

The committe... composed of Lab... only, but for the... last Tuesday, a ... campaign was ... invitation.

Mr Bryan sai... sition councillo... invited because ... interested in anyt...

He said the ... provide an oppo... the council-funde... deal with young ... together and of... anyone who atten...

The proposal w... Mr Toby Eckersle... tive Councillor ... leader of the opp... council.

He is angry th... mittee is deali... organization that ... ordered out of ... Party's headq... Walworth Road, ... and is at present ... an internal party i...

He said: "It is ... ordinary that ... extremists, chased ... Labour Party head... come a mile down ... obtain shelter fr... Labour authority".

'Go-it-alo... over fig...

Mr Denzil Dav... defence spokesman... day that Britain m... would-be partners ... nation European f... that she would "go ... build her own ai... agreement was not ...

He was com... reports that the pro... collapse because the ... West Germans h... deal which exclude...

...may be modified

...s, the members are likely to ...e a warning of the dangers in ... Heseltine's proposals. They ... also expected to criticize the ...rt period of time allowed for ...nsultation on them. ...t would be no surprise if they

fund would be much less than those for a private management scheme.

The unions have criticized the private management option as "reckless experimentation". More specific criticisms ... made

Times 15 vii 85

[illegible] Mr Nigel Lawson's green paper on personal taxation (promised this year) is likely to be the Government's last big gesture towards tax reform.

Believing as he does in the beneficial effects of competition, Mr Lawson should welcome the Social Democrats' (very green) tax plans published today. These make a kind of sweep over the tax terrain, including some exceedingly ambitious ideas for the treatment of savings, but focus in most detail on income tax.

The SDP favours complete fusion of income tax and employees' National Insurance. Mr Lawson seems already to have ruled this out. This reflects his boss's affection for "contributory" social security – even though every recent amendment to the benefits system has eroded this dubious principle further.

There are three real but surmountable objections to fusion. The first is that while the benefits system is no longer contributory, in the real sense of relating what you pay to what you get, eligibility for benefits does depend on a rudimentary National Insurance record. Some other test would have to be devised, otherwise, for example, every single person not actually in work would roll up for unemployment benefit.

The SDP green paper talks vaguely of a "work test", but the problem is a bit more complex than that. It can, however, be managed.

The second difficulty is that it would increase the tax paid by those not in work. Introducing a standard 39 per cent basic tax rate (the combination of present income tax and National Insurance) would place quite a heavy new burden on some not very rich people. The SDP attempts to duck this problem by mistakenly suggesting that pensioners should be exempt from the higher burden.

The precise purpose of fusing the two systems is to reduce the present tax surcharge on earnings. There is no reason why all those with some kind of income should not share the burden of supporting the sick and destitute. It may well make sense to cushion the blow to the retired by raising their tax thresholds, but it does not make sense to exempt them all.

The third difficulty, discussed much more intelligently in the SDP green paper, concerns this new tax threshold. At present, while you pay income tax only on that part of your income which is above the lower limit, one step across the lower limit for National Insurance renders you liable to pay it on all your earnings. This "trigger" system, Mr Lawson believes, is an advantage because it provides a cost-effective way of helping the lowest-paid. Raising the lower limit on National Insurance helps only those below the new limit – the rest pay as much as they did before.

This, however, is his mistake. For the trigger system creates a huge marginal tax rate at the entry point to National Insurance – Mr Lawson's attempts to smooth this out in the last Budget were well-intentioned, but unfortunately created a variety of new pressure points.

However, it remains true that the structure of income tax does not provide a cost-effective way of helping the lower-paid. Significantly, the SDP endorses the Government's present faith in higher income tax thresholds rather than lower income tax rates, which do very little for those just in the tax net. Even so, an increase in thresholds is costly because it helps all taxpayers – in hard cash, it gives most to those on the highest incomes. For example, the single person's allowance was raised in the Budget from £2,005 to £2,205; its value to the standard rate taxpayer went up from £602 to £662. To up from £1,204 to £1,324.

Were National Insurance to be fused with income tax, the combined system would have to use a threshold, not a trigger. This would mean a substantial loss of National Insurance revenue, which in turn would mean a lower joint threshold than today's threshold for income tax. (The SDP, rather optimistically, calculates the threshold would have to drop by 5.5 per cent, roughly £110 a year for a single man). Since it would simultaneously become even more expensive to raise the threshold, fusion might seem to fossilize the tax structure.

Here the SDP has a smart answer, which is to change the nature of tax allowances, so that they provide a fixed reduction not in taxable income but in tax bills. This is equivalent to taxing all income, then cutting the bill by the same sum for everybody in a particular category: for example, in today's figures, a maximum of £662 for all single people.

The SDP has less-founded objections to the Chancellor's proposal to introduce single transferable tax allowances. There is, at least, agreement on the problem. The present system gives a gross advantage to couples who can both go out to work (and receive roughly two-and-a-half single tax allowances) compared with those of whom one stays at home (receiving only one-and-a-half allowances). The SDP proposes giving couples a single allowance each – the Chancellor proposes giving them a pair of single allowances, which each could transfer to the other.

This takes us right to the core of the argument over whether married couples should be treated as two unconnected individuals, or whether they should be viewed by the taxman as a single unit. The individual route is appealing particularly to women who have endured so many generations of financial subservience (the Inland Revenue still seems to have extreme difficulty in beginning a letter other than "Dear Sir"). It is a route which has led, on the one hand, to payment of tax-free child benefits to mothers, and on the other, to separate assessment for high-earning couples.

Unfortunately, it is an approach that has its limits. For it is still generally accepted that families have to be treated as a unit for social security, and the closer the two systems are brought to fusion the greater the difficulties in squeezing conflicting principles into a coherent framework. At the other end of the income scale, it is generally agreed that separate assessment for unearned income opens up too many opportunities for tax dodging. The SDP, which plumps for the separate route, finds itself in such difficulties at this point that it ends up proposing the thoroughly uneasy compromise that only the first £500 of unearned income should be separately assessed.

The Chancellor, implicitly, is proposing to go in treating the married couple as a single tax unit. The SDP points out that his proposals for transferable allowances would in practice result in a sharp cut in take-home pay for men whose wives had been at home but then decided to go out to work. But the other side of this coin is the help transferable allowances would provide for women who stop work to start a family, by permitting them to shift the tax allowance previously set against their earnings to the family's remaining source of income. The transferable tax allowance would also provide for a £1,150 increase in the tax threshold faced by the married man supporting a family on the dole, which would have a far more substantial impact on the "unemployment trap" than the dribs and drabs of increases that can be afforded by the Chancellor each spring.

Sarah Hogg
Economics Editor

[illegible] leading banks failed to respond to this or to further hints on Friday, reasoning that market interest rates and the lack of liquidity did not point to a cut.

Unless the clearing banks relent by cutting rates from 12.5 to 12 per cent early this week, the Bank may decide temporarily to announce its own minimum lending rate of 12 per cent. It last took this step in January, when it raised interest

Secret move for Lloyd's rescue of names

By Alison Eadie

Leading figures n the Lloyd's insurance market are exerting pressure on the Lloyd's authorities behind the scene to stage some sort of rescue for names in the former PCW syndicates.

They believe it is vital to clear the matter up so that Lloyd's can attempt to attract new names to take advantage of better trading opportunities.

Lloyd's has so far refused to consider a market rescue for names, who face losses of £130 million. Mr Peter Miller, Lloyd's chairman, told the annual meeting last month there could be no financial lifeboat.

Several important underwriting figures are, however, concerned at Lloyd's unconciliatory stance, because it is unfair to the names and because of the long-term damage it could do to Lloyd's stnding and future business. They are not willing to express their view publicly, because they are worried that a public confrontation might force Lloyd's into taking a harder line.

It would be difficult for Lloyd's now to back a form of market rescue without some loss of face. It would also be difficult to come up with an equitable formula, as a market rescue would involve all names shouldering some of the PCW losses at a time when many others have been hit by bad trading results

Names on the former PCW syndicates – now renamed Richard Beckett – are victims of both a £40 million fraud and bad underwriting. They have been advised by a steering committee of names not to meet their losses by the July 31 deadline.

Further advice is expected this week from the names' solicitors, Ashurst Morris Crisp, on whether names should pass Lloyd's solvency test and so continue as underwriters.

Those who favour a market solution believe names should meet a substantial proportion of their losses, but be insured against any future deterioration of the losses.

THF considers the next step

Trusthouse Forte's lawyers are considering what steps to take after an offer to buy a crucial block of shares in the Savoy hotel group was turned down by the owner, the Savoy Educational Trust. The deal would have given THF control of the Savoy.

SECRET

SRW

cc Nick Owen

1

10 DOWNING STREET

From the Private Secretary 11 July 1985

TAXATION AND CHARITABLE DONATIONS

Earlier this year the Chancellor mentioned that he was examining ways in which the tax regime could be amended to give greater scope and incentive for charitable donations. The Prime Minister supports this objective and would welcome the opportunity to discuss it with the Chancellor, some time in the autumn, when his proposals have been further developed.

(ANDREW TURNBULL)

Mrs Rachel Lomax,
HM Treasury.

SECRET

DM

File

PRIME MINISTERS BRIEFING

Proposal to take mortgage interest out of the retail prices index

Line to take :

Mortgage interest is on the agenda of the Retail Prices Index Advisory Committee because the Committee itself recommended, when it advised on the introduction of mortgage interest into the index in 1975, that the approach to owner-occupiers' housing costs should be reviewed "in the light of experience". I expect the Committee, which includes representatives of both sides of industry and consumer interests, to take an objective view of the measurement of inflation.

RETAIL PRICES INDEX ADVISORY COMMITTEE

BACKGROUND NOTES

1. The RPI Advisory Committee is convened from time to time by the Secretary of State for Employment to advise on the coverage, construction and presentation of the retail prices index. It first met in 1947, when the present index was initiated, and has had eight series of meetings since then, most recently in 1977.

2. The Committee is advisory only, but every significant development in RPI methodology has followed from its advice. For example, in 1974 it recommended that mortgage interest payments should be introduced into the index and that the way the different components of the index are weighted together should be modified in certain respects. In 1977 it recommended that component indices should be published in somewhat more detail, and that a new formula be used for combining individual price quotations in some cases. The recommendations are published as command papers and/or reported in Employment Gazette.

3. The Committee normally consists of representatives of both sides of industry, trade and consumer interests, academic experts and government departments, under the chairmanship of a senior official from the Department of Employment. On some previous occasions the Committee has felt the need for a technical working party, chaired by the Department's Director of Statistics, to which matters of detail could be referred.

4. The Secretary of State attaches considerable importance to the work of the Committee, which he believes is valuable in maintaining public confidence in the RPI and ensuring that it fulfils the purposes which it is designed to serve. He announced on 6 June 1984 that he intended to reconvene the Committee to re-examine the treatment of housing costs, to consider the possibility of rebasing the index, and to consider certain technical points on coverage and construction.

5. The treatment of housing costs, which presents particular problems in the construction of price indices, has been considered by the Committee on

several previous occasions, at intervals of no more than ten years (in 1952, 1962, 1968 and 1975) and it is now appropriate that the issues be looked at again. The Committee has also advised on each previous change in the reference base (i.e. the month taken as 100 in constructing the index). The present series, based on January 1974, is now around 350 so there is a case for re-referencing it in the fairly near future. As regards the coverage and construction of the index the Committee will be asked, inter alia, to review the effect of some of its earlier recommendations.

6. The Committee's chairman on this occasion will be Mr D B Smith, CB (Deputy Secretary, Department of Employment), the secretary Mr D J Sellwood (Chief Statistician, Department of Employment) and the assistant secretary Mr M Hargreaves. Appropriate bodies are now being asked to nominate members to represent them. Membership is unpaid but reasonable travel and subsistence expenses will be reimbursed. It is envisaged that, to deal adequately with the matters for consideration, about half a dozen half-day meetings of the full Committee will be necessary, spread over about a year. Meetings will be held at the Department of Employment, Tothill Street, London SW1, probably in the afternoon.

7. Before the first meeting the secretariat will circulate for members' information some background information on the RPI itself, and on previous discussions in the Advisory Committee, in addition to the agenda and papers for discussion.

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OLO

File

~~Copy for DA + SS~~

CABINET OFFICE

Central Statistical Office

Great George Street, London SW1P 3AQ Telephone 01-233 6117

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

Our reference: G19/23 15 January 1985

Dear Prime Minister

You might again be interested in seeing the latest results of the CSO's work in analysing the effects of taxes and benefits on household incomes; this was published in December 1984 Economic Trends which appeared on 15 January and an offprint is enclosed.

There are two special features in this year's article. The first assesses the impact of the tax-benefit system on households according to "life-cycle" stages. It shows how the tax-benefit system has a levelling effect on income through the life-cycle, particularly in raising the income of the retired.

The second examines the trend in redistribution between 1975 and 1983. It shows that although the distribution of income before taxes and benefits, (ie original income), became more unequal over this period, this trend was largely offset by the associated growth in cash benefits.

I would very much welcome any comments and suggestions.

Yours sincerely

John Boreham

JOHN BOREHAM

The Rt Hon Margaret Thatcher MP
10 Downing Street
SW1

The effects of taxes and benefits on household income, 1983

Introduction

This article is the latest in a series which have appeared annually in *Economic Trends* since the early sixties. Its aim is to examine how the distribution of income amongst households is modified as a result of Government intervention through the tax-benefit system. During 1983 the Government raised and spent £138 billion; directly or indirectly most of this revenue is raised from households and the expenditure benefits households. Although greater equality of incomes is not necessarily a primary aim of this process it is nevertheless one of its consequences.

Some Government expenditure programmes are designed specifically to protect people against common sources of hardship such as old age, sickness, unemployment, disability, and so on. These programmes can be collectively described as expenditure on social protection, and are those from which households can most readily perceive a direct benefit, whether in cash or in kind. The Statistical Office of the European Communities has designed a framework for the presentation of information on such current expenditure and this has been adopted by Member Countries as the European System of Integrated Social Protection Statistics (ESSPROS). The sources of hardship or need to which the measures are directed are called 'functions', and data for the United Kingdom, classified by social protection function, are presented in Table A. Government is not the only agency to undertake social protection programmes; the private sector may also do so in the form, for example, of occupational pension schemes or payments made by friendly societies. By definition, the social protection measures must involve the intervention of a 'third party'. In Table A below, Government and non-Government expenditures are distinguished and, although the coverage of non-Government programmes is not complete, it can be seen that Government assistance is predominant and that the private sector makes a significant contribution only in the fields of sickness and old age. Government expenditure on social protection constituted 20 per cent of GDP in 1982/83. Thus the state plays a central role in cushioning the effect of events which reduce the earning power of individuals or impose major financial burdens on them.

In the following analysis, most of these items of Government expenditure are allocated to those households who benefit from them, though the classifications used are those of the national accounts rather than those of ESSPROS. Certain other types of Government expenditure not regarded as social protection are also allocated to households, the main one being education expenditure. However, as well as benefiting from these

Social protection expenditure 1982/83

TABLE A

million

Function	Government programmes		Non-government programmes			
	Benefits in cash	Benefits in kind	Benefits in cash	Benefits in kind	Total	Notes
1. Sickness	590	10 470	2 320	–	13 380	Includes: National Insurance sickness benefit; National Health Service (excluding maternity and services for disabled); employers sick pay.
2. Invalidity, disablement, occupational accidents and diseases	3 450	2 480	210	–	6 140	Includes: social security benefits for the disabled; NHS services for the disabled; personal social services for the disabled.
3. Old age and survivors (e.g. widowhood)	21 020	1 110	4 990	–	27 120	Includes: National Insurance retirement and widows pensions; supplementary pensions; personal social services for the elderly; occupational pensions.
4. Family and maternity	5 330	2 460	–	–	7 790	Includes: child benefit; one parent benefit; family income supplement; NHS maternity services; welfare foods.
5. Unemployment and promotion of employment	6 880	300	550	–	7 730	Includes: unemployment benefit; redundancy payments; supplementary benefit; special employment measures.
6. Housing	1 020	–	–	–	1 020	Includes: rent rebates and allowances.
7. Miscellaneous	220	480	–	–	700	Includes: legal aid and items not separately identifiable.
Total expenditure	38 510	17 300	8 070	–	63 880	

CHART 1

Stages of redistribution

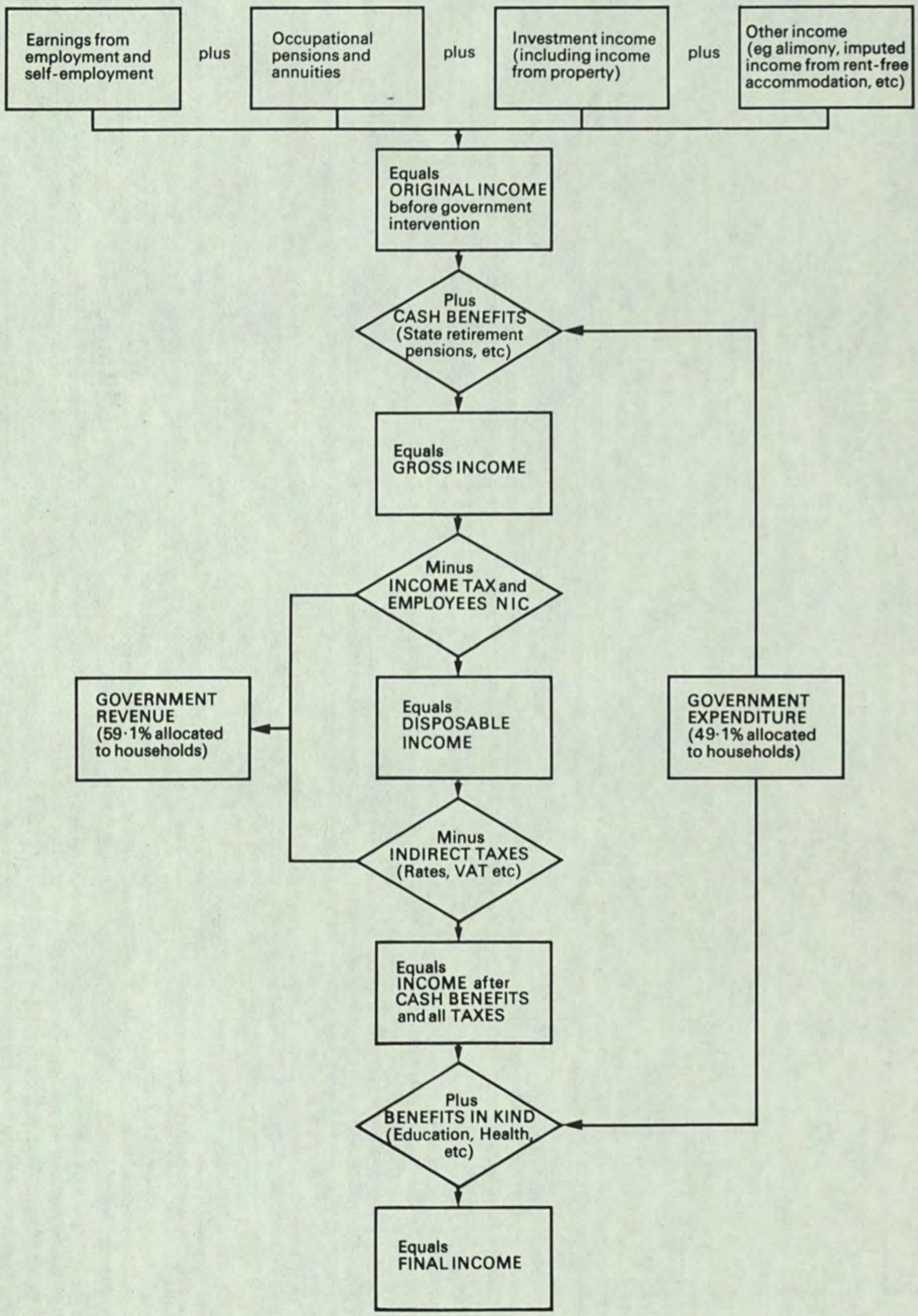
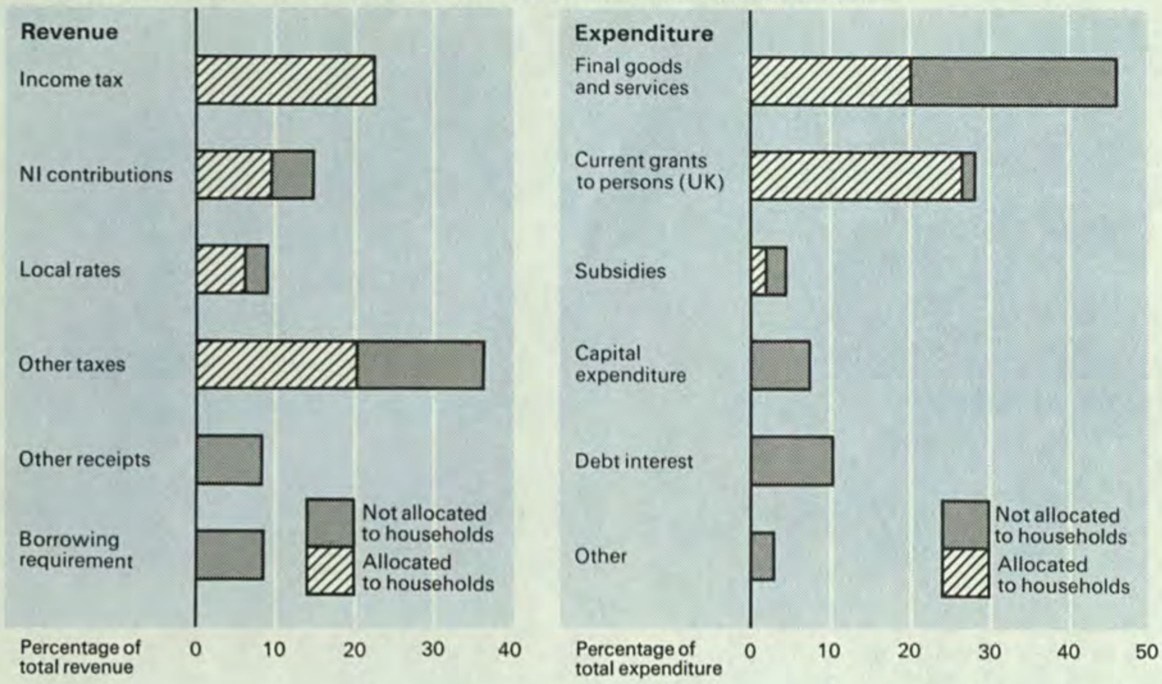


CHART 2

Allocated and unallocated items of government revenue and expenditure, 1983



programmes, households also contribute towards their cost through direct and indirect taxation and National Insurance contributions (NIC). For any one household, it is most unlikely that in any one year payments will equal benefits; 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. It has been possible to allocate to individual households only 59 per cent of Government revenue and 49 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 (e.g., the Government Borrowing Requirement) or because the data required to do so are not available (e.g., expenditure on libraries, museums and the arts). Since the total amount of revenue allocated exceeds the total amount of benefits, less significance should be attached to the exact figures of 'gains' and 'losses' in cash terms than to broad patterns of redistribution, particularly in the middle income ranges.

Chart 1 illustrates the stages of redistribution examined in this article. Initially, households receive income from various sources: as a result of their employment (e.g., wages and salaries, income from self-employment); from occupational pensions; from their investments; from other households (e.g., 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) 1983. This is a continuous household survey covering the United Kingdom, collecting information on household composition, and on the income, direct tax payments and expenditure of each household member aged 16 years or over. In 1983, 6973 households participated. The response rate in Great Britain was 67.3 per cent, lower than that recorded in 1981 and 1982 but similar to the response rates experienced in the late seventies. The variation in response rates does not affect the main analysis and results of the work described in this series of articles.

The methods used in preparing the estimates are described in Appendix 1 and the detailed results are given in Appendix 4.

Summary of main results

The main results of the analysis are:

(i) In 1983 taxes and benefits increased the share of total income of the bottom 20 per cent of households from 0.3 per cent to 6.9 per cent. The impact is more marked amongst retired than amongst non-retired households. Cash benefits play the largest part in reducing income dispersion.

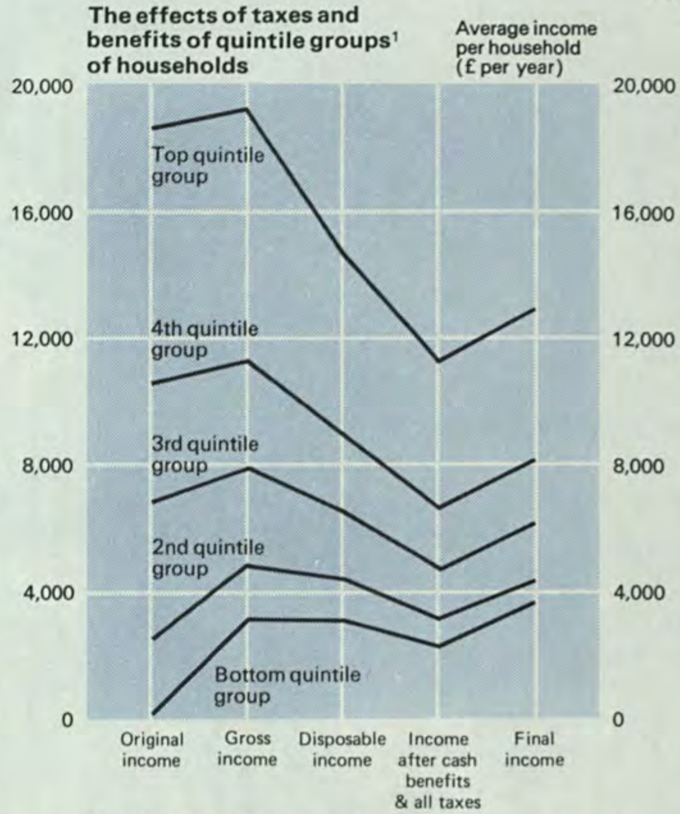
(ii) The impact of the tax-benefit system varies according to life-cycle stages, which in turn mark significant changes in economic circumstances through life. Households are divided into eight groups chosen to represent the stages of a typical life-cycle, and the effect of taxes and benefits on each is examined. This analysis shows that the tax benefit system has a smoothing effect on income through the life-cycle, compensating for the drop in economic activity rates for households with young children and helping to offset the decline in income of the elderly.

(iii) Part II of the article examines changes in Government revenue and expenditure and their effect on households between 1975 and 1983. Although the distribution of income before taxes and benefits became more unequal over this period, this trend was largely offset by corresponding growth in cash benefits.

(iv) The 20 per cent of households with the lowest incomes now rely almost entirely on cash benefits. The mix of household types forming this group changed considerably between 1975 and 1983, with increasing numbers of households with children appearing in the low income group and a decreasing proportion of retired households.

CHART 3

The effects of taxes and benefits of quintile groups[1] of households



[1] Households are ranked throughout by their original incomes

PART I
RESULTS FOR ALL HOUSEHOLDS

The distribution of household original income is highly unequal. The 20 per cent of households with lowest original income (the lowest 'quintile group') had an average original income of only £120 per annum in 1983, compared with an average original income of about £18 640 per annum in the highest quintile group (Table B). Chart 3 shows how the dispersion of incomes is reduced at each stage of redistribution, so that average final income ranges from £3 630 to £12 920, a ratio of about 1:4 compared with the ratio for original incomes of about 1:160.

The size of the original income of a household depends to a large extent on how many economically active people it contains. Only one in eighteen households in the lowest quintile group contain one or more economically active people. Nearly two-thirds of the households in this group are retired (Table C) – 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 since the state retirement pension (including any graduated or additional pension) is a cash benefit. The remainder include households either containing no earners (such as single full-time students and lone parent households with young children) or whose only earners are unable to work for all or part of the year. Only 3 per cent of households in the lowest quintile group contain one or more people who were in employment for the whole year.

An alternative way to illustrate the extent of income redistribution is to examine how income shares are modified by the tax-benefit system (Table D). For example, households in the highest quintile group receive 48 per cent of all original income. After taking into account cash benefits, this group's share falls to 42 per cent. At the other end of the scale, the share of

Summary of the effects of taxes and benefits, 1983

TABLE B

	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	120	2 580	6 880	10 570	18 640	7 760
plus cash benefits	3 020	2 250	1 100	730	600	1 540
Gross income	3 140	4 840	7 980	11 300	19 240	9 300
less income tax[1] and employees' NIC	10	410	1 410	2 340	4 510	1 740
Disposable income	3 130	4 420	6 570	8 960	14 730	7 560
less indirect taxes	840	1 270	1 850	2 280	3 380	1 920
Income after cash benefits and all taxes	2 290	3 150	4 720	6 680	11 350	5 640
plus benefits in kind	1 340	1 250	1 470	1 470	1 570	1 420
Final income	3 630	4 400	6 190	8 160	12 920	7 060
Percent that are public sector tenants	*59*	*34*	*28*	*17*	*9*	*30*
Average per household (number)						
Children (i.e. under 16)	0.4	0.4	0.9	0.9	0.7	0.7
Adults	1.5	1.7	2.0	2.2	2.6	2.0
People in full-time education	0.3	0.3	0.7	0.8	0.7	0.6
Economically active people[2]	0.1	0.6	1.3	1.7	2.2	1.2
Retired people	0.9	0.7	0.2	0.1	0.1	0.4

[1] After tax relief at source on mortgage interest and life assurance premiums.
[2] See Appendix 1 paragraph 10 for definition of economically active.

The composition of each quintile group of households ranked by original income[1], 1983

TABLE C

	Quintile group					
	Bottom	2nd	3rd	4th	Top	Total
Percentages						
Household type						
Retired	65	47	7	3	2	25
Non-retired						
1 adult	9	15	14	7	3	10
2 adults	5	15	23	28	27	20
1 adult with children	8	5	2	1	—	3
2 adults with children	9	13	39	38	28	25
3 or more adults	3	5	15	23	41	17
Total	100	100	100	100	100	100

[1] Appendix 4, Table 7 gives fuller details.

Percentage shares of total household income, 1983

TABLE D

	Percentage in each quintile group of households re-ranked at each stage				
	Original income	Gross income	Disposable income	Post-tax[1] income	Final income
Quintile group					
Bottom	0.3	5.8	6.9	6.0	6.9
2nd	7	11	12	11	12
3rd	18	17	18	17	18
4th	27	25	24	24	24
Top	48	42	40	42	39
Total	100	100	100	100	100
Decile group					
Bottom	—	2.3	2.8	2.1	2.6
Top	29	25	24	26	24
Gini coefficient (percent)	49.1	36.3	33.0	36.1	32.7

[1] Income after cash benefits and all taxes but before benefits in kind.

the lowest quintile group rises from 0.3 per cent to 5.8 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 summary measure of the inequality of the distribution of income (see paragraphs 38 and 39 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 from 49.1 per cent to 36.3 per cent shown in Table D clearly confirms that cash benefits produce the largest reduction in income inequality.

Attention has already been drawn to the preponderance of retired households in the lower ranges of the distribution of original income; nearly two-thirds of the households in the lowest quintile group and nearly half of those in the second quintile group are retired (Table C). The income profile of the retired is very different from that of households whose head is of working age, as is their expenditure pattern (which is reflected in their indirect tax payments). For this reason in the detailed examination of each stage of the tax-benefit system which follows, retired and non-retired households will be analysed separately. Non-retired households are examined first, followed by a discussion of the impact of the tax-benefit system on retired households.

RESULTS FOR NON-RETIRED HOUSEHOLDS

Original income

The distribution of original income amongst non-retired households is less unequal than amongst all households, ranging from an average of £1 440 per annum in the lowest quintile group to £20 230 in the highest (Table E). The relationship between a household's original income and the number of economically active people it contains is again very strong.

Summary of the effects of taxes and benefits on non-retired households, 1983

TABLE E

	Quintile groups of non-retired households ranked by original income					Average over all households
	Bottom	2nd	3rd	4th	Top	
Average per household (£ per year)						
Original income	1 440	6 070	8 880	12 150	20 230	9 750
plus cash benefits	2 730	1 090	790	660	540	1 160
Gross income	4 170	7 160	9 670	12 820	20 770	10 920
less income tax[1] and employees' NIC ..	190	1 200	1 910	2 750	4 910	2 190
Disposable income	3 980	5 960	7 760	10 070	15 850	8 730
less indirect taxes	1 210	1 720	2 080	2 560	3 550	2 220
Income after cash benefits and all taxes ..	2 780	4 240	5 680	7 510	12 310	6 500
plus benefits in kind	1 670	1 440	1 520	1 550	1 570	1 550
Final income	4 440	5 680	7 200	9 050	13 880	8 050
Percent that are public sector tenants	*54*	*33*	*21*	*15*	*8*	*26*
Average per household (number)						
Children (i.e. under 16)	0.9	0.9	1.0	0.9	0.7	0.9
Adults	1.7	2.0	2.1	2.3	2.7	2.2
People in full-time education	0.7	0.6	0.8	0.8	0.7	0.7
Economically active people[2]	0.6	1.3	1.6	1.9	2.3	1.5
Retired people	0.1	0.1	0.1	0.1	0.1	0.1

[1] After tax relief at source on mortgage interest and life assurance premiums.
[2] See Appendix 1 para 10 for definition of economically active.

Cash benefits

Most cash benefits are designed to help the aged, the sick and disabled, or people on low incomes (Table F). For non-retired households, income-related benefits such as Supplementary Benefit (SB) form the most important source of cash benefit income and, as would be expected, these are heavily concentrated in the lowest quintile group. Child-related benefits (mainly Child Benefit) are spread fairly evenly over the income distribution, though less benefit is received by the top quintile group where there tend to be fewer children per household (Table E). The presence of elderly people and widows within non-retired households means that these households still receive some age-related benefits (widow's pensions and allowances are classified as age-related benefits). On average, cash benefits formed 11 per cent of the gross income of non-retired households; their payment resulted in a significant reduction in income inequality.

Average value of cash benefits[1] for each quintile group of non-retired households ranked by original income, 1983

TABLE F

	Quintile group					
	Bottom	2nd	3rd	4th	Top	Total
£ per household						
Age-related	390	290	180	140	100	220
Income-related[2]	1 720	350	190	140	130	510
Child-related	310	300	320	320	250	300
Other[3]	310	150	100	70	60	140
Total	2 730	1 090	790	660	540	1 160
Cash benefits as a percentage of gross income	65	15	8	5	3	11

[1] Appendix 4, Table 5 gives more details of cash benefits.
[2] Includes unemployment benefit.
[3] Mainly related to sickness and disability.

The Housing Benefit scheme, which came into operation in November 1982 for certain Supplementary Benefit (SB) recipients and in April 1983 for other claimants, replaced the former system of rent rebates/allowances, rates rebates, and the 'housing requirements' element of SB. This was essentially only an administrative change and has had no effect on the distribution of final income, though the intermediate stages are altered slightly (see Box and Appendix 2 for details).

HOUSING BENEFIT

The Unified Housing Benefit scheme came into operation in November 1982 for certain Supplementary Benefit (SB) recipients and in April 1983 for other claimants. It replaced the previous arrangements under which SB recipients received a 'housing requirements' element in their SB payment and then paid their rent and rates in full, and others eligible for assistance with their rent and rates payments received rebates or allowances from their local authority. Under the new system, all those eligible for housing assistance receive it from their local authorities through rent and rates rebates if they are public sector tenants or rent allowances and rates rebates if they are private sector tenants. The effect of the scheme is to decrease SB payments by the amount of any rent or rates assistance included in the 'housing requirements' element, and to raise rent rebates/allowances and rates rebates by a similar amount. In Table F rent rebates and allowances and SB payments are classified as income-related cash benefits, and so this item will have fallen by the amount of rates assistance formerly included. Domestic rates are classified as an indirect tax and in the past have been shown as far as possible net of rebates. However, since the rates rebate element of SB could not be separately identified, SB recipients had to be shown as paying their rates in full, despite the fact that these costs may have been met at least in part by the DHSS. Under the new system it is possible to calculate rates net of rebates for all households, and this is the basis for the calculation of rates payments in Table H. Appendix 2 gives further information on these treatments.

Income tax and National Insurance contributions

Both income tax payments and employees' National Insurance contributions are closely related to the size of original income. Thus the size of employees' National Insurance contributions paid by each household varies with the number of persons in employment and with their earnings. However the existence of an earnings ceiling means that households in the top quintile group pay rather less in contributions as a percentage of gross income than the middle 60 per cent of households.

With the introduction of the Mortgage Interest Relief at Source (MIRAS) scheme in April 1983, the income tax payments reported after that date by most individuals with mortgages under £30 000 no longer reflected their true income tax liability. This is because under the scheme, tax relief at the basic rate (30 per cent) is deducted by borrowers from their mortgage interest payments to the lending institution, and their income tax payments rise by the same amount. In Table G, for households affected by this change, tax relief obtained under MIRAS has been imputed and deducted from their recorded income tax payments. Also deducted is the relief given by deduction at source obtained on life assurance premiums, formerly treated as a benefit in kind in previous articles.

The personal tax allowances are large enough to prevent households in the lowest quintile group from paying much tax. Due to the progressive nature of the income tax system, the proportion of gross income paid in income tax rises from 2.6 per cent for the lowest quintile group to 18.4 per cent for the highest.

Income tax and employees' NIC as percentages of gross income for each quintile group of non-retired households ranked by original income, 1983

TABLE G

	Quintile group					
	Bottom	2nd	3rd	4th	Top	Total
Income tax[1]	2.6	11.2	13.7	15.2	18.4	14.7
Employees' NIC	1.9	5.6	6.1	6.2	5.3	5.4
Total	4.6	16.7	19.7	21.4	23.7	20.1

[1] After tax relief at source on mortgage interest and life assurance premiums.

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 costs such as employers' National Insurance contributions, non-domestic rates, and duty on hydrocarbon oils, part of which they may pass on to households in the price of their products. These are called intermediate taxes.

Indirect taxes

Indirect taxation is the only component of the tax-benefit system which does not have the effect of reducing income inequality. In total, indirect taxes form a declining proportion of disposable income as original income rises (Table H), ranging from 30.3 per cent in the lowest quintile group to 22.4 per cent in the highest. However, individual taxes have divergent effects on income inequality.

Domestic rates, tobacco duty, beer duty and intermediate taxes (see box) all fall as a percentage of disposable income as income rises. The fall in tobacco duty payments is particularly marked because the incidence of smoking is higher amongst people with low incomes. VAT is not levied on basic necessities such as food and since such items form a declining proportion of expenditure as income rises, VAT payments tend to be smaller for low income households than for others. Car ownership increases with income and therefore so does the related expenditure, in the form of car tax, vehicle excise duty and duty on hydrocarbon oils.

Although some indirect taxes such as VAT are broadly progressive, Table H shows that the impact of each of the indirect taxes declines for the top quintile group compared with the fourth quintile group. This is so partly because higher income households tend to save a larger proportion of their income than households with smaller incomes.

Benefits in kind

Government current 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 largest items for which such imputations are made are health and education services, which together accounted for 21.1 per cent of total general government expenditure in 1983. Other items for which imputations are made are welfare food (mainly free school meals), the housing subsidy, travel subsidies, and expenditure on the option mortgage scheme, together accounting for a further 2.7 per cent of general government current expenditure.

Education benefit to individual households is imputed by reference to the number of pupils and students in the households (students living away from home are not included as part of their parents' household), and to the type of education they are receiving; higher imputed benefits are accorded to those in higher education (sixth form, university, etc.) than, for example, those in primary education. The bottom quintile group contains the largest number of student households for whom the costs of education are greatest, and this means that this quintile group is allocated the highest average imputed benefit (Table J). The impact of welfare foods, which benefit mainly children, is greatest in the lower income groups since children from these

Indirect taxes[1] as a percentage of disposable income for each quintile group of non-retired households ranked by original income, 1983

TABLE H

	Quintile group					
	Bottom	2nd	3rd	4th	Top	Total
Domestic rates[2]	6.2	4.9	4.3	3.7	2.9	3.9
VAT	6.9	7.6	7.4	7.4	7.0	7.2
Duty on beer	1.2	1.3	1.2	1.1	1.0	1.1
Duty on wines and spirits	0.8	1.1	0.9	1.1	1.1	1.1
Duty on tobacco	4.8	3.2	2.7	2.0	1.5	2.4
Duty on hydrocarbon oils	1.2	1.7	1.8	1.9	1.6	1.7
Car tax and vehicle excise duty	0.7	1.0	1.1	1.1	0.9	1.0
Other taxes on final goods and services	1.9	1.8	1.7	1.5	1.3	1.5
Intermediate taxes	6.6	6.3	5.8	5.6	5.1	5.7
Total	30.3	28.9	26.8	25.4	22.4	25.5

[1] Appendix 4, Table 6 gives more detailed figures on taxes.
[2] Net of rate rebates and the rates element of housing benefit supplement, but including water, etc. charges.

Average value of benefits in kind[1] for each quintile group of non-retired households ranked by original income, 1983

TABLE J

	Quintile group					Average over all house-holds
	Bottom	2nd	3rd	4th	Top	
£ per household						
Education	840	650	730	800	790	760
Health	560	630	630	600	600	610
Housing subsidy	130	80	60	40	20	60
Travel subsidies	50	60	60	70	130	70
Other	100	30	30	30	20	40
Total	1 670	1 440	1 520	1 550	1 570	1 550
Benefits in kind as a percentage of post-tax[2] income	60	34	27	21	13	24

[1] Appendix 4, Table 6 gives more details of benefits in kind.
[2] Income after cash benefits and all taxes.

households are more likely to take school meals and to have them provided free of charge. Welfare foods form about 90 per cent of the 'other benefits in kind' in Table J, the only other allocated item being option mortgage expenditure. The option mortgage scheme was in operation only until April 1983 when it was subsumed in MIRAS.

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 aggregated for 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 to base the allocation, but age is certainly a very important factor. Data availability also limits the choice of determinants. Table J shows that these benefits are lowest for the bottom quintile group but fairly flat in the remainder of the income distribution.

Housing subsidy is taken to be the excess of expenditure over income on the aggregate local authority housing revenue account, that is the sum of Exchequer Subsidy and local authority determined Rate Fund Contributions to the housing revenue account. Thus housing subsidy as defined here has been spread between public sector tenants. Since the proportion of households who are public sector tenants is 54 per cent in the lowest quintile group compared with only 8 per cent in the highest group (Table E), the imputed housing subsidy is larger for low income households than for others. In this article, tax relief on mortgage interest is treated as an adjustment to income tax, not as a housing subsidy.

Travel subsidies cover the passenger element of the grants made to various public transport operations. This year the bus travel subsidy (including the cost of concessionary fares for the elderly) has been allocated to households for the first time, in addition to the passenger rail travel subsidy (see Appendix 3 for methodology and detailed results). The use of public transport by non-retired households is partly related to the need to travel to work and thus to the number of economically active people in a household. Since households in the middle and upper ranges of the income distribution tend to make heavier use of the railways and those on low incomes make more use of bus transport, the combined effect of these travel subsidies shows some rise over the income distribution, except that the heavy use of railways by households in the top quintile group means that their imputed benefit is nearly twice the average for all households.

Table J shows that taken together the absolute values of these benefits in kind show no clear relationship with household income, falling in the lower half of the distribution and rising in the upper half. However as a proportion of post-tax income, benefits decrease from 60 per cent in the lowest quintile group to 13 per cent in the highest quintile group, indicating that this expenditure contributes to the reduction in income inequality.

The overall effect of the various stages of the tax-benefit system on non-retired households is summarised in Table K. Households in the highest quintile group receive 41 per cent of all original income, compared with 3 per cent received by the lowest quintile group. However after taxes and benefits are taken into account, the share of the lowest quintile group rises to 8 per cent and that of the highest falls to 37 per cent. Cash benefits are the major factor underlying these changes, causing the Gini coefficient to fall from 38.1 per cent based on original income to 31.0 per cent based on gross income. Income tax and employees' National Insurance contributions produce a further reduction in inequality, but payment of indirect taxes increases the Gini coefficient. Benefits in kind reduce income dispersion further.

Percentage shares of total household income for non-retired households, 1983

TABLE K

	Percentage in each quintile group of non-retired households re-ranked at each stage				
	Original income	Gross income	Disposable income	Post-tax[1] income	Final income
Quintile group					
Bottom	3.0	7.2	8.1	6.8	7.6
2nd	12	13	14	13	14
3rd	18	18	18	18	18
4th	25	24	23	23	23
Top	41	38	37	39	37
Total	100	100	100	100	100
Decile group					
Bottom	0.1	2.6	3.1	2.3	2.7
Top	25	23	22	24	22
Gini coefficient (percent)	38.1	31.0	28.8	32.3	29.4

[1] Income after cash benefits and all taxes but before benefits in kind.

RESULTS FOR RETIRED HOUSEHOLDS

Retired households have quite distinct income and expenditure patterns and so the tax-benefit system affects them in a different way to non-retired households (Table L). Few retired households have substantial original income; those who do are concentrated in

Effects of taxes and benefits on retired households, 1983

TABLE L

	Quintile groups of retired households ranked by original income					Average over all house-holds
	Bottom	2nd	3rd	4th	Top	
Average per household (£ per year)						
Original income	—	110	550	1 550	6 390	1 720
plus cash benefits						
Age-related	1 930	2 120	2 170	2 180	2 160	2 110
Child-related	—	—	—	10	—	—
Income-related	760	470	300	120	50	340
Other	160	110	270	350	300	240
Gross income	2 850	2 810	3 290	4 200	8 900	4 410
less income tax[1]	—	—	40	220	1 540	360
less employees' NIC	—	—	—	—	20	—
Disposable income	2 860	2 800	3 250	3 970	7 340	4 050
less indirect taxes						
Domestic rates	200	190	200	260	410	250
VAT	120	140	170	250	460	230
Tobacco duty	90	70	90	100	80	80
Other taxes on final goods & services	100	130	170	240	440	220
Intermediate taxes	150	180	190	250	390	230
Income after cash benefits and all taxes	2 200	2 080	2 430	2 870	5 570	3 030
plus benefits in kind						
Education	—	—	10	30	20	10
National health service	830	840	850	850	900	860
Housing subsidy	140	110	90	60	40	90
Travel subsidies	60	60	60	70	90	70
Final income	3 220	3 100	3 450	3 880	6 630	4 060

[1] After tax relief at source on mortgage interest and life assurance premiums.

the top quintile group and are receiving occupational pensions. However the majority of retired households are dependent on cash benefits, in the form of state retirement pensions and, particularly in the bottom quintile group, income-related benefits such as Supplementary Pension. Thus cash benefits form a very high proportion of gross income for all but the wealthiest retired households. However, the bulk of these cash benefits are paid from the National Insurance Fund into which the recipients will have made contributions throughout their working lives.

By definition, the National Insurance contributions of retired households are very small. All except those in the highest quintile group pay very little income tax, because their income is unlikely to exceed their tax allowances unless they have significant income from investments or occupational pensions in addition to their state retirement pension.

Domestic rates form the largest indirect tax payments made by retired households, followed by VAT and intermediate taxes. VAT, which is the largest indirect tax for non-retired households, is less important to most retired households because they spend a high proportion of their income on exempt or zero-rated goods such as food and heating.

Retired households derive significant benefits from health services and, to a lesser extent, the housing subsidy and travel subsidies. Health benefit is spread fairly evenly within the group of retired households, but housing subsidy is substantially higher for low income households because low income households are more likely to be public sector tenants. The benefits received by retired households from travel subsidies are mainly for bus travel, particularly in the form of concessionary fares, passes, etc. for senior citizens.

Table M shows the extent to which income inequality amongst retired households is reduced by the tax-benefit system. Cash benefits play by far the largest part in bringing about this reduction and income tax payments make a further, though much smaller, contribution. Payments of indirect taxes and receipts of benefits in kind make only a marginal reduction in dispersion and so the distribution of final income is virtually unchanged from the distribution of disposable income. A comparison of Table M with Table K shows that although the distribution of original income amongst retired households is much more unequal than that within the non-retired household group, the distribution of final income is more equal amongst the retired than amongst the non-retired.

Percentage shares of total household income for retired households, 1983

TABLE M,

	Percentage in each quintile group of retired households re-ranked at each stage				
	Original income	Gross income	Disposable income	Post-tax[1] income	Final income
Quintile group					
Bottom	—	9.6	10.3	8.7	9.8
2nd	1	13	13	14	14
3rd	6	16	17	17	18
4th	18	21	21	21	22
Top	74	41	38	40	37
Total	100	100	100	100	100
Decile group					
Bottom	—	4.3	4.6	3.2	4.0
Top	53	27	24	25	23
Gini coefficient (percent)	71.8	31.1	27.3	30.4	26.3

[1] Income after cash benefits and all taxes but before benefits in kind.

LIFE-CYCLE ANALYSIS OF REDISTRIBUTION

Although the sharpest contrasts in the impact of the tax-benefit system are to be observed between retired and non-retired households, there are also significant differences in its effects at various stages throughout the 'life-cycle' of a household. To examine these effects in more detail, the following eight household types are defined:

(i) Single adult under 30 years

(ii) Married couple, no children, head of household under 30 years

(iii) Married couple with child(ren), the youngest under 5 years

(iv) Married couple with child(ren), all over 5 years

(v) Married couple with 'child(ren)', at least one of whom is dependent and aged 16–24 years

(vi) Married couple, no children, head of household aged 45–65 years

(vii) Married couple, retired

(viii) Single person, retired

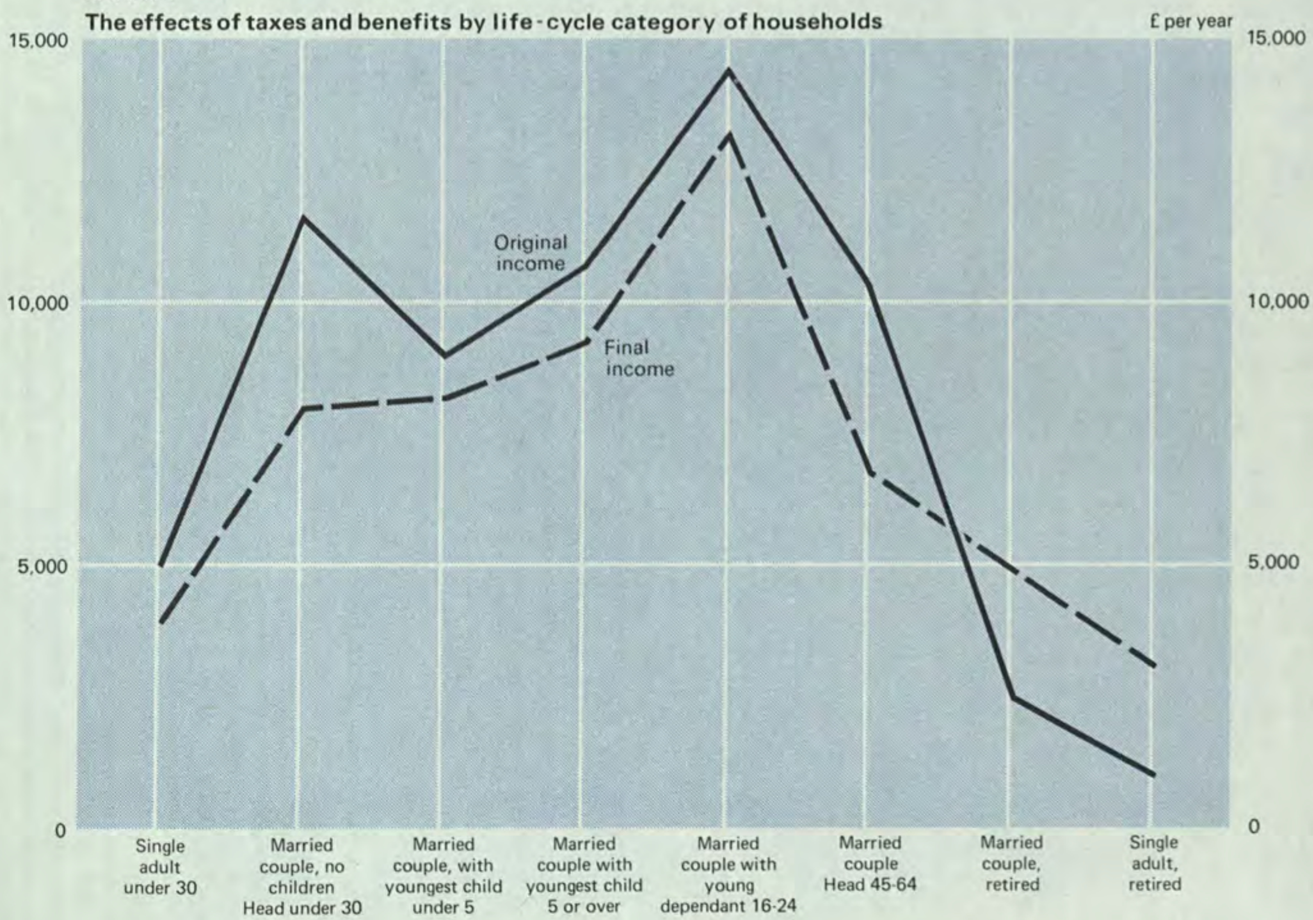
This life-cycle pattern of marriage, family-building, children leaving home and return to two adult and then one adult households is only one of many patterns which actually take place; others are adults remaining single, married couples remaining childless, and married couples with children becoming lone parent households. Appendix 4 Table 8 gives details of these alternative life-cycle household types as well as the eight described above. However, these eight types account for about two-thirds of the FES sample.

The original income of young childless married couples is more than twice that of young single adults (Table N and Chart 4), partly because they tend to be older and also because there are more student households in the latter group. It falls back sharply when there are pre-school children in the household since it is then much less likely that both parents will be economically active. The original income of young childless couples is only exceeded when the children have all reached the age of 16, at which stage household wages and salaries are at a peak. Final income is also at a maximum for this group, having risen at each stage of the life-cycle rather than dipping during the period when there are children under 16.

Older married couples with no children in the household experience a drop in household original income, despite the fact that the head is at an age at which one might expect individual earnings to be at their highest. It was found in the 1980 Department of Employment/Office of Population Censuses and Surveys Women and Employment Survey that women in their fifties are less likely than younger women to work, and so there are less likely to be two wage-earners in these older households than in those where the head is aged under 30 years. This is confirmed by the fact that on average there are 1.4 economically active persons per household where the head is aged 45–65 compared with 1.8 where the head is aged under 30. Wages and salaries per worker are in fact slightly higher for the older age group.

CHART 4

The effects of taxes and benefits by life-cycle category of households



Average incomes, taxes and benefits by life-cycle categories, 1983

TABLE N

	Single adult aged under 30	Married couples non-retired: no children head aged under 30	youngest child under 5	youngest child 5 or over	with young dependant(s) aged 16-24	no children head aged 45-64	Married couple retired	Single adult retired
Number of households in the sample	*167*	*243*	*921*	*785*	*287*	*577*	*698*	*911*
Average per household (£ per year)								
Original income	5 010	11 660	8 980	10 670	14 450	10 290	2 450	990
plus cash benefits	610	330	1 240	970	1 200	510	3 100	2 160
Gross income	5 610	11 990	10 220	11 640	15 650	10 800	5 550	3 150
less income tax and employees' NIC	1 190	2 520	1 860	2 370	3 320	2 440	540	210
Disposable income	4 420	9 470	8 360	9 270	12 330	8 370	5 010	2 950
less indirect taxes	1 270	2 090	2 030	2 350	3 010	2 160	1 350	700
Income after cash benefits and all taxes	3 150	7 380	6 330	6 920	9 320	6 210	3 660	2 250
plus benefits in kind	810	620	1 860	2 320	3 930	580	1 170	810
Final income	3 960	8 000	8 190	9 240	13 250	6 790	4 830	3 060
Average per household (numbers)								
Children	—	—	2.0	1.9	0.8	—	—	—
Adults	1.0	2.0	2.0	2.0	3.6	2.0	2.0	1.0
In full-time education	0.2	—	0.9	1.9	1.9	—	—	—
Economically active people	0.8	1.8	1.2	1.6	2.4	1.4	0.1	—
Retired people	—	—	—	—	—	0.2	1.7	1.0
Gini coefficients (per cent)								
Original income	*44.4*	*26.7*	*34.2*	*29.9*	*27.8*	*34.9*	*67.2*	*74.4*
Gross income	*33.6*	*24.3*	*26.2*	*24.9*	*24.3*	*31.0*	*27.7*	*22.9*
Final income	*32.1*	*26.6*	*23.9*	*20.2*	*19.6*	*30.7*	*22.1*	*19.3*

The degree of dispersion of original incomes within each of the eight life-cycle groups, as measured by the Gini coefficient, is reduced by the tax-benefit system, though the impact of taxes and benefits varies considerably at different stages of the life-cycle. The largest reductions occur for retired households (though a reduction of a similar size occurs for lone parent households—see Appendix 4 Table 8). Of the non-retired groups, dispersion is reduced significantly amongst young single adult households and amongst households with children under school-leaving age, but the tax-benefit system has very little impact on income distribution within the groups of non-retired married couples at either end of their working lives.

Table N also shows how the importance of the different components of the tax-benefit system varies at different stages of the life-cycle and more detailed information is contained in Appendix 4 Table 8. Employees' payments of National Insurance contributions are lowest when receipts of contributory benefits are highest, with the main contributory benefit, the state retirement pension, reaching its maximum at a time when virtually no contributions are paid. Of the remaining contributory benefits, married couples with pre-school age children receive most Unemployment Benefit, followed by married couples with heads between 45 and 65, and single adults under 30. Non-contributory benefits peak much earlier in the life-cycle, for married couples with pre-school age children, and the most important of these benefits, Supplementary Benefit and Child Benefit, are also at a maximum for this group.

Payment of income tax depends not only on income but also on the tax allowances for which a household is eligible. Thus, households with the same income may pay different amounts of tax according to whether, for example, the income is earned by the husband only or by the husband and wife, the amount of mortgage interest relief allowable, and so on. Thus young married couples pay less income tax than their older counterparts both in absolute terms (£1710 per annum compared with £1900 per annum) and as a percentage of gross income, because both husband and wife are more likely to be earning and so their personal allowance will be higher, and any mortgages held by this group are likely to be less mature and thus eligible for more tax relief. Married couples with pre-school children pay less income tax as a proportion of gross income than any other of the non-retired household groups because of the importance in their gross income of non-taxable benefits such as Child Benefit and Supplementary Benefit (unless paid to an unemployed head of household).

Married couples with children over 16 pay most indirect taxes of all the life-cycle groups shown, though as a proportion of disposable income their payments are actually below average. Single retired people pay less in indirect taxes than any other group.

Of the benefits in kind allocated to households, by far the highest education benefit is received by families where the children are over 16. In these families, those young adults still in education will be in either sixth forms or further education, which are more expensive services to provide than primary education. Health benefits show considerable variation over the life-cycle, ranging from £140 per annum for young single adults to £1010 per annum for retired married couples. Since the cost of providing health care to a baby or a very young child is similar to the cost of providing health services to an elderly person, families with pre-school children receive benefits at a comparable level to retired couples (£1000 per annum). Taken together, allocated benefits in kind peak for married couples with children over 16.

PART II

RESULTS FOR THE YEARS 1975 TO 1983

This part of the article examines the changes which took place between 1975 and 1983 in the impact of taxes and benefits on household income. The main conclusion is that although the distribution of original income became more unequal over this period, taxes and benefits largely offset this trend so that the distribution of final income in 1983 was little changed from that in 1975. This has been achieved mainly through the increased role played by cash benefits in household income over the period, but other components of the tax-benefit system have also altered in importance. The changes in the tax-benefit system in aggregate will be examined first, by reference to the level and composition of government expenditure and financing over the period. This is followed by a discussion of demographic factors, which can also influence the distribution of income between households and the impact of taxes and benefits on them. These two aspects give the background to the period 1975-83. The changes observed over the period in the shares of household income at different stages of the tax-benefit system are then examined in detail.

Total government expenditure 1975-83

Government expenditure and revenue at current prices rose throughout the period, largely due to inflation (Table P). However, when allowance is made for the effects of inflation, the pattern of growth from year to year has been rather uneven, as is clear from comparing the growth in government expenditure with that of gross domestic product (GDP). Taking the period as a whole, the growth in GDP has exceeded the growth in government expenditure measured in current prices.

The growth in government current transfer payments has exceeded that in final consumption throughout the period, more than trebling in current price terms since 1975. Much of this growth can be attributed to increases in the number of recipients, such as retired people and those out of work requiring income support.

Growth in gross domestic product and general government expenditure, 1975-83

TABLE P

	1975	1977	1979	1981	1983
Gross domestic product					
At current market prices (1975 = 100)	100	137	185	239	284
At constant (1980) market prices (1975 = 100)	100	105	111	107	113
General government expenditure and financing (1975 = 100)	100	120	166	227	268
Government expenditure categories (1975 = 100):					
Current transfer payments	100	140	197	281	336
Capital transfer payments	100	36	103	103	90
Final consumption	100	127	168	240	285
Capital formation and stocks	100	98	104	91	115

Allocated and unallocated expenditure

Of the four types of government expenditure shown in Table P, a part of both current transfer payments and final consumption is allocated to households in this study. Both these items have shown strong growth between 1975 and 1983, and Tables Q and R illustrate the changes which have taken place in their composition over this period.

Taken together, the current transfers allocated to households have increased as a proportion of all transfers from 48 per cent to 60 per cent (Table Q). This has been due mainly to the growth in importance of non-contributory benefits which increased from 8 per cent of all transfer payments in 1975 to 18 per cent in 1983. The rise between 1975 and 1979 was partly due to the introduction of Child Benefit, but the main cause over the period as a whole has been the growth in Supplementary Benefit payments. Contributory benefits, mainly the state retirement pension but also Unemployment Benefit, have also increased their share but the growth has been much less marked. The rise in the level of long-term unemployment over the period has had a big impact on total expenditure on Supplementary Benefit, because Unemployment Benefit is payable only for a year after which those out of work may become solely dependent on Supplementary Benefit.

Changes in the composition of Government transfer payments, 1975-83

TABLE Q

Percentages

	1975	1977	1979	1981	1983
Current transfers					
Allocated					
Cash benefits: contributory	*27.2*	*33.3*	*28.6*	*30.1*	*30.0*
non-contributory	*8.4*	*11.6*	*13.6*	*15.5*	*18.0*
other[1]	*2.2*	*2.8*	*2.3*	*2.2*	*4.3*
Subsidies[2]	*6.1*	*6.7*	*6.6*	*5.7*	*4.2*
Other[3]	*3.7*	*4.3*	*3.4*	*3.5*	*3.2*
Total	*47.6*	*58.9*	*54.6*	*57.0*	*59.8*
Unallocated	*31.4*	*34.7*	*33.1*	*34.1*	*33.6*
Capital transfers (unallocated)	*21.1*	*6.5*	*12.3*	*8.9*	*6.7*
General government transfers	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*

[1] Student maintenance grants, rent rebates and allowances.
[2] Housing subsidy, travel subsidies (excluding concessionary fares).
[3] Institutional cost of university education, option mortgages expenditure.

Changes in the composition of government final consumption, 1975-83

TABLE R — Percentages

	1975	1977	1979	1981	1983
Current expenditure on goods and services					
Allocated					
Health	*20.8*	*21.6*	*21.9*	*22.9*	*22.9*
Education[1]	*21.4*	*20.0*	*19.3*	*18.8*	*18.5*
Welfare foods, concessionary fares	*2.0*	*1.9*	*1.6*	*1.3*	*1.2*
Total	*44.1*	*43.4*	*42.8*	*43.0*	*42.6*
Unallocated	*52.6*	*53.0*	*53.6*	*53.4*	*54.2*
Other final consumption[2]	*3.3*	*3.5*	*3.6*	*3.6*	*3.2*
General government final consumption	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*

[1] Universities are part of the personal sector in the National Accounts therefore the institutional cost of university education forms part of government transfer payments.
[2] Non-trading capital consumption.

The pattern of government final consumption has remained much more stable than the pattern of transfer payments. The items of final consumption allocated to households have decreased slightly in importance from 44 per cent of final consumption in 1975 to 43 per cent in 1983, though at the same time individual items have changed in importance; health expenditure increased from 21 per cent to 23 per cent whilst education expenditure has fallen from 21 per cent to 18 per cent (Table R).

Allocated and unallocated revenue

The pattern of government financing changed considerably between 1975 and 1983 (Table S). Of those items not allocated to households in this article, borrowing halved in importance as a source of revenue, falling from 19 per cent to 9 per cent, whilst other receipts, such as those from petroleum revenue tax, rose by a similar amount. However the major shift affecting households is the decline in the importance of income tax from 28 per cent to 23 per cent of total revenue, and the rise in the share of indirect taxes from 24 per cent to 29 per cent. There was a significant increase in the share of indirect taxes between 1975 and 1977 due to above average increases in revenue from most specific duties, since when their share has increased steadily in line with government policy to shift the balance of personal taxation from income to expenditure. Income tax fell from 28 per cent of total revenue in 1977 to 24 per cent in 1979 when the basic rate of tax was reduced from 33 per cent to 30 per cent and higher rates of tax were reduced.

In terms of revenue allocated to households rather than total revenue, the shift from income tax to indirect taxes has been even more marked, income tax having declined from 49 per cent of allocated revenue to 38 per cent and indirect taxes having risen from 42 per cent to 49 per cent. Since income tax increases as a proportion of gross income as gross income rises whereas most indirect taxes tend to decrease, one might expect these shifts in government financing to have resulted in some increase in dispersion of post-tax incomes. The extent to which this has actually happened is examined below.

Changes in the composition of general government financing, 1975-83

TABLE S — Percentages of total financing

	1975	1977	1979	1981	1983
Allocated revenue:					
Income tax	*28.0*	*28.2*	*23.8*	*23.6*	*22.7*
Employees' NIC	*5.4*	*6.1*	*5.4*	*6.0*	*7.2*
Indirect taxes on households[1]	*24.3*	*27.2*	*28.0*	*28.7*	*29.2*
Total	*57.7*	*61.5*	*57.2*	*58.3*	*59.1*
Unallocated revenue:					
Borrowing	*18.9*	*7.2*	*14.3*	*9.7*	*8.7*
Other receipts	*23.4*	*31.3*	*28.5*	*32.0*	*32.2*
Total financing	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*

[1] Including employers' NIC allocated to households.

Changes in household formation

Demographic changes and changes in household size can have an impact on income distribution even if tax-benefit policy remains unchanged. A trend towards smaller households, for example one parent households, may mean that although *individual* incomes remain unchanged, average *household* incomes fall and there are more low income units. Increased numbers of retired households can also result in more low income units and in greater dependence on cash benefits in the lower ranges of the income distribution.

Because the FES is known to under-represent the elderly, trends in household formation are better studied using the General Household Survey (GHS) which does not suffer from this problem and, in addition, has a larger sample size of about 10 000 respondent households per annum. The household types which can

Changes in household formation, 1975-83

TABLE T — Percentages

	1975	1977	1979	1981	1983
By composition					
1 adult over retirement age[1]	*14*	*14*	*15*	*15*	*16*
2 adults, both over retirement age[1]	*9*	*10*	*9*	*9*	*10*
2 adults, one over retirement age[1]	*6*	*6*	*5*	*6*	*6*
1 adult, under retirement age[1]	*6*	*7*	*8*	*7*	*8*
2 or more adults, no children	*26*	*26*	*26*	*26*	*26*
2 or more adults, 1-3 children	*34*	*33*	*32*	*32*	*30*
2 or more adults, 4 or more children	*3*	*2*	*2*	*2*	*1*
1 adult with children	*3*	*3*	*3*	*3*	*3*
All households	*100*	*100*	*100*	*100*	*100*
By size:					
1 person	*20*	*21*	*23*	*22*	*23*
2 people	*32*	*33*	*32*	*31*	*32*
3 people	*18*	*17*	*17*	*17*	*17*
4 people	*17*	*18*	*17*	*18*	*18*
5 people	*8*	*7*	*7*	*7*	*7*
6 or more people	*5*	*4*	*4*	*4*	*3*
All households	*100*	*100*	*100*	*100*	*100*

[1] 60 for women, 65 for men.

Source: *General Household Surveys*

be identified from the GHS are not precisely the same as those identified in the FES, but have been chosen to align as closely as possible. Table T shows the distribution of households by composition and by size over the period 1975 to 1983. Changes in population structure occur only very slowly and a longer time period than that chosen for this article is needed to observe underlying trends; thus Table T does not show any dramatic movements. Nevertheless some changes can be discerned. Retired households have increased as a proportion of all households, in particular one person retired households, and the proportion of households with children has declined. The increase in one person retired households is part of a general trend towards more one person households, whilst the number of large households containing six or more people has declined. Comparison of 1971 and 1981 Census data confirms that these trends are part of long-term structural changes in household formation.

The effect of taxes and benefits on household income, 1975 to 1983

In using the FES to study the effects of changes in government expenditure and financing on household incomes, interpretation can be complicated by year to year variation in the mix of households responding to the survey, though such variation is generally quite small. It can be eliminated by imposing a standard mix of households on the sample, but such a process will also remove any genuine changes in household formation over the period such as those shown in Table T. No attempt has been made to standardise FES data in the discussion below, but this caveat should be borne in mind when interpreting the results and undue significance should not be attached to small year to year changes.

The results of the changing pattern of government expenditure and revenue are illustrated in Table U. Cash benefits have grown as a proportion of gross income from 11 per cent in 1975 to 17 per cent in 1983 for all households, and this growth has been spread throughout the income distribution. Between 1975 and 1979 part of the rise was caused by the introduction of Child Benefit; this benefit was phased in between 1977 and 1979 and replaced child tax allowances and family allowances. Throughout the period the increase in the number of retired households has also been a factor. The lowest quintile group have come to rely even more heavily on cash benefits as their major source of income during the period, but the largest change has been in the composition of gross income of the second quintile group, for whom cash benefits have grown in importance from 24 per cent to 47 per cent of gross income. This is largely because in 1983 a much higher proportion of this quintile group were retired households compared with 1975 (47 per cent in 1983 compared with 21 per cent in 1975).

Income tax and employees' National Insurance contributions (NIC) as a percentage of gross income declined throughout the income distribution over this period. The biggest drop occurred in 1979 with the reduction of the standard rate of income tax, and had its greatest impact at the top of the income distribution. However, because high income households tend to be under-represented in the FES sample the drop in overall tax burdens in 1979 is likely to be understated in Table U since the full effect of the reduction of the higher rates of tax is not reflected. At the lower end of the distribution, the bottom quintile group paid negligible amounts of income tax and employees' NIC throughout the period, but the tax burden of the second quintile group fell significantly from 14 per cent of gross

Taxes and benefits as percentages of income by quintile group of households

TABLE U

Households ranked by original income

	1975	1977	1979	1981	1983
Cash benefits as a percent of gross income					
Bottom quintile group	*87*	*91*	*92*	*92*	*96*
2nd	*24*	*29*	*33*	*37*	*47*
3rd	*6*	*8*	*9*	*11*	*14*
4th	*3*	*4*	*5*	*6*	*7*
Top	*2*	*2*	*3*	*3*	*3*
Average over all households	*11*	*13*	*13*	*14*	*17*
Income tax and NI contributions as a percent of gross income					
Bottom quintile group	*1*	*1*	–	–	–
2nd	*14*	*13*	*10*	*11*	*9*
3rd	*20*	*19*	*18*	*18*	*18*
4th	*22*	*22*	*19*	*21*	*21*
Top	*26*	*25*	*21*	*23*	*23*
Average over all households	*21*	*20*	*18*	*19*	*19*
Indirect taxes as a percent of disposable income					
Bottom quintile group	*21*	*22*	*23*	*26*	*27*
2nd	*24*	*25*	*25*	*28*	*29*
3rd	*23*	*24*	*25*	*27*	*28*
4th	*22*	*23*	*24*	*25*	*25*
Top	*20*	*21*	*21*	*22*	*23*
Average over all households	*22*	*23*	*23*	*25*	*25*
Benefits in kind as a percent of final income					
Bottom quintile group	*34*	*34*	*35*	*38*	*37*
2nd	*27*	*27*	*27*	*29*	*28*
3rd	*24*	*22*	*23*	*24*	*24*
4th	*19*	*18*	*17*	*18*	*18*
Top	*14*	*14*	*12*	*12*	*12*
Average over all households	*21*	*20*	*19*	*20*	*20*

income to 9 per cent, partly because of the fall in the basic rate of tax in 1979 but also because of the increasing importance to them of non-taxable income such as Supplementary Benefit.

Indirect taxes rose steadily as a proportion of disposable income between 1975 and 1983 both on average and at all income levels, though the rise was rather greater in the lower half of the income distribution than in the upper half. Benefits in kind fell marginally between 1975 and 1979 from 21 per cent of final income to 19 per cent, but then rose to 20 per cent in 1981 and stayed at that level in 1983.

Table V shows the effect of these changes on shares of income at the various stages of the tax-benefit system, and in Table W their effect is summarised by Gini coefficients. The distribution of original incomes became more unequal over this period, with the shares of the first three quintile groups falling, that of the fourth quintile group rising marginally and the share of the top quintile group increasing from 44 per cent to 48 per cent. These changes are reflected in the increase in the Gini coefficient from 43 per cent to 49 per cent. However, to a large extent the tax-benefit system counteracted this increase in inequality so that the distribution of final income showed little change in 1983 from that in 1975 and the increase in the Gini coefficient based on final income, from 31 per cent to 33 per cent, was much smaller.

Percentage distribution of original, disposable, post-tax, and final income, households re-ranked at each stage

TABLE V

	1975	1977	1979	1981	1983
Original income					
Quintile group					
Bottom	0.8	0.6	0.5	0.6	0.3
2nd	10	10	9	8	7
3rd	19	19	19	18	18
4th	26	27	27	27	27
Top	44	44	45	46	48
All households	100	100	100	100	100
Disposable income					
Quintile group					
Bottom	6.6	6.9	6.5	6.7	6.9
2nd	13	13	12	12	12
3rd	18	18	18	18	18
4th	24	24	25	24	24
Top	38	38	39	39	40
All households	100	100	100	100	100
Income after cash benefits and all taxes					
Quintile group					
Bottom	6.2	6.4	6.1	6.0	6.0
2nd	12	12	11	11	11
3rd	18	18	18	17	17
4th	24	24	25	24	24
Top	39	39	40	41	42
All households	100	100	100	100	100
Final income					
Quintile group					
Bottom	7.1	7.3	7.1	7.2	6.9
2nd	13	13	12	12	12
3rd	18	18	18	18	18
4th	24	24	24	24	24
Top	38	38	38	39	39
All households	100	100	100	100	100

Gini coefficients for the distribution of income at each stage of the tax-benefit system

TABLE W

	1975	1977	1979	1981	1983
Gini coefficients (per cent)					
Original income	43	44	45	47	49
Gross income	35	34	35	36	36
Disposable income	32	31	33	33	33
Income after cash benefits and all taxes	33	33	35	36	36
Final income	31	31	32	32	33

As would be expected from all the foregoing discussion, it is the payment of cash benefits which has contributed most towards maintaining roughly the same distribution of final income over this period. Although the Gini coefficient based on gross income increased slightly, the rise was much less than that based on original income. Payment of income tax and employees' National Insurance contributions resulted in a further reduction in the Gini coefficient of about 3 percentage points throughout the period. The payment of indirect taxes caused an increase in the dispersion of incomes in each of the years examined and, as government financing shifted in favour of taxes on expenditure over the period, the difference between Gini coefficients before and after indirect tax payments widened. However, since benefits in kind are highest in percentage terms for low income households they redress the effect of indirect taxes, so that the distribution of final income is very similar to that of disposable income.

Low income households

With significant shifts in government expenditure and financing having taken place between 1975 and 1983, it is of interest to examine what their impact has been not only on the overall distribution of income amongst households but in particular on those households with low incomes. The final paragraphs will therefore discuss the changes which have taken place affecting the 20 per cent of households with the lowest original incomes, the bottom quintile group.

The first point to note is that the mix of household types in the bottom quintile group of original income has changed considerably between 1975 and 1983 (Table X). In 1975, 80 per cent of these households were retired, compared with 65 per cent in 1983. Although it appears from Table S that the proportion of lone parent households in the national population did not change very much over this period, the proportion of lone parent households in the bottom quintile group rose from 5 per cent to 8 per cent. The increase in 2 adult households with children was even greater, from 2 per cent to 9 per cent. It thus seems that there have been increasing numbers of households with children appearing in the lowest income group, mainly because of the rising levels of unemployment over this period, and this has meant that more retired households now appear in the second quintile group.

Referring back to the information on the bottom quintile group contained in Table U, these households now rely almost entirely on cash benefits. Changes in income tax rates and employees' NIC have no impact on them since the vast majority are not liable for either

... composition of the lowest quintile group of households ranked by original income.

TABLE X

	1975	1977	1979	1981	1983
Percentages					
Household type					
Retired	81	80	83	78	65
Non-retired					
1 adult	7	5	6	6	9
2 adults	4	4	3	3	5
1 adult with children	5	5	5	6	8
2 adults with children	2	4	4	6	9
3 or more adults	1	1	–	2	3
All households in the bottom quintile group	100	100	100	100	100

type of payment. However, the shift of taxation from income to expenditure has had a greater than average effect on the bottom quintile group, with indirect tax payments rising from 21 per cent of their disposable income in 1975 to 27 per cent in 1983. This compares with the rise from 22 per cent to 25 per cent for all households. Finally, although benefits in kind averaged over all households remained virtually constant at about 20 per cent of final income between 1975 and 1983, their importance to low income households has increased so that these imputed payments formed 37 per cent of final income in 1983 compared with 34 per cent in 1975.

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 *United Kingdom National Accounts* the CSO 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 1983, 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 in the United Kingdom responding to the FES in 1983 was 6 973. The response rate in Great Britain was 67.3 per cent. 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)). However at present 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

5. 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.

6. 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.

7. 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.

8. 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.

9. 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.

10. *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

[illegible]ies 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.

Income: redistributive stages

11. *Stage one*

Original income *plus* cash benefits = Gross income.

Stage two

Gross income *minus* income tax and employees' national insurance contributions = Disposable income.

Stage three

Disposable income *minus* indirect taxes = income after cash benefits and all taxes.

Stage four

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

12. 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.

13. 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.

14. 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 (including graduated and additional pensions), Widows' benefits, Christmas bonus for pensioners and others.

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 pensions, Mobility allowance, Job Release allowance, Statutory Sick Pay, Attendance allowance, Sickness benefit, Industrial injury disablement benefit, Death grant, other benefits.

15. 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. Statutory Sick Pay is classified as a cash benefit even though it is paid through the employer.

16. 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. Supplementary Benefit includes all supplementary allowances where they are separately distinguished by respondents.

17. Income tax and employees' and self-employed contributions to National Insurance and National Health services are then deducted to give disposable income.

18. 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, with the exception of tax relief obtained 'at source'. In 1983 there were two types of tax relief obtained in this way: mortgage interest relief and life assurance premium relief. As explained in the article, where households are eligible for these reliefs imputations are made and deducted from recorded income tax payments. In the case of mortgage interest relief obtained through the MIRAS scheme, which was introduced in April 1983, these imputations are based on the interest component of the latest mortgage repayment. Where the interest component is not known it is estimated by reference to the size of instalment and the age of the mortgagor.

19. Life assurance premium relief is calculated by allocating the amount paid by Central Government to life assurance funds in respect of this relief in proportion to each household's premium payments.

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* include:

- 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
- Gas Levy

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 shown net of all rebates, whereas in the past the rates assistance received by Supplementary Benefit recipients could not be separately identified. The Housing Benefit scheme replaced the 'housing requirements' element of Supplementary Benefit payments by a system of rebates for all households. Further details of the scheme and its treatment in this article are contained in Appendix 2.

25. VAT and car tax affect the prices of secondhand cars and are therefore assumed to be incident on the purchasers of such cars as well as on the purchases of new cars. In allocating taxes, expenditures recorded in the FES on alcoholic drink, tobacco, ice cream, soft drinks and confectionary 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
- Employers' contributions to national insurance, the National Health Service, the industrial injuries fund and the redundancy payments scheme
- National insurance surcharge
- Customs (import) duties
- Stamp duties
- VAT

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
- Bus travel subsidy
- Concessionary bus fares for senior citizens
- Option mortgage expenditure

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 16, 18 and 24 respectively).

34. The rail travel subsidies allocated are those to British Rail passenger operations and London Transport railways (the Underground). The method of allocation has been revised this year and is described in more detail in Appendix 3.

35. The bus travel subsidy (including the cost of concessionary travel schemes for senior citizens) has been allocated to households for the first time in this year's article. The methods used are described in Appendix 3.

36. *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. This scheme ended in April 1983 with the implementation of MIRAS (see paragraph 18 above).

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 1982 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 and November 1983. 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 1983 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

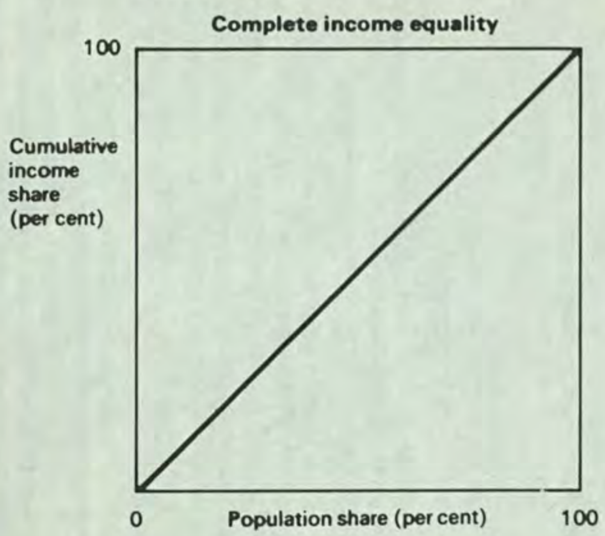
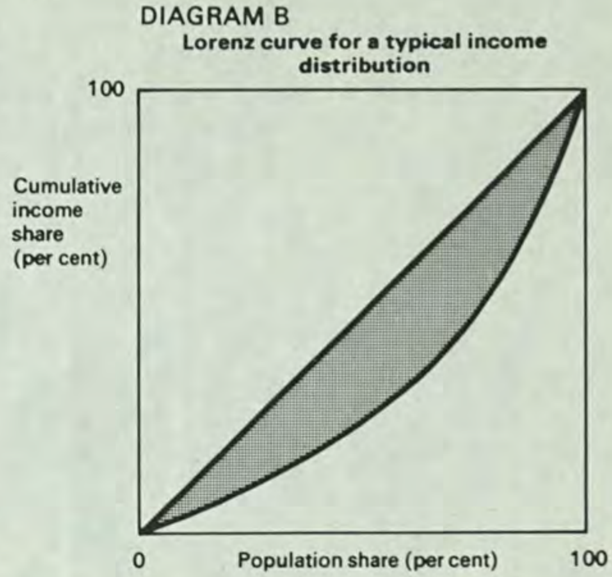


DIAGRAM B



APPENDIX 2

Housing Benefit Scheme

The new Housing Benefit scheme came into operation on 22 November 1982 for certain Supplementary Benefit recipients and on 1 April 1983 for other claimants. Prior to November 1982, assistance with housing costs could be obtained in one of two ways. People in receipt of Supplementary Benefit could have the amount of their benefit assessed to include a 'housing requirements' element. Others could receive assistance from their local authority in the form of rate rebates, rent rebates to council tenants, or rent allowances to tenants of private landlords. Under the new scheme all government assistance with rents and rates payments is paid through local authorities and Supplementary Benefits are reduced accordingly.

Under the new scheme there are two types of claimant:

(i) Standard claimants - persons who are liable to pay rent or general rates on the dwelling they occupy as a home, and who are not receiving Supplementary Benefit.

(ii) Certificated claimants - persons who are treated as householders for Supplementary Benefit purposes, and who are entitled to a supplementary allowance or pension.

The effects of the changes on the national accounts are as follows:

(i) Central government grants to the personal sector no longer include the 'housing requirements' element of Supplementary Benefit or the central government share of local authority rent rebates/ allowances, and are thus reduced by about £1 800 million.

(ii) The central government share of the cost of the housing benefit scheme is now included in current grants to local authorities which are thus increased by about £2 000 million.

(iii) Payment of local authority rates are now shown net of all rebates, including those paid to Supplementary Benefit recipients, and are thus reduced by about £400 million.

(iv) Local authority grants to the personal sector now include all rent rebates and allowances, and are thus increased by about £1 400 million.

Thus the total receipts of the personal sector from general government are reduced by the amount of rates assistance formerly included in Supplementary Benefit, an estimated reduction of £400 million, and consumers' expenditure on housing in respect of rates payments is reduced by the same amount.

Previous treatment of housing assistance

In previous articles in this series Supplementary Benefit, including the 'housing requirements' element, has been treated as an income-related cash benefit as have rent rebates/allowances received from local authorities. However, in accordance with national accounts practice, domestic rates are treated as an indirect tax, net of any local authority rate rebates received. However, since the rate rebate element of the 'housing requirements' part of Supplementary Benefit could not be identified, recipients of Supplementary Benefit had to be shown as paying their local authority rates in full even though these costs were being met in part or in full by the DHSS. To try to get around this problem, certain tables gave a range of payments of domestic rates, based at the lower point on the assumption that Supplementary Benefit recipients paid zero rates and, at the upper point, that they paid their rates in full. The true position lay somewhere between the two.

Treatment of housing benefit

The main difference in this year's article compared with previous years is that the new scheme enables rates payments to be shown net of rebates for *all* households, including those on Supplementary Benefit. In detail, the treatment of the various elements of the scheme is as follows:

(i) *Supplementary Benefit* continues to be treated as an income-related cash benefit, though receipts will have fallen by the amount of 'housing requirements' no longer payable under the new scheme.

(ii) *Rent rebates/allowances* continue to be treated as income-related cash benefits, and will rise by the amount of rent assistance formerly included in the 'housing requirements' element of Supplementary Benefit.

(iii) *Domestic rates* continue to be shown as an indirect tax, net of all rebates. Payments will fall by the amount of rates assistance formerly included in the 'housing requirements' element of Supplementary Benefit payments.

Housing Benefit Supplement (HBS) is a form of Supplementary Benefit created under the housing benefit scheme. It is payable to claimants who receive less in standard housing benefit than they would have received in rent and rates assistance if the former Supplementary Benefit scheme had continued. It is assessed by the local authorities based on information supplied by the DHSS and paid with standard housing benefit. In theory it should be shown as a separate income-related cash benefit or included with Supplementary Benefit. However, in practice it is paid as an enhanced rebate and as such is virtually indistinguishable from other rebates and allowances. A negligible number of FES respondents were able to identify HBS separately. In cases where HBS was separately identified, the amounts were allocated to rent and rates rebates in proportion to the gross rent and rates payable by the household.

APPENDIX 3

Changes in the treatment of travel subsidies

In 1983, for the first time, the subsidy to bus travel and the cost of concessionary bus travel schemes for the elderly have been allocated to households. In addition, the method of allocating rail travel subsidy has been revised and, in line with the changed treatment in National Accounts, the proportion of rail subsidies allocable to households has been increased. The total effect of these changes has been to increase considerably the importance of travel subsidies in the analysis.

Bus subsidies and concessionary fares schemes

The main difficulty which had hitherto prevented an allocation of bus subsidies to households was the value to assign to concessionary fares for senior citizens under the various schemes in operation in different areas of the country. Apart from the difficulty inherent in the data, that is to say the problem of estimating at the household level how much these concessions were being used by the elderly, there were profound conceptual difficulties in putting a value on this usage with such a wide variety of schemes operated by local authorities. In addition, because it is the purpose of the analysis to allocate National Accounts totals for the household sector to individual households any valuation would have to sum to these totals. Data on concessionary fares were first collected by the FES in 1980, but it was not until several years' results were available and improved data-handling facilities had been developed that it was possible to test concepts by making experimental allocations. Broadly, the method used to allocate the cost of concessionary fares in 1983 was to derive the valuations for the various types of passes from a comparison of recorded expenditure in the FES on bus travel by holders of 'free' passes and 'half-fare' passes. Thus the valuations were in terms of expenditure on fares saved by pass holders. But the sum of these valuations could at the same time be taken as a measure of the loss of revenue by bus operators from the use of such passes. Happily, the grossed up estimates agree quite closely with the amounts of money paid over by public authorities and included in National Accounts to compensate bus operators taking part in these schemes. In addition, the relative values of the various types of passes derived from FES figures by the method outlined above agree broadly with estimates made by Department of Transport.

In order to retain, as far as was practicable, regional differences, three separate allocations were made for the GLC, the English Metropolitan areas and the rest of the United Kingdom. Using aggregates of bus receipts, bus subsidies and the cost of concessionary fares and after making allowances for the use of road passenger transport by tourists, the business sector and the institutional part of the personal sector, figures for the total cost of providing bus travel to households in these three areas was estimated. The estimated cost was then divided between households according to their usage of buses. This usage figure was derived from expenditure on road travel recorded in the FES plus the valuations assigned to concessionary passes held by household members. Thus, for each household the combined figure for bus subsidy and concessionary fares expenditure was found by deducting any payments made by the household from the estimated cost of providing bus travel to that household.

Rail travel subsidy

As mentioned above, the method of allocating passenger rail travel subsidy to households has been revised. Formerly, the basis of the allocation was simply to divide the total amount of subsidy appropriate to the household sector between households in proportion to their recorded expenditure on rail travel. The revised allocation, however, attempts to make some provision for the varying amounts of subsidy to rail travellers using inter-city, London and South East and other services. To this end the subsidy to London and South East services is allocated to households living in the area and subsidies to provincial services to households living outside the South East, in proportion to households' expenditure on rail fares as recorded in the FES. A single allocation of the subsidy to inter-city services was made by dividing that subsidy between all households in proportion to their recorded expenditure on rail fares. In making both these allocations allowances were made for the use of rail travel by the business sector, tourists and the institutional part of the personal sector.

The results

Tables 1 and 2 show how the two elements of travel subsidy differ in their impact on households. Rail travel subsidy rises strongly with original income amongst non-retired households, being associated both with levels of economic activity and with higher personal incomes (Table 1). The increase in the highest quintile group is most striking. Bus travel subsidy however is rather flat across the income groups of non-retired households. Taken together travel subsidies rise quite strongly with income.

The impact of travel subsidies also differ according to household composition (Table 2). Rail travel subsidy predominantly benefits non-retired households. On the other hand bus subsidy is of particular benefit to retired households who receive, on average, about twice as much subsidy as non-retired households despite their much smaller average size. This is primarily due to the large amount of concessionary fares expenditure included in the allocation of the bus subsidy.

Average value of travel subsidies for each quintile group of non-retired households ranked by original income, 1983

TABLE 1

	Quintile group					
	Bottom	2nd	3rd	4th	Top	Total
£ per household						
Rail subsidies ..	21	24	36	44	100	45
Bus subsidies ..	29	32	27	25	31	29
Total	49	56	64	69	132	74

Average value of travel subsidies for each household type, 1983

TABLE 2

	Retired		Non-retired								
	1 adult	2 or more adults	1 adult	2 adults	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 households
£ per household											
Rail subsidies	10	21	44	53	66	15	36	31	22	59	38
Bus subsidies	40	67	22	32	50	26	19	14	20	43	35
Total	51	88	66	86	115	41	55	45	42	102	73

APPENDIX 4 CONTENTS

General government expenditure in 1983

TABLE 1

	£ million	*Percentage of total expenditure*
Allocated expenditure		
Allocated cash benefits		
Social security benefits[1]		
National Insurance (contributory)		
Retirement	14 370	*10.4*
Widows and guardians	770	*0.6*
Unemployment	1 540	*1.1*
Sickness/Statutory sick pay	740	*0.5*
Invalidity	1 860	*1.3*
Maternity	170	*0.1*
Disablement	380	*0.3*
Other	180	*0.1*
Non-contributory		
Child benefit	4 330	*3.1*
Supplementary benefit	5 840	*4.2*
War pension	520	*0.4*
Other	1 300	*0.9*
Student maintenance grants[2]	700	*0.5*
Rent rebates and rent allowances	2 250	*1.6*
Allocated benefits in kind[1]		
Health services	15 080	*10.9*
Education	14 150	*10.2*
School meals, milk, welfare foods	560	*0.4*
Option mortgage scheme	90	*0.1*
Housing subsidy	1 560	*1.1*
Travel subsidies[3]	1 510	*1.1*
	67 900	*49.1*
Unallocated expenditure		
Other current expenditure on social, environmental and protective services		
Social services		
Social security benefits administration	1 470	*1.1*
Personal social services	2 680	*1.9*
Other	50	–
Environmental services		
Housing	260	*0.2*
Water, sewerage, land drainage and public health	1 350	*1.0*
Parks, etc	860	*0.6*
Miscellaneous local authority services	1 250	*0.9*
Libraries, museums, and arts	750	*0.5*
Protective services		
Police	2 950	*2.1*
Parliament, courts, and prisons	1 690	*1.2*
Fire services	640	*0.5*
	13 950	*10.1*
Capital expenditure on social, environmental and protective services		
Social services	1 690	*1.2*
Environmental services		
Housing	2 500	*1.8*
Other	1 510	*1.1*
Protective services	260	*0.2*
	5 960	*4.3*
Other current expenditure		
Defence and external relations	17 910	*12.9*
Roads, transport and communications	2 370	*1.7*
Industry, trade, agriculture, research and employment	7 230	*5.2*
Other	1 950	*1.4*
	29 460	*21.3*
Other capital expenditure	4 240	*3.1*
Debt interest	14 660	*10.6*
Non-trading capital consumption	2 140	*1.5*
Total expenditure	138 310	*100.0*

[1] Including benefits to people not living in private households.
[2] Estimated.
[3] Including concessionary fares expenditure.

Source: *United Kingdom National Accounts, 1984 Edition*, Table 9.4

Financing of general government expenditure in 1983[1]

TABLE 2

	£ million	*Percentage of total financing*
Allocated financing[2]		
Income tax[3]	31 370	*22.7*
Employees' and self-employed NI contributions	10 010	*7.2*
Indirect taxes		
Domestic rates (net of rebates)	5 460	*3.9*
Taxes on final goods and services		
VAT	11 790	*8.5*
Duty on beer	1 620	*1.2*
Duty on wines and spirits	1 870	*1.3*
Duty on tobacco	3 730	*2.7*
Duty on hydrocarbon oils	2 690	*1.9*
Car tax, vehicle excise duty and driving licences	1 640	*1.2*
Other	1 390	*1.0*
Taxes and NI contributions on intermediate goods and services		
Employers' NI contributions	3 440	*2.5*
Commercial and industrial rates	3 130	*2.3*
Duty on hydrocarbon oils	1 410	*1.0*
VAT	720	*0.5*
National insurance surcharge	620	*0.4*
Motor vehicle duty and driving licences	410	*0.3*
Other	470	*0.3*
	81 770	*59.1*
Unallocated financing		
Employers' NI contributions not allocated	7 190	*5.2*
Indirect taxes		
Commercial and industrial rates not allocated	3 970	*2.9*
Taxes on final goods and services not allocated		
VAT	3 640	*2.6*
Duty on hydrocarbon oils	1 390	*1.0*
National insurance surcharge	1 290	*0.9*
Other	2 630	*1.9*
Other taxes		
Corporation tax	5 640	*4.1*
Petroleum revenue tax[4]	6 120	*4.4*
Taxes on capital	1 480	*1.1*
Other receipts[5]	11 150	*8.1*
Government borrowing requirement	12 040	*8.7*
Total financing	138 310	*100.0*

1 See Appendix 1 for notes on definitions for these items.
2 Including taxes paid by people not living in private households.
3 Net of tax relief at source on mortgage interest and life assurance premiums.
4 Including supplementary petroleum duty.
5 Receipts of rent, royalties and licence fees on oil and gas production, interest, dividends, trading income and miscellaneous transactions (net).

Source: *United Kingdom National Accounts, 1984 Edition*, Table 9.1

Average incomes, taxes and benefits, 1983

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 (£)	*18*	*623*	*2 418*	*5 100*	*6 904*	*8 589*	*10 450*	*12 816*	*16 656*		
Number of households in the sample	697	698	697	697	697	698	697	697	698	697	6 973
Original income	1	241	1 360	3 808	6 011	7 742	9 515	11 617	14 491	22 788	7 757
Direct benefits in cash											
Age-related	1 083	1 756	1 627	925	459	324	243	170	187	117	689
Child-related	191	71	92	186	271	319	298	313	263	259	226
Income-related	1 668	811	563	518	303	260	128	144	133	129	466
Other	274	187	321	275	166	103	107	67	74	46	162
Gross income	3 218	3 065	3 962	5 711	7 210	8 748	10 290	12 311	15 149	23 339	9 300
Income tax[1] and Employees' NIC	2	15	152	674	1 227	1 594	2 081	2 602	3 380	5 650	1 738
Disposable income	3 216	3 050	3 810	5 036	5 983	7 154	8 209	9 709	11 768	17 690	7 562
Domestic rates[2]	231	199	241	282	295	327	341	370	404	489	318
Taxes on final goods and services	449	413	608	850	1 044	1 232	1 322	1 516	1 860	2 470	1 176
Intermediate taxes	201	186	251	316	373	429	463	538	630	904	429
Income after cash benefits and all taxes	2 335	2 252	2 710	3 588	4 271	5 166	6 084	7 285	8 874	13 827	5 639
Benefits in kind											
Education	456	263	310	433	574	730	638	788	751	817	576
National health service	714	784	721	673	648	664	633	603	612	620	667
Housing subsidy	158	105	75	86	75	64	52	39	27	18	70
Travel subsidies	48	54	69	64	56	59	68	67	92	150	73
Other allocated benefits	65	25	32	34	32	31	30	31	29	20	33
Final income	3 776	3 483	3 917	4 878	5 657	6 714	7 504	8 813	10 386	15 453	7 058
(ii) Ranked by disposable income											
All households											
Decile points (£)	*2 657*	*3 613*	*4 486*	*5 520*	*6 658*	*7 762*	*8 982*	*10 684*	*13 455*		
Number of households in the sample	697	698	697	697	697	698	697	697	698	697	6 973
Original income	412	890	1 860	3 748	5 802	7 567	9 202	11 433	14 317	22 342	7 757
Direct benefits in cash											
Age-related	1 204	1 448	1 302	789	560	407	388	285	284	223	689
Child-related	27	53	145	247	301	301	322	311	276	279	226
Income-related	514	732	914	699	467	339	310	230	225	226	466
Other	73	127	179	268	214	217	168	142	129	103	162
Gross income	2 232	3 250	4 399	5 750	7 345	8 831	10 390	12 402	15 231	23 172	9 300
Income tax[1] and Employees' NIC	136	149	366	754	1 248	1 623	2 031	2 607	3 327	5 135	1 738
Disposable income	2 096	3 101	4 033	4 996	6 097	7 208	8 359	9 795	11 903	18 037	7 562
Domestic rates[2]	188	223	256	281	307	324	343	367	405	485	318
Taxes on final goods and services	317	434	658	854	1 056	1 184	1 314	1 628	1 863	2 456	1 176
Intermediate taxes	167	193	252	316	378	418	467	561	633	906	429
Income after cash benefits and all taxes	1 424	2 253	2 867	3 545	4 355	5 283	6 235	7 239	9 002	14 190	5 639
Benefits in kind											
Education	106	145	296	549	628	643	752	803	864	973	576
National health service	559	687	722	674	699	676	671	648	656	682	667
Housing subsidy	78	108	113	99	89	64	62	34	34	18	70
Travel subsidies	44	58	61	56	60	67	62	66	89	162	73
Other allocated benefits	9	13	40	59	46	37	36	30	36	23	33
Final income	2 221	3 264	4 098	4 982	5 878	6 770	7 819	8 820	10 681	16 049	7 058

[1] Net of tax relief at source on mortgage interest and life assurance premiums. See Appendix 1.
[2] Net of rate rebates and the rates element of housing benefit supplement, but including water, etc. charges.

Average incomes, taxes and benefits, 1983

By quintile groups of original income within household type

TABLE 4

	£ per year					
	Quintile group					Average over all quintile groups
	1st	2nd	3rd	4th	5th	
(i) 1 adult retired						
Quintile points (£)		—	86	500	1 378	
Number of households in the sample		365[1]	183	182	183	913
Original income		13	240	888	3 784	989
Direct benefits in cash						
Age-related		1 688	1 739	1 706	1 661	1 696
Child-related		—	—	—	—	—
Income-related		719	359	151	26	395
Other		65	46	81	112	74
Gross income		2 485	2 384	2 827	5 582	3 154
Income tax[2] and Employees' NIC		−2	23	115	897	207
Disposable income		2 487	2 360	2 712	4 685	2 947
Domestic rates[3]		199	179	212	352	228
Taxes on final goods and services		212	241	302	533	300
Intermediate taxes		147	135	178	256	172
Income after cash benefits and all taxes		1 929	1 805	2 020	3 545	2 246
Benefits in kind						
Education		1	—	—	4	1
National health service		717	675	640	596	669
Housing subsidy		133	98	64	41	94
Travel subsidies		46	42	59	60	51
Other allocated benefits		—	—	—	—	—
Final income		2 826	2 621	2 783	4 245	3 061
(ii) 2 or more adults retired						
Quintile points (£)		130	633	1 522	4 317	
Number of households in the sample	164	164	164	164	164	820
Original income	29	354	1 011	2 662	8 614	2 534
Direct benefits in cash						
Age-related	2 696	2 739	2 589	2 552	2 288	2 573
Child-related	—	7	15	—	4	5
Income-related	623	372	263	77	64	280
Other	341	313	604	511	329	419
Gross income	3 688	3 785	4 483	5 802	11 298	5 811
Income tax[2] and Employees' NIC	−6	20	84	424	2 188	542
Disposable income	3 693	3 765	4 399	5 378	9 110	5 269
Domestic rates[3]	206	205	238	316	431	279
Taxes on final goods and services	570	551	710	866	1 232	786
Intermediate taxes	215	226	256	336	472	301
Income after cash benefits and all taxes	2 703	2 783	3 195	3 860	6 975	3 903
Benefits in kind						
Education	—	17	63	—	47	25
National health service	1 147	1 084	1 029	1 046	1 013	1 064
Housing subsidy	131	104	83	49	36	81
Travel subsidies	85	77	70	87	121	88
Other allocated benefits	—	1	6	—	—	1
Final income	4 066	4 067	4 446	5 042	8 192	5 163

[1] More than a fifth of these households had no original income, so the bottom group is undefined.
[2] After tax relief at source on mortgage interest and life assurance premiums.
[3] Net of rate rebates and the rates element of housing benefit supplement, but including water, etc. charges.

Average incomes, taxes and benefits, 1983

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	
(iii) 1 adult non-retired						
Quintile points (£)		*647*	*3 844*	*5 995*	*8 700*	
Number of households in the sample	133	133	133	134	133	666
Original income	118	2 218	5 021	7 207	12 347	5 385
Direct benefits in cash						
Age-related	339	520	269	106	95	265
Child-related	—	—	—	—	—	—
Income-related	1 325	464	124	24	2	387
Other	361	81	30	21	8	100
Gross income	2 143	3 283	5 443	7 358	12 452	6 138
Income tax[1] and Employees' NIC	10	356	1 201	1 843	3 226	1 328
Disposable income	2 133	2 927	4 242	5 515	9 226	4 810
Domestic rates[2]	191	207	252	304	358	263
Taxes on final goods and services	421	478	703	902	1 231	747
Intermediate taxes	162	196	253	326	442	276
Income after cash benefits and all taxes	1 359	2 046	3 034	3 984	7 195	3 524
Benefits in kind						
Education	340	244	95	59	60	160
National health service	197	244	193	181	180	199
Housing subsidy	104	71	62	56	38	66
Travel subsidies	33	49	62	98	87	66
Other allocated benefits	3	—	5	3	—	2
Final income	2 036	2 653	3 450	4 381	7 560	4 017
(iv) 2 adults non-retired						
Quintile points (£)		*5 023*	*7 935*	*10 663*	*14 649*	
Number of households in the sample	275	275	276	275	275	1 376
Original income	2 443	6 476	9 346	12 511	20 967	10 348
Direct benefits in cash						
Age-related	939	502	250	155	74	384
Child-related	25	7	6	3	—	8
Income-related	1 002	218	105	58	56	288
Other	363	156	83	43	20	133
Gross income	4 772	7 359	9 790	12 770	21 117	11 160
Income tax[1] and Employees' NIC	387	1 298	2 051	2 966	5 355	2 411
Disposable income	4 384	6 061	7 739	9 804	15 762	8 749
Domestic rates[2]	245	300	316	356	470	338
Taxes on final goods and services	798	1 082	1 378	1 523	1 973	1 351
Intermediate taxes	277	372	439	501	726	463
Income after cash benefits and all taxes	3 064	4 308	5 606	7 424	12 592	6 598
Benefits in kind						
Education	189	76	47	52	105	94
National health service	557	502	429	385	375	450
Housing subsidy	92	54	40	33	13	46
Travel subsidies	60	54	76	88	150	86
Other allocated benefits	1	5	16	9	—	6
Final income	3 962	4 998	6 213	7 992	13 236	7 279

1 After tax relief at source on mortgage interest and life assurance premiums.
2 Net of rate rebates and the rates element of housing benefit supplement, but including water, etc. charges.

Average incomes, taxes and benefits, 1983

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 (£)		*7 569*	*11 037*	*14 663*	*19 133*	
Number of households in the sample	142	141	142	141	142	708
Original income	4 549	9 429	12 966	16 889	24 566	13 681
Direct benefits in cash						
Age-related	687	667	356	222	179	422
Child-related	72	68	62	66	67	67
Income-related	1 633	592	301	257	307	619
Other	638	338	176	152	95	280
Gross income	7 579	11 094	13 860	17 586	25 215	15 069
Income tax[2] and Employees' NIC	849	1 939	2 897	3 965	6 432	3 217
Disposable income	6 730	9 155	10 963	13 620	18 783	11 851
Domestic rates[3]	285	340	353	363	444	357
Taxes on final goods and services	1 388	1 697	2 093	2 473	3 092	2 149
Intermediate taxes	461	553	637	726	979	671
Income after cash benefits and all taxes	4 596	6 566	7 880	10 058	14 268	8 675
Benefits in kind						
Education	1 327	726	423	525	845	770
National health service	712	748	706	656	700	704
Housing subsidy	108	73	47	38	33	60
Travel subsidies	90	104	70	83	230	115
Other allocated benefits	9	7	6	7	5	7
Final income	6 842	8 223	9 132	11 367	16 080	10 330
(vi) 1 adult with children						
Quintile points (£)		*–*	*80*	*1 248*	*4 906*	
Number of households in the sample	91[1]		45	46	45	227
Original income	5		579	3 023	7 868	2 289
Direct benefits in cash						
Age-related	28		111	97	38	61
Child-related	585		617	685	586	612
Income-related	2 647		2 393	877	189	1 751
Other	77		120	13	16	61
Gross income	3 343		3 821	4 695	8 697	4 773
Income tax[2] and Employees' NIC	30		−5	216	1 122	277
Disposable income	3 313		3 825	4 479	7 575	4 496
Domestic rates[3]	317		274	232	337	295
Taxes on final goods and services	370		478	585	997	559
Intermediate taxes	215		231	258	429	269
Income after cash benefits and all taxes	2 411		2 843	3 404	5 812	3 372
Benefits in kind						
Education	912		1 510	1 117	991	1 088
National health service	541		488	427	419	483
Housing subsidy	220		142	124	88	159
Travel subsidies	41		24	38	61	41
Other allocated benefits	187		260	144	69	169
Final income	4 312		5 267	5 253	7 439	5 312

[1] More than a fifth of these households had no original income, so the bottom group is undefined.
[2] After tax relief at source on mortgage interest and life assurance premiums.
[3] Net of rate rebates and the rates element of housing benefit supplement, but including water, etc. charges.

Average incomes, taxes and benefits, 1983

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 (£)	*5 494*	*7 758*	*9 629*	*13 046*		
Number of households in the sample	117	117	118	117	117	586
Original income	2 416	6 664	8 690	11 304	17 972	9 408
Direct benefits in cash						
Age-related	150	41	—	—	29	44
Child-related	364	375	371	355	352	363
Income-related	1 716	231	114	123	32	443
Other	317	64	64	25	36	101
Gross income	4 964	7 376	9 240	11 807	18 421	10 359
Income tax[1] and Employees' NIC	357	1 207	1 740	2 503	4 227	2 006
Disposable income	4 606	6 169	7 499	9 304	14 193	8 353
Domestic rates[2]	271	301	330	378	457	347
Taxes on final goods and services	849	1 125	1 177	1 414	1 767	1 266
Intermediate taxes	312	369	412	520	691	461
Income after cash benefits and all taxes	3 174	4 374	5 581	6 992	11 278	6 279
Benefits in kind						
Education	577	445	392	459	528	480
National health service	793	712	704	650	673	706
Housing subsidy	151	82	56	45	18	70
Travel subsidies	78	26	28	66	76	55
Other allocated benefits	52	12	30	26	27	29
Final income	4 826	5 651	6 790	8 238	12 600	7 620
(viii) 2 adults, 2 children						
Quintile points (£)	*6 300*	*8 238*	*10 573*	*13 514*		
Number of households in the sample	163	163	164	163	163	816
Original income	3 335	7 295	9 351	11 880	19 191	10 209
Direct benefits in cash						
Age-related	23	—	11	—	—	7
Child-related	659	628	637	622	615	632
Income-related	1 392	102	55	13	9	314
Other	177	33	43	8	19	56
Gross income	5 586	8 057	10 097	12 522	19 833	11 218
Income tax[1] and Employees' NIC	492	1 424	2 049	2 777	4 162	2 181
Disposable income	5 094	6 633	8 048	9 745	15 671	9 037
Domestic rates[2]	268	323	355	415	520	376
Taxes on final goods and services	935	1 119	1 339	1 472	2 001	1 373
Intermediate taxes	343	403	487	562	855	530
Income after cash benefits and all taxes	3 549	4 789	5 867	7 295	12 296	6 758
Benefits in kind						
Education	1 040	1 024	1 139	1 247	1 238	1 138
National health service	878	828	778	679	651	763
Housing subsidy	108	57	43	17	3	46
Travel subsidies	34	23	45	39	85	45
Other allocated benefits	141	58	45	52	52	70
Final income	5 750	6 779	7 916	9 331	14 325	8 819

[1] After tax relief at source on mortgage interest and life assurance premiums.
[2] Net of rate rebates and the rates element of housing benefit supplement, but including water, etc. charges.

Average incomes, taxes and benefits, 1983

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 (£)		*3 428*	*6 760*	*9 039*	*12 821*	
Number of households in the sample	72	71	72	71	72	358
Original income	804	5 424	7 968	10 784	18 160	8 631
Direct benefits in cash						
Age related	—	—	—	—	—	—
Child-related	1 079	970	979	984	968	996
Income-related	3 195	448	94	70	71	779
Other	280	169	40	63	8	112
Gross income	5 359	7 012	9 082	11 901	19 207	10 518
Income tax[1] and Employees' NIC	82	896	1 662	2 345	4 383	1 875
Disposable income	5 277	6 116	7 420	9 556	14 824	8 643
Domestic rates[2]	297	281	322	382	487	354
Taxes on final goods and services	859	996	1 215	1 252	1 747	1 214
Intermediate taxes	328	408	477	525	756	499
Income after cash benefits and all taxes	3 793	4 431	5 407	7 396	11 834	6 576
Benefits in kind						
Education	2 474	1 999	2 062	2 102	1 875	2 103
National health service	1 093	1 000	922	921	977	983
Housing subsidies	233	93	149	48	15	108
Travel subsidies	36	32	30	20	90	42
Other allocated benefits	420	145	76	98	85	165
Final income	8 049	7 700	8 646	10 584	14 876	9 976
(x) 3 or more adults, with children						
Quintile points (£)		*7 225*	*10 308*	*12 969*	*16 708*	
Number of households in the sample	101	100	101	100	101	503
Original income	3 962	8 826	11 610	14 621	22 068	12 219
Direct benefits in cash						
Age-related	238	314	111	257	54	194
Child-related	699	557	590	480	561	578
Income-related	2 196	646	363	280	218	742
Other	650	219	130	80	27	222
Gross income	7 744	10 563	12 804	15 718	22 929	13 955
Income tax[1] and Employees' NIC	641	1 738	2 429	3 191	5 062	2 613
Disposable income	7 103	8 825	10 375	12 527	17 866	11 342
Domestic rates[2]	273	315	348	380	507	365
Taxes on final goods and services	1 462	1 427	1 791	2 185	2 894	1 952
Intermediate taxes	498	524	653	726	1 081	696
Income after cash benefits and all taxes	4 870	6 559	7 582	9 237	13 385	8 328
Benefits in kind						
Education	2 235	1 924	2 075	1 842	1 915	1 999
National health service	908	920	759	814	811	842
Housing subsidy	119	63	62	45	30	64
Travel subsidies	74	81	73	141	140	102
Other allocated benefits	171	73	76	61	39	84
Final income	8 377	9 620	10 627	12 140	16 320	11 419

[1] After tax relief at source on mortgage interest and life assurance premiums.
[2] Net of rate rebates and the rates element of housing benefit supplement, but including water, etc. charges.

Average incomes, taxes and benefits, 1983

By decile groups of households ranked by original income

TABLE 5

	£ per year										
	Decile group										Average over all decile groups
	1st	2nd	3rd	4th	5th	6th	7th	8th	9th	10th	
Decile points (£)		*18*	*623*	*2 418*	*5 100*	*6 904*	*8 589*	*10 450*	*12 816*	*16 656*	
Number of households in the sample	697	698	697	697	697	698	697	697	698	697	6 973
Original income											
Earnings of main earner	—	32	394	2 392	4 781	5 976	7 126	8 349	9 570	14 878	5 350
Other earnings	—	—	12	137	359	927	1 573	2 502	3 783	6 428	1 572
Occupational pensions, annuities	—	89	544	725	452	445	386	321	482	400	384
Investment income	1	97	309	436	334	302	354	318	496	876	352
Other income	—	23	101	118	85	91	76	128	161	206	99
Total	1	241	1 360	3 808	6 011	7 742	9 515	11 617	14 491	22 788	7 757
Direct benefits in cash											
Age-related											
Retirement and old persons' pension	1 038	1 689	1 547	849	376	270	225	154	162	111	642
Widows' benefit	38	56	70	69	80	53	16	16	24	6	43
Christmas bonus for pensioners, etc	7	11	10	6	3	2	2	1	1	1	4
Child-related											
Child benefit	187	70	90	174	255	306	282	302	256	252	217
Maternity allowance	3	1	1	10	14	11	14	10	6	6	8
Maternity grant	1	—	—	1	2	2	2	1	1	1	1
Income-related											
Supplementary benefit	958	381	230	199	113	104	42	53	49	46	217
Unemployment benefit/TOPS, etc, awards	74	50	123	150	94	105	64	60	66	44	83
Rent rebates and allowances	590	331	168	115	57	25	6	6	2	2	130
Student maintenance grants	45	44	34	30	30	22	14	23	16	37	29
Family income supplement	2	5	9	24	8	3	2	2	—	—	6
Other											
Invalidity pension and allowance	168	85	162	132	67	41	41	29	19	8	75
Sickness, industrial injury benefit	13	7	14	32	25	25	22	12	16	11	18
Attendance allowance	34	20	27	20	12	13	5	4	9	6	15
Disablement and war disability pension	10	9	26	13	12	2	8	1	4	2	9
Industrial injury disablement benefit	4	11	38	22	5	7	11	1	8	7	11
Mobility allowance	17	8	16	11	11	4	7	3	5	4	9
Job release allowance	5	16	23	18	18	3	—	4	—	—	9
Statutory sick pay	—	—	—	7	7	6	6	6	6	7	4
Non contributory invalidity pensions	15	14	6	8	6	—	4	4	1	—	6
Miscellaneous cash benefits	9	16	7	13	4	2	3	3	3	—	6
Total	3 216	2 824	2 602	1 903	1 200	1 006	775	694	657	551	1 543
Gross income	3 218	3 065	3 962	5 711	7 210	8 748	10 290	12 311	15 149	23 339	9 300
Income tax and Employees' NIC											
Income tax	4	19	140	523	911	1 213	1 604	2 005	2 678	4 725	1 382
Employees' national insurance contributions	4	3	22	179	373	478	602	751	877	1 171	446
less: Tax relief at source[1]	6	7	9	27	57	97	126	154	175	246	90
Total	2	15	152	674	1 227	1 594	2 081	2 602	3 380	5 650	1 738
Disposable income	3 216	3 050	3 810	5 036	5 983	7 154	8 209	9 709	11 768	17 690	7 562
Indirect taxes											
Domestic rates[2]	231	199	241	282	295	327	341	370	404	489	318
Taxes on final goods and services											
VAT	169	163	253	365	453	524	598	691	860	1 225	530
Duty on tobacco	144	100	126	156	180	210	193	184	227	237	176
Duty on beer	25	22	36	52	76	95	87	103	131	162	79
Duty on wines	5	5	9	15	19	22	25	30	40	77	25
Duty on spirits	16	20	29	44	49	56	53	72	91	138	57
Duty on hydrocarbon oils	20	21	42	75	97	127	146	189	207	262	119
Car tax	1	2	4	13	14	15	24	26	41	45	19
Vehicle excise duty	9	14	28	38	49	59	69	78	87	101	53
Television licences	25	31	34	35	38	40	41	42	43	44	37
Stamp duty on house purchase	1	1	2	4	5	7	10	16	21	38	11
Customs' duties	11	10	14	19	24	26	29	34	42	52	26
Betting taxes	12	14	18	20	23	32	29	30	41	51	27
Other	11	10	12	14	17	18	20	20	26	36	18
Intermediate taxes											
Commercial and industrial rates	62	59	79	99	117	136	146	171	199	287	135
Employer's NI contributions	77	72	98	125	147	170	184	215	252	363	170
Duty on hydrocarbon oils	30	26	34	43	50	57	60	69	81	115	56
Vehicle excise duty	8	7	9	12	14	16	17	19	23	33	16
Other	24	23	31	38	46	52	56	65	76	106	52
Total indirect taxes	881	798	1 100	1 448	1 712	1 988	2 126	2 424	2 894	3 863	1 923
Income after cash benefits and all taxes	2 335	2 252	2 710	3 588	4 271	5 166	6 084	7 285	8 874	13 827	5 639
Benefits in kind											
Education	456	263	310	433	574	730	638	788	751	817	576
National health service	714	784	721	673	648	664	633	603	612	620	667
Housing subsidy	158	105	75	86	75	64	52	39	27	18	70
Rail travel subsidy	8	4	25	22	22	30	42	42	64	118	38
Bus travel subsidy	41	50	43	42	34	28	25	25	28	33	35
Welfare foods	64	25	31	31	27	25	19	25	23	18	29
Option mortgage subsidy	1	—	2	3	5	5	11	6	6	2	4
Total	1 442	1 231	1 207	1 290	1 386	1 548	1 420	1 528	1 512	1 626	1 419
Final income	3 776	3 483	3 917	4 878	5 657	6 714	7 504	8 813	10 386	15 453	7 058

[1] On mortgage interest and life assurance premiums.
[2] Net of rate rebates and the rates element of housing benefit supplement, but including water, etc charges.

Average incomes, taxes and benefits, 1983

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 (£)	*2 717*	*3 749*	*4 956*	*6 492*	*8 053*	*9 597*	*11 313*	*13 621*	*17 261*		
Number of households in the sample ..	697	698	697	697	697	698	697	697	698	697	6 973
Original income	289	646	1 444	3 715	5 888	7 633	9 346	11 526	14 391	22 696	7 757
Direct benefits in cash											
Age-related	1 229	1 545	1 376	761	510	380	354	280	275	182	689
Child-related	28	62	173	249	281	307	316	309	271	267	226
Income-related	561	828	1 034	700	405	315	247	191	190	187	466
Other	71	132	273	304	215	175	148	102	119	79	162
Total	1 889	2 567	2 855	2 014	1 412	1 177	1 065	881	855	714	1 543
Gross income	2 178	3 213	4 298	5 729	7 300	8 811	10 411	12 407	15 245	23 410	9 300
Income tax and Employees' NIC											
Income tax	29	74	164	516	864	1 228	1 570	2 035	2 616	4 725	1 382
National insurance contributions	11	17	53	200	360	479	593	733	864	1 147	446
less: Tax relief at source[1]	5	8	16	35	63	97	120	148	170	242	90
Total	35	84	202	681	1 161	1 610	2 043	2 620	3 311	5 630	1 738
Disposable income	2 142	3 129	4 097	5 048	6 139	7 201	8 368	9 787	11 935	17 780	7 562
Indirect taxes											
Domestic rates[2]	185	226	256	279	303	326	338	367	408	491	318
Taxes on final goods and services											
VAT	129	179	253	364	443	533	589	726	864	1 222	530
Duty on tobacco	68	103	161	178	187	205	179	203	225	247	176
Duty on beer	15	23	39	53	77	86	90	110	132	164	79
Duty on wines	4	7	11	13	17	25	23	30	41	77	25
Duty on spirits	12	22	31	37	48	59	45	77	100	137	57
Duty on hydrocarbon oils	15	24	43	76	97	121	156	187	208	259	119
Car tax	1	2	4	10	15	16	23	30	37	46	19
Vehicle excise duty	10	17	27	37	48	57	72	76	87	101	53
Television licences	25	30	32	36	38	40	41	42	43	44	37
Stamp duty on house purchase	1	1	2	3	5	8	10	16	22	38	11
Customs' duties	8	11	14	19	23	26	29	35	42	52	26
Betting taxes	8	11	20	24	27	28	32	28	43	51	27
Other	8	11	13	15	16	17	20	21	27	36	18
Intermediate taxes											
Commercial and industrial rates	51	62	80	100	118	134	149	173	202	287	135
Employers' NI contributions	63	77	98	126	147	168	187	218	255	363	170
Duty on hydrocarbon oils	23	27	34	43	50	56	62	70	82	115	56
Vehicle excise duty	6	7	9	12	14	15	17	19	23	33	16
Other	19	24	31	39	45	52	57	66	77	106	52
Total indirect taxes	651	865	1 157	1 466	1 719	1 970	2 121	2 495	2 918	3 871	1 923
Income after cash benefits and all taxes	1 491	2 264	2 940	3 582	4 420	5 230	6 247	7 292	9 016	13 909	5 639
Benefits in kind											
Education	111	175	379	547	607	667	761	828	824	862	576
National health service	569	718	752	704	665	657	661	643	657	648	667
Housing subsidy	86	112	117	91	77	69	59	37	33	19	70
Rail travel subsidy	8	14	17	23	20	27	44	43	67	116	38
Bus travel subsidy	34	46	46	38	34	33	27	28	29	34	35
Welfare foods	8	17	51	55	33	27	28	25	23	21	29
Option mortgage subsidy	1	1	1	4	5	8	7	8	5	2	4
Total	817	1 082	1 362	1 463	1 439	1 487	1 588	1 611	1 637	1 702	1 419
Final income	2 308	3 346	4 302	5 044	5 859	6 718	7 834	8 904	10 653	15 611	7 058

[1] On mortgage interest and life assurance premiums.
[2] Net of rate rebates and the rates element of housing benefit supplement, but including water, etc. charges.

Distribution of households co-operating in the Family Expenditure Survey, 1983

By decile groups of households ranked by original, gross, disposable, post-tax[1] and final incomes

TABLE 7

	Retired households		Non-retired households								
	1 adult	2 or more adults	1 adult	2 adults	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 households
Decile groups of original income											
Bottom	270	100	78	40	17	82	29	27	42	12	697
2nd	313	226	52	27	9	36	10	13	5	7	698
3rd	209	245	82	59	8	32	18	20	12	12	697
4th	85	113	124	157	28	35	49	47	34	25	697
5th	15	47	117	173	55	20	78	103	53	36	697
6th	6	34	76	154	60	7	107	148	51	55	698
7th	10	16	60	194	82	8	92	124	49	62	697
8th	2	19	39	195	88	3	78	146	39	88	697
9th	3	14	21	207	143	3	70	91	46	100	698
Top	—	6	17	170	218	1	55	97	27	106	697
Total	913	820	666	1 376	708	227	586	816	358	503	6 973
Decile groups of gross income											
Bottom	475	10	150	23	1	32	3	2	1	—	697
2nd	280	206	68	51	2	58	18	13	—	2	698
3rd	81	268	70	83	20	70	36	37	28	4	697
4th	38	133	121	137	18	29	73	69	53	26	697
5th	14	63	96	189	42	18	76	115	57	27	697
6th	8	45	60	176	58	7	108	133	53	50	698
7th	6	37	42	187	90	7	79	118	53	78	697
8th	8	25	24	177	105	2	78	145	37	96	697
9th	3	20	20	194	151	3	63	87	47	110	698
Top	—	13	15	159	221	1	52	97	29	110	697
Total	913	820	666	1 376	708	227	586	816	358	503	6 973
Decile groups of disposable income											
Bottom	462	12	158	25	2	31	4	2	1	—	697
2nd	305	169	99	48	1	47	14	10	3	2	698
3rd	75	250	100	96	13	66	42	39	13	3	697
4th	33	141	103	143	23	45	73	72	49	15	697
5th	13	85	81	175	28	11	85	123	65	31	697
6th	7	58	48	201	63	11	87	126	61	36	698
7th	9	43	25	183	80	6	84	132	51	84	697
8th	6	24	23	176	114	5	82	131	41	95	697
9th	3	26	15	181	165	2	61	86	44	115	698
Top	—	12	14	148	219	3	54	95	30	122	697
Total	913	820	666	1 376	708	227	586	816	358	503	6 973
Decile groups of post-tax income[1]											
Bottom	344	49	162	54	9	35	16	19	5	4	697
2nd	356	118	94	56	4	30	16	14	8	2	698
3rd	104	212	98	100	23	57	40	41	14	8	697
4th	56	173	92	126	19	51	61	62	40	17	697
5th	23	87	78	154	34	23	84	115	64	35	697
6th	10	60	56	195	77	10	75	125	48	42	698
7th	7	40	30	187	87	8	92	122	50	74	697
8th	7	33	21	170	103	7	89	124	43	100	697
9th	5	29	17	178	162	2	53	93	51	108	698
Top	1	19	18	156	190	4	60	101	35	113	697
Total	913	820	666	1 376	708	227	586	816	358	503	6 973
Decile groups of final income											
Bottom	330	39	221	61	8	16	9	11	—	2	697
2nd	348	102	102	90	8	27	15	4	1	1	698
3rd	152	211	104	117	17	36	37	17	3	3	697
4th	43	190	84	177	22	49	76	46	6	4	697
5th	18	91	64	217	53	39	86	89	19	21	697
6th	8	61	33	193	71	28	92	141	40	31	698
7th	7	52	22	155	93	11	98	139	76	44	697
8th	5	26	15	140	121	12	67	154	65	92	697
9th	1	33	6	121	143	4	54	112	90	134	698
Top	1	15	15	105	172	5	52	103	58	171	697
Total	913	820	666	1 376	708	227	586	816	358	503	6 973

[1] Income after cash benefits and all taxes but before benefits in kind.

Average incomes, taxes and benefits by life-cycle categories, 1983

Typical life-cycle categories

TABLE 8a

	Single adult aged under 30	Married couples non-retired: no children head aged under 30	youngest child under 5	youngest child 5 or over	with young dependant aged 16-24	no children head aged 45-64	Married couple retired	Single adult retired
Number of households in the sample	*167*	*243*	*921*	*785*	*287*	*577*	*698*	*911*
Average per household (£ per year)								
Original income								
Wages and salaries	4 503	10 291	7 310	9 049	12 713	8 152	78	5
Other income	504	1 366	1 671	1 620	1 736	2 137	2 375	984
Total	5 007	11 658	8 981	10 669	14 449	10 290	2 452	989
Cash benefits								
Contributory								
Retirement pension	—	—	—	8	57	106	2 479	1 654
Sickness/injury-related	20	25	64	53	140	154	226	39
Unemployment benefit	83	61	112	68	59	92	7	1
Other	8	11	61	5	1	6	17	48
Non-contributory								
Supplementary benefit	173	133	251	176	180	67	63	114
Child benefit	—	—	600	568	537	—	—	—
Sickness/disablement-related	—	8	13	20	31	38	69	15
Other	322	92	138	77	200	51	240	293
Total	606	331	1 238	975	1 204	513	3 101	2 164
Gross income	5 613	11 988	10 219	11 644	15 653	10 803	5 553	3 154
Income tax (net)	851	1 714	1 308	1 733	2 462	1 896	536	206
National insurance contributions	342	809	552	641	859	542	3	—
Total	1 194	2 523	1 861	2 374	3 320	2 437	538	207
Disposable income	4 419	9 465	8 359	9 270	12 333	8 366	5 015	2 947
Indirect taxes								
Domestic rates (net)	213	291	346	383	414	362	281	228
Taxes on final goods and services	767	1 334	1 214	1 431	1 872	1 342	775	300
Intermediate taxes	287	464	473	538	727	451	294	172
Total	1 267	2 088	2 033	2 351	3 013	2 156	1 350	701
Income after cash benefits and all taxes	3 152	7 377	6 326	6 919	9 320	6 210	3 665	2 246
Benefits in kind								
Education	541	150	677	1 588	3 002	—	—	—
National health service	138	316	999	556	718	462	1 008	669
Housing subsidy	34	34	75	49	34	49	75	94
Travel subsidies	94	99	50	44	111	68	84	51
Other	4	23	63	86	63	1	—	—
Total	810	623	1 865	2 322	3 928	581	1 167	814
Final income	3 962	7 999	8 190	9 241	13 247	6 791	4 832	3 060
Average per household (numbers)								
Children	—	—	2.0	1.9	0.8	—	—	—
Adults	1.0	2.0	2.0	2.0	3.6	2.0	2.0	1.0
In full-time education	0.2	—	0.9	1.9	1.9	—	—	—
Economically active people	0.8	1.8	1.2	1.6	2.4	1.4	0.1	—
Retired people	—	—	—	—	—	0.2	1.7	1.0
Gini coefficients (per cent)								
Original income	*44.4*	*26.7*	*34.2*	*29.9*	*27.8*	*34.9*	*67.2*	*74.4*
Gross income	*33.6*	*24.3*	*26.2*	*24.9*	*24.3*	*31.0*	*27.7*	*22.9*
Final income	*32.1*	*26.6*	*23.9*	*20.2*	*19.6*	*30.7*	*22.1*	*19.3*

Average incomes, taxes and benefits by life-cycle categories, 1983

Alternative life-cycle categoreis

TABLE 8b

	Single adult aged 30 or over	Single adult with children	Married couple no children head aged 30-44	All house-holds
Number of households in the sample	*499*	*227*	*220*	*6 973*
Average per household (£ per year)				
Original income				
Wages and salaries	4 507	1 449	12 396	6 210
Other income	1 004	840	1 393	1 548
Total	5 512	2 289	13 789	7 757
Cash benefits				
Contributory				
Retirement pension	150	—	8	639
Sickness/injury-related	85	30	61	109
Unemployment benefit	57	19	68	67
Other	205	70	4	59
Non-contributory				
Supplementary benefit	140	1 037	73	217
Child benefit	—	604	1	217
Sickness/disablement-related	36	29	29	38
Other	129	695	75	196
Total	802	2 484	320	1 543
Gross income	6 313	4 773	14 109	9 300
Income tax (net)	1 060	176	2 367	1 292
National insurance contributions	313	102	905	446
Total	1 373	277	3 272	1 738
Disposable income	4 941	4 496	10 837	7 562
Indirect taxes				
Domestic rates (net)	279	295	360	318
Taxes on final goods and services	741	559	1 687	1 176
Intermediate taxes	272	269	566	429
Total	1 292	1 124	2 612	1 923
Income after cash benefits and all taxes	3 649	3 372	8 225	5 639
Benefits in kind				
Education	32	1 088	64	576
National health service	219	483	320	667
Housing subsidy	77	159	21	70
Travel subsidies	56	41	95	73
Other	2	169	7	33
Total	386	1 939	506	1 419
Financial income	4 035	5 312	8 731	7 058
Average per household (numbers)				
Children	—	1.7	—	0.7
Adults	1.0	1.0	2.0	2.0
In full-time education	—	1.3	—	0.6
Economically active people	0.8	0.4	1.8	1.2
Retired people	—	—	—	0.4
Gini coefficients (per cent)				
Original income	*46.9*	*69.7*	*27.1*	*49.1*
Gross income	*35.4*	*26.4*	*25.2*	*36.3*
Final income	*34.1*	*23.1*	*27.4*	*32.7*

Fde Taxation and Budget

LLOYDS BANK ECONOMIC BULLETIN

A MONTHLY ANALYSIS FROM LLOYDS BANK NUMBER 73 JANUARY 1985

Rejig mortgage interest relief

Since the Chancellor of the Exchequer has indicated that he is examining with a critical eye all forms of tax relief, and he has already moved with unexpected daring against corporation tax allowances, it may be thought that mortgage interest relief (MIR) is on the agenda for the March 1985 Budget. On the other hand, the Prime Minister appears to be committed to feeding rather than killing this particular sacred cow, as evidenced by the raising of the ceiling from £25000 to £30000 in the 1983 Budget.

There are 7 million taxpayers with mortgages, the vast majority of whom are getting MIR. (Those who do not are unemployed owner-occupiers whose mortgage interest is paid – to themselves and not to the building societies – as part of housing benefit.) The number of taxpayers on higher rates getting MIR is 600,000, or about 9 per cent of the total. It is also estimated that 9 per cent of all mortgages are over the £30000 MIR ceiling, a percentage that must increase with a fixed ceiling and a rising average mortgage.

The present system

The cost of mortgage interest relief to the Treasury has risen, as shown in table 1, from £1450m in 1979-80 to £3500m in 1984-85. It has thus risen from 0.7 per cent of gdp at market prices to 1.1 per cent. It should be noted that the rise has not been even. MIR has risen and fallen with interest rates during this period; it has fallen as marginal rates of tax have been cut and tax bands raised, and risen with the amount of mortgage finance.

Table 1
COST OF MORTGAGE INTEREST RELIEF £m

		Higher rate taxpayers	
	Total	Relief	In excess of basic rate
1979-80	1450	200	80
1980-81	1960	300	115
1981-82	2050	450	170
1982-83	2150	390	150
1983-84	2750	375	140
1984-85	3500	410	160

Source: *Hansard*, 12 June, 26 July, 31 October 1984.

MIR of £3.5bn is 3.5 per cent of outstanding mortgage debt of about £100bn, and is thus equivalent to 3.5 percentage points off the current advised building society mortgage rate of 11.75 per cent. This is a reduction of 30 per cent in the mortgage interest rate, corresponding to the basic rate of income tax, which is what nine-tenths of mortgagors get. To take the extreme case, a high income taxpayer getting all his relief at the top marginal rate of 60 per cent on a mortgage of £30000 gets an interest subsidy of 7 percentage points, and is paying an effective 4.8 per cent for his loan.

The average MIR is £270 per owner-occupier, but £500 per mortgagor, on the average mortgage of £14300. If MIR did not exist, the basic rate of income tax could be lowered by 3 percentage points, to 27 per cent. But in this case, the average tax cut for all taxpayers would be no more than £170, and the average mortgagor would lose £330 on the deal.

It may not be generally known that in granting MIR the UK is typical of the vast majority of industrial countries. In fact mortgage interest relief was never brought in as such in the UK. Until 1968, all UK borrowers got interest relief against tax, just as they all paid tax on interest received. It was in that year that the Labour Government withdrew relief for consumer and other personal borrowing, thus by default restricting it to mortgages and home improvements. The position was reversed by the Conservative Government in 1972, and reversed again by the next Labour Government in 1974, when the £25000 ceiling on mortgage interest relief was first introduced. This is a classic example of the see-saw effect of adversary politics on economic policy.

The IMF has shown that among 16 OECD countries, only Australia has no mortgage interest relief, see table 2. Ten of these countries, including the USA, have MIR broadly similar to that in the UK, and four give tax relief for the principal as well as the interest, and are thus more generous than the UK. Among the countries which give MIR, six allow deductions for consumer credit as well. Half of the 16 countries tax imputed income from owner-occupation. While the UK abolished Schedule A in 1963, it still has domestic rates, which represent a much higher tax on house property than in any other industrial country apart from the USA.

Is MIR a subsidy?

MIR is sometimes discussed as a subsidy to owner-occupation, along with exemption from capital gains tax on principal residences. The case for or against then becomes an argument about the merits of owner-occupation versus rented accommodation. There is no particular virtue about owner-occupation as such, since many young couples in the

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Table 2
PERSONAL INCOME TAX DEDUCTIBILITY

	Owner-occupied housing: Imputed income taxable	Owner-occupied housing: Deductibility for Interest only	Owner-occupied housing: Deductibility for Interest + principal	Consumer credit
Australia				
Austria			x	
Belgium	x		x	
Canada			x	
Denmark	x	x		x
France		x		
Germany	x	x		
Ireland		x		
Italy	x	x		
Japan			x	
Netherlands	x	x		x
Norway	x	x		x
Sweden	x	x		x
Switzerland	x	x		x
United States		x		x
United Kingdom		x		

Source: *Taxation, Inflation and Interest Rates* (1984)
Ed. Vito Tanzi, (Washington: IMF) page 59

UK today resort to it willy-nilly for want of an adequate market in private rented property. Nor is there any correlation between the percentage of tenures in owner-occupation and the standard of living. Certainly the USA, with a higher standard of living than the UK, has a slightly higher percentage of owner-occupiers; but Switzerland, also with a higher standard of living, has an owner-occupation ratio of only 30 per cent. Developing countries typically have the highest ratios of owner-occupation.

The level of subsidy, as John Ermisch has pointed out, should be measured not by the ammount of public money spent, but by the broader criterion of the difference between the price of housing and some measure of its true cost. By this criterion, rent control creates a subsidy for most of the rented sector, but MIR and other forms of fiscal privilege cause an artificially high price for owner-occupied and the upper range of private rented housing. It can be argued, however, that the gradual removal of rent control, by creating a supply of private rented accommodation at a reasonable price, would itself bring down the premium on owner-occupied housing.

The arguments about owner-occupation do not lead to any clear conclusion. It is doubtful whether MIR should be regarded as a subsidy at all, on three counts. First, it is not applied in such a way as to be of particular benefit to those most in need. Second, while it makes interest payments cheaper, it makes house prices more expensive, so it is not clear whether it reduces total housing costs or not. Thirdly, it can be seen as arising naturally out of general rules about the tax treatment of interest paid and received.

The brunt of the case against MIR is that it distorts the market for funds towards mortgage loans, and away from industrial and commercial lending or, for that matter, consumer credit. This case is often no sooner stated than uncritically accepted. Yet interest relief is granted without question to business borrowing and not even mentioned in the Treasury's list giving the cost of various tax reliefs. All forms of borrowing by industrial and commercial companies, non-bank financial institutions and unincorporated businesses now amount to roughly £120bn, 20 per cent more than mortgage debt, or about the same as all household debt if another £20bn of consumer credit is added. Assuming an average interest rate of 2 per cent over base rate, the interest on business borrowing amounts to about £14bn a year, which is costing the Treasury £7bn at an average rate of 50 per cent, about double the cost of mortgage interest relief. This £7bn should no more be termed a subsidy to industry and commerce than MIR should be called a subsidy to owner-occupiers.

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Unlimited relief at 30%

The after tax interest rate paid by UK businesses is about 6 per cent, somewhere between the 8.25 per cent paid by basic rate mortgage borrowers and the 4.8 per cent paid by the highest income top marginal rate borrowers. MIR should be looked at on the basis of whether it preserves approximate neutrality between business and mortgage borrowers. Since the rate of corporation tax is being reduced by stages from 52 per cent to 35 per cent — 30 per cent for small companies — by 1986-87, MIR should be limited to the 30 per cent basic rate of income tax so that it does not offer a possible 60 per cent relief compared with only 30 - 35 per cent for business borrowers.

Together with the abolition of MIR at higher rates of income tax should go the abolition of the £30000 ceiling, which appears to have survived simply as a sop to those who oppose MIR on principle, and has no logical justification. The net cost to the Treasury of the two reforms combined is likely to be of the order of £100m. Since the £25000 ceiling was introduced in 1974, prices have multiplied 2½ times; rather than raising the ceiling to £62500, it would be simpler to do away with it altogether, since the removal of higher rate relief will already be hitting those who might benefit from the absence of any ceiling. The ceiling has in fact concentrated demand more than otherwise on mortgages of less than or not much over £30000, and has thus helped to bid up the price of cheaper housing units. Its removal will thus make it slightly less difficult for first-time buyers to afford their first step onto the owner-occupation ladder.

The effect of different forms of MIR change on taxpayers above average earnings is shown in table 3. Variant 3, removal af the ceiling and restriction of relief to 30 per cent, shows MIR rising gradually in line with the mortgage as income rises, but remaining at 6 per cent of income. At least for those on above average incomes — who are those mainly affected by the changes — it gives distributive justice, being neither progressive nor regressive.

Table 3
MORTGAGES OF £30000 OR OVER — INTEREST RELIEF CHANGES

Gross income £/year	Base case: £30,000 ceiling Marginal relief £	% income	Variant 1: £30,000 ceiling 30% relief £	% income	Variant 2: No ceiling Marginal relief £	% income	Variant 3: No ceiling 30% relief £	% income
15,000	900	6.0	900	6.0	900	6.0	900	6.0
20,000	1100	5.5	900	4.5	1250	6.0	1200	6.0
25,000	1325	5.3	900	3.6	2125	8.5	1500	6.0
30,000	1465	4.9	900	3.0	2815	9.4	1800	6.0
35,000	1500	4.3	900	2.6	3500	10.0	2100	6.0
40,000	1650	4.1	900	2.3	4220	10.6	2400	6.0
45,000	1725	3.8	900	2.0	5025	11.2	2700	6.0
50,000	1800	3.6	900	1.8	5825	11.7	3000	6.0
55,000	1800	3.3	900	1.6	6600	12.0	3300	6.0
60,000	1800	3.0	900	1.5	7200	12.0	3600	6.0

Assumptions: Other tax allowances - £3300 married allowance (1985-86 indexed figure given in *Autumn Statement 1984).* Mortgage interest rate - 10 per cent. Size of mortgage - two times gross income (base case and variant one assume a mortgage of at least £30,000, but are unaffected if the mortgage is over £30,000). Marginal relief — based on 1985-86 indexed tax bands given in *Autumn Statement 1984.*

The main beneficiaries from the change will be those who have or wish to obtain mortgages or home improvement loans over the £30000 ceiling, particularly if they have incomes of about £16000 or less, since they do not now get any benefit from MIR at higher rates of tax. The main losers will be those on higher incomes, particularly £50000 and over, but with mortgages of £30000 or less. They will lose their higher rate relief, but get no benefit from the lifting of the ceiling. However, they will in many cases be households whose mortgages were contracted some time ago; they will usually have a big unrealized capital gain on their houses; and they may show a net gain if they move house and take out a mortgage of over £30000.

Other housing taxes

If MIR is to be reformed, but essentially retained, it may be argued that the owner-occupiers who benefit from it should not receive other fiscal privileges. But the exemption from capital gains tax, which was estimated to cost £2.5bn in 1983-84, is of much less significance since capital gains tax was indexed. The accumulated liability on ower-occupied homes arises only because indexation has not been carried back before 1983, as arguably it should have been. The Chancellor is in any case reported to be in the throes of reforming or possibly even abolishing capital gains tax. Any final judgment on capital gains tax for housing must await these wider measures.

There should be no question of bringing back Schedule A income tax, as long as domestic rates bring in a revenue of £5.5bn a year, of which about £4bn probably comes from owner-occupiers. There is a good case for abolishing rates (see 'Down with the Rates', *Lloyds Bank Economic Bulletin* No 39, March 1982), and a good case for updating rateable values if they are retained. Since the reintroduction of Schedule A would in any case require a nationwide revaluation, it would be better to spend five years carrying out this overdue task before deciding between rates and Schedule A as two alternative long-run options for the taxation of housing.

There is no sound economic reason for limiting personal interest relief to home loans, and denying it to borrowing for other purposes, including consumer credit and the purchase of financial assets. All personal interest qualified for tax relief before 1968 and between 1972 and 1974, and there is no justification for discriminating in favour of housing and against consumer spending or share ownership — both laudable economic objectives which have been favoured already by the present Government's policies. In fact the generalization of personal interest relief might divert some borrowing away from housing to other forms of personal expenditure, thus moderating the increase in house prices. The cost of extending interest relief at the basic rate to all personal borrowing would be about £900m, well within the Chancellor's expected 'fiscal adjustment' of £1.5bn in the March 1985 Budget. However, the timing of this measure could be related to the state of consumer spending, which might lead to its postponement to the 1986 or 1987 Budget, rather than the 1985 Budget.

Conclusions

1. Mortgage interest relief is costing the Treasury £3.5bn this year, the equivalent of 3p in the pound income tax. It is received by 7m mortgagors, and is worth an average of £500 each.
2. Mortgage interest relief exists in almost all industrial countries, and some also give tax relief on the principal of mortgage loans.
3. There is no particular economic merit in owner-occupation, so this form of tenure is not in itself a valid justification for mortgage interest relief.
4. Mortgage interest relief can be defended on the grounds that interest relief is given on business borrowing, and should not therefore be withheld on home loans.
5. The Chancellor should reform mortgage interest relief in this year's Budget, by limiting it to the basic rate of income tax, and removing the £30000 ceiling, at a cost of about £100m.
6. Interest relief should be given to personal borrowers on consumer credit and share ownership loans. as well as on mortgages, at a cost of about £900m, but not necessarily in the next Budget.
7. Mortgage interest relief should be balanced by taxation on housing. This exists in the form of domestic rates. Although rates are not the best form of housing taxation, efforts to abolish them have failed. There is no case for an additional tax on housing services as long as rates remain.

CHRISTOPHER JOHNSON
Group Economic Adviser, Lloyds Bank

Main economic indicators

NOVEMBER

Two main economic events dominated November: The Chancellor's Autumn Statement to the House of Commons on 12 November and the flotation of the British Telecom £3.9bn issue two weeks later. Both were well received by the financial markets, though the latter has caused temporary distortions to the money supply figures, as a result of the building up of bank deposits prior to the issue. Together with a PSBR of £2.6bn in banking November, this contributed to an unexpected high rise in £M3 (2¾ per cent), and brought the annualized rate to 12¼ per cent, 2¼ per cent outside the top of the target band. Since banking December is likely to be affected by the unwinding of the effects of the BT issue, it will not be until early February, when banking January's figures are released, that a clear picture of monetary trends will emerge. In the real economy, there has been a marked rise in retail sales, industrial production and the leading indicators. However, the Treasury's forecasts of 3½ per cent growth in gdp in 1985 and in a slowing-down in inflation from 4¾ per cent in the fourth quarter of 1984 to 4½ per cent by the fourth quarter of 1985 are widely regarded as too sanguine. Although retail prices rose by only 4.9 per cent in the year to November and will probably rise by less in the year to December because of the impact of the reduction in the mortgage rate, producer input prices were up 8.9 per cent and producer output prices rose by 6 per cent. The rise in average earnings is also still running well above inflation, at an underlying rate of 7½ per cent.

Publication date		Series	Change	Comment
Nov	Dec			
22	21	Current balance of payments (October p, sa)	−£73m	Record visibles deficit of £851m, resulting from imports being brought forward to avoid the VAT changes introduced on November 1st and additional fuel imports. Current account was −£73m, compared with −£578m in September, as a result of £528m EEC rebate and £250m surplus on invisibles.
29	3	Unemployment (excludes school leavers, p, sa)	+3,500	Follows revised increase of 3,200 in October, bringing the seasonally adjusted total to all time high of 3,103,200.
Dec	Jan			
4	3	UK Official Reserves	+$143m	Underlying rise $12m. Total $15,496m (£12,874m).
4	9	Housing starts (October, p, sa)	+4%	Down 6% in latest three months, compared with previous three months, and 14% lower than in August - October 1983.
6	Q	Balance of payments (Q3)	−£542m	Invisibles surplus revised upwards to £1.1bn. Visibles deficit widened to £1.6bn and £3.4bn excluding oil.
10	14	Producer output prices (p)	+0.3%	Twelve month increase 6.0%, compared with 6.2% in October.
10	14	Producer input prices (p)	+0.9%	Twelve month increase 8.9%, compared with 9.0% in October.
10	14	Retail sales volume (p)	+1.7%	Up 2½% in latest three month period compared with previous three months, and 4% higher than Sept - Nov 1983.
13	17	Output of the production industries (October, p, sa)	+0.8%	Up 1% in latest three month period compared with previous three months. Manufacturing output fell by 0.7% in October, while energy production soared by 4.7% because of rapid increase in oil production.
14	18	Retail prices index	+0.3%	Twelve month increase 4.9% compared with 5.0% in October.
14	11	Building society savings	+£502m	Follows October's £1,504m rise. Net receipts, £363m, were low because of BT issue, interest credited to accounts £139m.
17	21	Longer leading cyclical indicators (p)		Fourth successive monthly rise. Caused by rising share prices and lower interest rates.
18	17	Public sector borrowing requirement (p)	£1.8bn	Brings total so far in 1984/85 to £9.8bn, compared with target of £8½bn in 1984/85.
19	16	Average earnings (October, p, sa)	+2.7%	Up 8.2% in latest twelve months, compared with 6.3% in September. Underlying rise unchanged at 7½%.
20	Q	GDP (average measure, Q3, p,)	+0.3%	Up 1.4% on Q3 1983.
20	17	M0 (BN, sa) M1 (BN, sa) M2 (BN) M3 (BN, sa) £M3 (BN, sa) PSL2 (BN,sa)	+0.6% +3.3% +0.9% +2.8% +2.7% +2.2%	Increases at annual rate since start of target period (Feb 1984): M0 6.2%, M1 21.9%, M3 12.2%, £M3 12.2%, PSL2 16.9%. Target ranges set at 4 - 8% for M0 and 6 - 10% for £M3. Larger than expected rise in £M3 caused by high bank lending figure (£1.7bn, including Bank of England commercial bills) and large (£2.6bn) PSBR.

All changes are on previous month or quarter. BN = Banking November. p = provisional. sa = seasonally adjusted. * = level not change.

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ACCOUNTANCY AGE

15 NOVEMBER 1984

Prime Minister ④

ACCOUNTANCY AGE
15 NOV 1984

NEWS EXTRA

You might like to see the reactions of the accountancy profession (who are also partners) to Inland Revenue's consultative document. AT 16/11

Stopgap measures in the reform of partnership tax

Simon Pincombe gauges initial reaction to the Inland Revenue's consultative document on changes to the taxation of partnerships

Despite predictions by many leading experts that change is inevitable in the tax rules covering partnerships, there can be few who believe that the Inland Revenue has made a serious move in this direction with last week's consultative document.

By precluding a switch to the current-year basis of assessment because 'it would go very much wider than partnerships', the Revenue has denied itself the only solution that makes any long-term sense, even if it would be accompanied by horrendous transitional problems.

'All the other measures outlined in this document have their problems,' said Bill Packer, tax partner with Touche Ross. 'Any basis other than current year is arbitrarily unsatisfactory for one reason or another.'

The consensus is that the Revenue's document is inadequate because it contains no positive recommendations. Instead it merely identifies a problem and puts forward several different methods of tackling it.

But the document is uncharacteristically quick to point out the disadvantages of each method.

This negative approach is rather unusual in a Revenue consultative document and had prompted one source close to the Treasury to observe: 'The Revenue may well try to persuade the politicians that the time is not right to attempt such reforms and to shelve the project.'

But according to Wreford Voge, president of the institute of taxation, there can be no doubt that the Revenue is still working hard towards a current-year basis of assessment.

'I think it is particularly keen to tackle the existing partnership rules,' Voge said. 'But the move to a current-year basis will form part of an overall review of the tax system. The proposals in the consultative document are merely stopgap measures because the Revenue does not want to be seen as picking only on partnerships.'

Stopgap or not, the Revenue suggestions look certain to provoke a weighty response from partnerships, both individually and through the relevant professional bodies.

Few will argue that legal tax avoidance by partnerships under the present continuation and cessation provisions – which apply when there is a change in a partnership – can remain in principle. The document claims this could amount to £30 million a year. But it does not give any indication of how much revenue partnerships contribute to the exchequer's coffers.

Instead the profession will be keen to highlight the inherent difficulties in each of the Revenue's options and will press hard for equitable transitional arrangements to avoid undue hardship to individual partners.

Of the possible alternatives outlined in the document, the

Of the possible alternatives appears to be a mandatory continuation where the profits of a firm carrying on a continuing business would be assessed on the previous-year basis.

The commencement and cessation rules would apply only when a business actually began or ended and not when there was merely a change in the partnership line-up.

This approach would cut out all 'cessation coups' without placing an undue administrative burden on the Revenue and the taxpayers,

Wyman: 'potential hardship'

according to Thornton Baker partner Philip Hardman. But complex transitional arrangements would be needed and the possible introduction of a 'substantial common interest' proviso between old and new firms would pose further complications.

'But it looks like the best approach,' Hardman said.

Others, though, do not agree.

The first reaction of Deloitte Haskins and Sells tax partner Peter Wyman was to plump for an individual assessment of partners, despite Revenue complaints that this would mean employing 400 extra staff.

'While this option poses transitional problems the other measures contain potential elements of hardship in an ongoing situation,' he said.

Coopers and Lybrand tax partner Tony Tansley favoured yet another option in the extension of the existing commencement and cessation rules. 'Given that the only logical step of a switch to a full current-year basis has been precluded, this one looks like a fair bet,' he said.

The Revenue claims this would extend the cessation-coup cycle from five to nine years and reduce but not eliminate subsequent tax avoidance.

Other suggestions from the Revenue include the use of balancing adjustments. This was favoured originally by the public accounts committee when it drew attention in the late 1970s to the increasing use of tax avoidance by partnerships.

But the administrative burden on both the Revenue and firms would be immense. 'Good grief,' Hardman commented after considering the implications.

Although one tax partner said he was pleased that the Revenue 'had come out with an open mind' the document still has attracted pointed criticism.

One specific omission, according to Tansley, is the document's failure to address the subject of partnership mergers. 'This has been completely ignored,' he said.

And Wyman called the Revenue's insinuation that firms were manipulating their profits for cessation-coup purposes 'an unfortunate instance of mixing supposition with otherwise hard fact'.

The Revenue's final suggestion that there is a case for withdrawing the conventional accounting treatment used by some partnerships is also likely to provoke heated debate.

This has come as no surprise. But many believe the net gain will be immaterial to the Revenue while it is certain to completely upset affected firms' financing.

'This cannot be justified on equitable grounds – or any other grounds at all,' said Tansley.

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cc. Mr. HOBSON

10 DOWNING STREET

From the Private Secretary

25 October, 1984

Partnership Taxation: Basis of Assessment

The Prime Minister discussed with the Chancellor his minute of 28 September. She had also seen the exchange of correspondence between Sir Geoffrey Howe and Mr. Healey in 1978 which you sent over. It was agreed that it would not be right to pursue current-year assessment for partnerships.

The discussion then turned to whether the Inland Revenue should issue the proposed consultative document. The Prime Minister questioned whether it was necessary to change the basis of assessment of partnerships. The Chancellor explained that the document was intended as a response to the PAC which had identified an avoidance device. He assured the Prime Minister that if the result of the consultation process showed that changes to close this loophole could not be made without damaging the legitimate operation of partnerships, he would not proceed with them. On this basis, it was agreed that the document could be issued by Inland Revenue.

ANDREW TURNBULL

David Peretz, Esq.,
HM Treasury.

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

24 October 1984

Andrew Turnbull Esq
10 Downing Street
LONDON
SW1

Dear Andrew

PARTNERSHIP TAXATION:
BASIS OF ASSESSMENT

The Chancellor thought the Prime Minister should see a copy of the attached 1978 correspondence between Sir Geoffrey Howe and Denis Healey, the then Chancellor, before they discuss this matter tomorrow morning. I apologise for the quality of the copies.

Yours ever
David

D L C PERETZ
Principal Private Secretary

HOUSE OF COMMONS

LONDON SW1A 0AA

CH/EXCHEQUER
REC. - 8 DEC 1978
ACTION
COPIES TO
MR LOVELL
MR ...

Dear Denis

4th December, 1978

I have been studying the recommendations made in the Sixth Report from the Public Accounts Committee (Paragraph 60) to the effect that Schedule D tax assessments should be changed to a current year basis. I have, of course, also seen the Treasury Minute in reply, to the effect that the Board of Inland Revenue are continuing to study possible ways of putting this into effect.

You will appreciate that there is increasingly widespread concern amongst the self-employed at the prospect of this change. I should be most grateful if you could give me an indication of the Government's likely attitude to this proposal and also furnish some information which will help people in their consideration of the subject.

Am I right in thinking that about 2 million Schedule D taxpayers are likely to be affected by a change of this kind? The Committee's consideration of this subject originally arose from difficulties arising in connection with partnership accounts, a problem which it might be possible to deal with separately. Can you give me an idea of the (presumably much smaller) number of taxpayers who would be involved if any change was confined to partnerships?.

I believe that the total revenue raised from Schedule D taxpayers is about £4,000 million pounds? It has been suggested that any change of the kind proposed would involve either the collection of that sum of money from Schedule D taxpayers twice over (subject to any spreading provisions) in one year, or a willingness by the Treasury to forego the same sum, by missing a year's revenue? I understand the second alternative was adopted in Ireland in 1962 and should be grateful if you could confirm that point. Perhaps you could let me have a note about the Irish experience, specifying the number of taxpayers involved, and the amount of revenue that was, as I understand it, foregone.

Do you know which other countries follow the present British pattern? And are there any other examples of countries (apart from Ireland) which have changed from one system to the other? What was the procedure followed in any such case of changeover?

Mr Corlett

cc. Chairman
Mr ...
Mr ...
Mr ...
Mr ...
Mr ...
Mr ...
Mr Rogers
Mr ...
Mr ...
Mr ... Lewis

Quite apart from any change in the basis of assessment, may I ask whether you are also contemplating any change in the pattern of payment? And particularly any change which might accelerate the weighted average date of payment of the tax?

My present impression is that a general change (as distinct from one confined to the partnership problem) would involve a substantial upheaval, particularly in tax expectations, for some 7 million taxpayers. The not dissimilar changes made in respect of companies in 1965 involved considerable difficulty (albeit for a smaller number of tax units), including very complex transitional provisions. Is it not the fact that both the Tucker Committee and the Royal Commission (which reported respectively in 1951 and 1955) concluded against any change in the basis of assessment of individual Schedule D taxpayers?

Does not this experience suggest that we should be very reluctant to contemplate yet another change for the sake of change?

Certainly, I should have thought, it would be most undesirable to proceed with any change of the kind suggested unless and until draft proposals (together with all their implications) had been fully considered by a Parliamentary Select Committee, of the kind which has in the past considered, for example, changes in Corporation Tax and your own Wealth Tax proposals. I should be very glad to know that you agree with this view.

Perhaps you could be kind enought to give me an indication of the present Government's plans on this entire front, together with an indication of the possible timing of any changes which you may have in mind.

In view of the widespread interest in this subject, I am releasing copies of this letter to the press.

The Rt. Hon. Denis Healey MBE MP
Chancellor of the Exchequer
The Treasury
Parliament Street
SW1

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

5 January, 1979

Dear Geoffrey,

You wrote to me on 4th December about the recommendation made in the Sixth Report from the Public Accounts Committee that consideration should be given to switching Schedule D assessments from a previous year to a current year basis.

I think that any concern about this matter on the part of the self-employed is unnecessary. The Inland Revenue are carrying out a broad-based review of methods of tax assessment and collection generally, of which the examination of the possibility of a current year basis for Schedule D is just one aspect. So far as Schedule D is concerned, the review is still at an early stage.

The Government has undertaken this enquiry with an entirely open mind, without any commitment whatsoever to change, and we shall not be taking any decisions until in due course we have seen and considered the Inland Revenue's report. I am well aware of the importance of these matters to unincorporated businesses and the self-employed, and I can assure you that there is no question of our introducing fundamental changes in this area without full consultation beforehand with all interested parties.

The answers to the specific questions you put to me about the current year basis are as follows:

i. There are about 2 million assessments a year to tax under Cases I and II of Schedule D. Of these, about 400,000 relate to partnerships (covering 900,000 or so individual partners).

/ii.

The Rt. Hon. Sir Geoffrey Howe, QC., MP

ii. The latest available figure of the annual yield from Cases I and II of Schedule D is around £m1,200 (not £m4,000 as you suggest).

iii. It has always been recognised that there are a number of very real problems in moving to a current year basis, and those of the transition for existing businesses and the question of when tax is payable will be considered in the Inland Revenue's review. I cannot see, however, that it would be possible in moving to any new system to require businesses to pay two years' tax in a single year.

iv. I think you may have misunderstood what happened in the Irish Republic. They have always been on a previous year basis. In 1962, a Commission there advised against a switch to a current year basis, but recommended a change to the individual assessment of partners (which was subsequently implemented).

v. Most other countries seem to operate a current year basis, even though tax may be payable after the end of the year. None seem recently to have made a change from the previous year basis.

vi. The Tucker Committee did, as you say, come down against switching to a current year basis for Schedule D in 1951, and the 1955 Royal Commission accepted that conclusion for the taxation of those carrying on a trade either solely or in partnership.

Whether or not the basis of assessment for Schedule D is a suitable matter for a Select Committee is something that we can no doubt consider when the time comes. For the present, it is too early to say when the Government will be in a position to give its views on this matter, or even to issue some sort of discussion document. I envisage this review, however, as a contribution to the debate on the longer-term structure of the tax system, and clearly it is not something which should be rushed.

Since your letter to me was released to the press I am doing likewise with this reply.

Yours
Denis

(DENIS HEALEY)

CONFIDENTIAL

24 October 1984

MR TURNBULL

PARTNERSHIP TAXATION

As this subject may be discussed between the Prime Minister and the Chancellor tomorrow, a little more background information may be helpful.

Late in 1982, Nicholas Ridley at Treasury announced a review of Schedule D and the proposed issue of a consultation document.

The Revenue submitted a draft of this document, which included a discussion of a change to a current-year basis of assessment, late in 1983. This was turned down by Treasury Ministers in mid-1984, following which it was decided to issue the consultation document on partnership taxation, based on the continuance of the preceding-year basis.

Now that they have decided that they do not want to move to a current-year basis at the moment, it would be difficult to revive the project at an early stage, as the 1983 document would, in the view of the Revenue, "need to be looked at again fairly carefully". On the other hand, planning of important tax changes takes a long time if the necessary consultation process is to be followed, and it is probable

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that current-year assessment would be a necessary step in introducing computerisation of Schedule D.

Significant changes in Schedule D were introduced in the Finance Act 1984, but plans for further simplification - such as the introduction of a current-year basis - will need to be progressed, having regard particularly to the long timescale and the effect of the programme on computerisation.

As advised previously, we should not seek to prevent the consultative document going out, as it has been announced and is a response to PAC comment. But the general policy for Schedule D reform is of much greater importance. The Chancellor will argue that there is strong political opposition to current-year assessment: many partnerships benefit from paying tax on the lower figures of the previous year. He is right that any changes may arouse considerable fears and opposition; but simplification always does entail losers as well as winners. Its reception will depend on how fairly the changeover is accomplished.

David Hobson

DAVID HOBSON

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c Mr Hobson.

CC 1 / Revenue

10 DOWNING STREET

From the Private Secretary

8 October 1984

Partnership Taxation: Basis of Assessment

The Prime Minister has seen the Chancellor's minute of 28 September and has expressed concerns about the course he is proposing, in particular the decision not to pursue the introduction of a current year basis of assessment.

Andrew Turnbull

CST

David Peretz Esq
HM Treasury.

E.R.

Prime Minister (2)
John Redwood tells me you mentioned this subject today.
AT 5/10

I have grave doubts about the concerns the Chancellor proposes. I have already heard some criticism even though the paper is not released. I agree with David Hobson

MR TURNBULL 5 October 1984

PARTNERSHIP TAXATION: BASIS OF ASSESSMENT

It is regrettable that Nigel Lawson has found it necessary to change Geoffrey Howe's decision that this problem should be dealt with in the context of wider changes in Schedule D, including introducing a current year basis of assessment. It is understood that the 'political reasons' include the following:-

i. Uncertainty over how the changeover could best be accomplished.

ii. The changeover might affect progress towards self-assessment.

iii. The Revenue might need more staff. They say that the introduction of composite rate tax on bank interest will, however, reduce their additional staff needs by eliminating much work on bank interest assessments.

A current year basis of assessment would provide substantial tax simplification. The proposals in this consultative document will not do so. Nor do they deal with loss of revenue due to changes of financial year end.

Since the document has been announced as due for publication, we should not seek to prevent it going out. It will be received with little enthusiasm, and it may be felt that a good opportunity for tax simplification has been lost and that the proposals will in due course lead to further lengthy legislation.

The suggestion on the elimination of the 'conventional' or 'cash' basis of assessment include the possibility of continuing it for sole traders but not for partnerships. This needs reconsideration to avoid giving the impression that a successful one-man business which grows and takes on one or two partners might then be penalised by the Revenue by changing the basis of assessment. (Paragraphs 37 and 42).

David Hobson

DAVID HOBSON

file

08

cc 1/Revenue

5 October 1984

This is just to record that the Prime Minister has seen the Chancellor's minute of 28 September about the basis of assessment of partnership taxation. She is grateful to be kept informed of progress.

Timothy Flesher

Miss Margaret O'Mara,
H.M. Treasury.

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CC NO

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

PRIME MINISTER

PARTNERSHIP TAXATION: BASIS OF ASSESSMENT

In 1977-78 and again in 1979-80 the Public Accounts Committee were very critical of the ease with which partnerships could avoid income tax. The main way in which they can do this is by arranging for their profits to fluctuate from year to year and by then making partnership changes (which effectively wind up one business and start another) at appropriate times. Because of the rules of assessment for the opening and closing years of a business, years with low profits can then form the basis of assessment two or three times, while years with high profits are never assessed.

2. When I was Financial Secretary to the Treasury I announced in the course of one of the annual debates on the PAC reports that a consultative document on this matter would be issued. Subsequently, however, Geoffrey Howe decided that the issue should be considered, and a consultative document should be prepared, in the context of wider changes in the handling of Schedule D generally, including the possibility of introducing a current year basis of assessment. Because of the difficulties, particularly the political difficulties in that wider course, I have now decided to consider these further aspects on a longer timescale and to limit the document to its original purpose.

3. I thought that you would wish to be aware of the progress being made and I attach a copy of the document. Just before the recess John Moore announced that it would be published around now and the news did not attract a great deal of comment in the professional press. I believe that even those who benefit

from the avoidance recognise the present position cannot be justified.

N.L.
28 September 1984

318.2

PARTNERSHIP TAXATION: BASIS OF ASSESSMENT

INTRODUCTION

1. In answer to a Parliamentary Question on 25 July 1984 the Financial Secretary to the Treasury, Mr John Moore MP, said that he had authorised the Inland Revenue to issue a consultative document on the avoidance of tax by partnerships (Hansard, 25 July 1984 Col 637, Written Answers).

2. As Mr Moore said, attention was drawn to this form of tax avoidance by the Public Accounts Committee in two reports (Sixth Report in Session 1977-78 and Eighth Report in Session 1979-80). The Committee said that many partnership changes were arranged to secure the maximum tax advantage. The process was repeated at regular intervals, with the result that part of the profits earned over the life of the business was normally excluded from assessment to tax. In their view an equitable tax system required that all the profits should be assessed; and they hoped that every effort would be made to find a way of giving effect to that principle, either by the adoption of a current year basis of assessment or, as an interim measure, by some other means. This paper considers some of the ways in which effect might be given to their recommendations.

3. The views of interested parties and of others would be welcomed on these possibilities. Comments should be sent to Inland Revenue, Policy Division, Room 125, New Wing, Somerset House, London WC2R 1LB by the middle of November.

BACKGROUND

Partnerships

4. There are about half a million partnerships in the United Kingdom. Almost any form of business activity may be undertaken by them and they form an important part of the business sector. They range from two member trading partnerships operating in a local environment to large international firms commonly found in the professions. In general the maximum number of partners allowed in any firm is 20, but since 1967 this limit has not applied to accountants, solicitors and members of the Stock Exchange, and some firms now have over 200 partners. The latest analysis available [1981] of the number of partners in each firm is:

Total			457,221
of which	3	or more partners	86,639
"	4	"	30,276
"	5	"	9,175
"	10	"	951
"	20	"	189

5. Partnership is defined in Section 1(1) of the Partnership Act 1890 as "the relation which subsists between persons carrying on a business in common with a view of profit". Carrying on a business in partnership imposes particular obligations on partners as regards their liabilities to their fellow partners and others. Under English law a partnership is not a separate legal entity and the business is carried on not by the partnership but by the partners jointly. Under the different rules of Scottish law a partnership is a legal "person". In practical terms there is no distinction between Scottish and other partnerships in the matters considered by this document. But under both

systems each combination of members is in law a separate partnership and any change in its members brings it to an end.

Basis of assessment to tax

6. The profits of a business carried on by a partnership of individuals are computed under the normal rules of Cases I and II of Schedule D. The tax on those profits is charged in one sum in a joint assessment in the name of the partnership and not by way of separate assessments on each partner. The tax is calculated by allocating the assessable profit among the partners according to their respective rights to share in the profits of the year of assessment (not in the year used as the basis for that assessment) and the partners bear joint liability for the tax so charged.

7. Each time that there is a change in the partners carrying on a business, and whether or not the business continues more or less as before, its profits are computed as if it had been permanently discontinued and a new business set up and commenced. However where at least one individual is carrying on the business both immediately before and after the change and if all the partners in both the old and the new partnerships agree, the partnerships are assessed as if the business were continuing and the special rules for the opening and closing years of an unincorporated business are not applied.

The commencement/cessation cycle

8. Under the normal rules of Case I and II of Schedule D unincorporated businesses (both sole traders and partnerships) are assessed to income tax in any year on the profits of the 12 months period of account ending in the previous tax year. This rule is modified in the opening and closing years of business. The assessment for the tax year in which a business starts is based on the actual profits

arising in that year; for the second tax year it is based on the profits of the first 12 months of the trade or profession; and for the third year (and subsequent years) it is based on the profits of the 12 months account ending in the previous year. In the closing year (and in the two previous years if the profits are higher than on the preceding year basis) the assessment is on the profits actually made. The result is that in the normal way the profits of the first year form the basis of up to three years of assessment, while on a cessation the profits of a corresponding period of up to two years fall out of assessment altogether.

9. These rules almost always result in a mismatch between the profits earned over the lifetime of a business and the profits assessed to tax. In general the benefit lies with the taxpayer since the profits assessed more than once at the beginning of the business will usually, but not always, be less than the profits not assessed at all at the end, even setting on one side the effects of inflation. However in the ordinary way the commencement and cessation rules will apply only once over the lifetime of a business.

10. When applied to partnerships however these rules on the opening and closing of a business may operate more than once and can give rise to substantially greater reductions in tax liabilities. This is because, as explained above, on each occasion when a new partner is admitted or a partner retires, the partnership has the opportunity, quite legitimately, to choose between treating its business as ceasing (and hence as a new business commencing) and electing to regard it as continuing. In a big firm there will inevitably be partnership changes every year, while a small firm can often arrange to have a partnership change when it is most advantageous.

11. In the large firms a commencement/cessation cycle can be arranged every five or six years; and within that period the profits for some years will be taxed two or three times while for other years the profits will not be taxed at all. A firm with frequent partnership changes can arrange, quite simply, that a change before a year of abnormally low profit will be treated as the occasion for a cessation for tax purposes. With a little more sophistication, involving, for example, the transfer of work in progress, the profits of the year which is to be taxed more than once can be substantially reduced to below the normal figure and the profits which fall out of the tax charge will be very much greater.

12. Example A firm with a continuing business and partnership changes every year starts a new partnership for tax purposes in 1980 and closes it in 1985. In the intervening years the partners elect for the partnership to continue. The firm makes up its accounts to 5 May. Its actual profits and work in progress are running at the same level each year but by transferring the work in progress from the old firm to the new firm at a figure considerably in excess of cost, (in this example for £1,080,000 more than the normal valuation) it ensures that its accounts show an abnormally low profit for the first year of the new partnership.

Profits		Income tax			
Year to 5 May	Amount shown (000s)	Year of assess- ment	Basis	Basis period	Amount assessed (000s)
1981	120	1980-81	Actual	6 May 1980 -5 April 1981	110
1982	1200	1981-82	First 12 months	6 May 1980 -5 May 1981	120
1983	1200	1982-83	*PY	6 May 1980 -5 May 1981	120
1984	1200	1983-84	≠PY	6 May 1981-5 May 1982	1200
1985	1200	1984-85	≠PY	6 May 1982-5 May 1983	1200
		1985-86	Actual	6 April 1985-5 May 1985	100
	4920				2850
Assessed on old partnership	1080				1080
Actual profits	6000			Amount assessed	3,930

*The partners do not elect for the actual profits to be assessed.

≠ No cessation adjustment is necessary for these two years since the actual profits are the same as the profits on the preceding year basis.

Taking the figures for the new partnership in isolation, 42 per cent of the profits have not been taxed. However, as a result of the disposal of the work in progress, there will be an increase in the profits of the final year assessed on the old partnership. To that extent the amount unassessed will be lower than shown. Nevertheless there will still be a considerable shortfall of 34.5 per cent in the amount taxed, 6000 - (2850 + 1080), and this process could be repeated at five-yearly intervals.

13. At the time of their enquiry, the Public Accounts Committee found that in a selection of 13 partnerships some £m12 or 23 per cent of the actual profits had escaped assessment with the individual amounts ranging up to more than £m2 and up to 35 per cent of the profits in some cases. Very many partnerships pay tax on the full amount of their earnings; but the latest estimates suggest that the amount of tax being avoided by other partnerships could be of the order of £m30 which, allowing for changes in earnings and tax rates, remains very much in line with these earlier figures. In addition in some cases substantial accumulated profits have not been charged to income tax because of the use of a basis for computing profits other than a full earnings basis (see paragraph 35 below).

14. The next section of this paper is concerned with possible ways in which the opportunities for partnerships to take advantage of the opening and closing rules for businesses could be eliminated or at least reduced. In considering the various possibilities outlined, the Government will wish to be satisfied that the effects on the firms and their partners are not unduly onerous; and that the administrative costs on the Inland Revenue and the compliance burden on firms are acceptable.

POSSIBLE CHANGES TO THE PRESENT RULES

Current year basis of assessment

15. As the Public Accounts Committee pointed out, the use of a current year basis of assessment for unincorporated businesses generally would ensure that the profits assessed always equalled the profits earned over the lifetime of a business. A current year basis would therefore

automatically eliminate the present loss of tax from partnerships simply because there would be no opportunity for profits to escape assessment.

16. The introduction of a current year basis of assessment however would raise questions which go very much wider than partnerships. The paper is solely concerned with measures which could be taken within a system in which assessments are made generally on the profits of the previous year.

Individual assessment of partners

17. One possibility would be to assess each partner individually on his share of the partnership profits as if he were carrying on a business which started when he joined the partnership and ended when he left it. But this would bring the complication that for any year of assessment some partners might be assessable on a previous year basis and others on a current year basis. There would also be difficult technical problems such as, for example, in allocating capital allowances. Up to 400 additional Revenue staff would be required because of the extra work arising from assessing and collecting tax from all partners separately, and by the same token there would be more work in total for partners and their advisers.

18. One of the possibilities suggested by the Public Accounts Committee was that the benefit of the commencement and cessation provisions should be denied to the continuing members of a partnership but allowed to departing or new members. This would give rise to the same sort of difficulties as with individual assessments, but the application of the provision and hence the frequency with

which the technical problems would arise would be less: accordingly the administrative consequences would be less serious. Nonetheless at first sight an approach along these lines would appear to have considerable disadvantages.

Mandatory continuation

19. A second possible approach would be to provide that, although each successive partnership should be assessed separately, the profits of a firm carrying on a continuing business should be assessed on the previous year basis; the commencement and cessation rules would apply only when a business actually began or ended. This would more closely reflect reality for large partnerships where a change in the members usually has no appreciable effect on either the business or its profitability.

20. One question which the Government will wish to consider is whether continuation treatment throughout the life of a business might cause hardship to new partners. First, a partnership change may in some instances fundamentally reduce the size and profitability of the business - for example on the retirement of a senior partner in a small firm - leaving the remaining partners liable to tax on the higher profits of the old partnership; and second, while a change in partners may not affect the ongoing level of business profits, an in-coming partner may find himself liable to pay tax on more profits than he is entitled to receive.

21. On the other hand, continuation elections are often made following a partnership change and a new partner may frequently find himself in this position. In particular, for partnerships taxed on a conventional basis (see paragraph 35 below), a continuation election is usually essential: if it is not made, the consequences will often be a substantial tax charge for the reason given in paragraph 39. When there is a change in the partnership

arrangements the old and new partners often have to settle a great many matters besides tax and it might not be unreasonable to assume that the taxation consequences of continuation could be left as a domestic matter for the partners in reaching a new partnership agreement.

22. Alternatively, mandatory continuation might not apply to all partnership changes. It might be possible, for example, for continuation to apply automatically only where there was a substantial common interest (eg 75 per cent) between the old and new firms. However there could be an additional measure of complexity in ensuring that this operated satisfactorily.

23. Mandatory continuation would be administratively simpler for both the Revenue and for taxpayers than the present system. Even though each partnership would still need to be assessed separately, it would no longer be necessary to adjust the assessments for previous years following a change.

Greater use of the current year basis

24. A third possible approach would be to apply the current year basis to partnerships generally, even though the present rules (set out in paragraph 8 above) were being maintained for sole traders - the difference in treatment would then be justified on the grounds that the scope for manipulation of the opening and closing rules by sole traders was very considerably less than the Public Accounts Committee had found was being practised by partnerships. If it were felt however that to apply the current year basis to all partnerships would be carrying the logic of this argument too far, then the previous year basis might be retained but the extent of its use restricted.

25. <u>Mandatory Cessation</u>. Under one variant of this approach each change in the members of a partnership would be treated for tax purposes as a cessation of the business. Mandatory cessation would effectively result in large firms with frequent changes in composition being permanently taxed on a current year basis, but small firms with less frequent changes of partner would remain relatively unaffected.

26. Although (as with mandatory continuation) there would be no possibility of a new partner being required to pay tax on the profits earned before he joined the firm, mandatory cessation could also pose difficulties for firms. Given the tendency for profits to rise, the effect of the closing rules is normally to require an adjustment to the assessments for the two years prior to a cessation. As a result there could be further and possibly unexpected bills for some partners. There would also be problems for partnerships now assessed on a conventional basis for the reasons discussed in paragraph 39 below.

27. The additional work involved in reviewing the assessments and making adjustments would add both to the administrative costs of the Inland Revenue and to the compliance costs of firms. Moreover mandatory cessation could also have an adverse effect on the cash flow to the Exchequer. At present in the year of a partnership change, tax is paid on a provisional basis on the normal due dates until the necessary continuation elections are made. Mandatory cessation might delay the payment of tax until at least 12 months after the commencement of the new partnership and there could be considerable delay in settling the individual partners' liabilities.

28. One way of cutting down the use of the preceding year basis, which would at least reduce the difficulties suggested above, would be to apply the current year basis permanently where continuation could have, but had not, been claimed even though there was a substantial common interest

between the partnerships. On this approach, following a comparatively minor change in the interests in a partnership, the partners would be able to choose between electing for the continuation treatment or having the cessation provisions applied to the old partnership and the permanent adoption of the current year basis for the new (and any subsequent) partnership.

29. <u>Extension of existing commencement and cessation rules</u>. An alternative way of getting round the difficulties seen under this head would be to retain the present election for the continuation basis, but to provide that, on the cessation of a partnership and on the commencement of a new partnership, the current year basis should be used for a longer period - for, say, the last four years of the old partnership and/or the first four years of the new partnership. This would ensure that a large firm which elected for continuation regardless of partnership changes was unaffected, but at the same time it would reduce, although not eliminate, the opportunities for avoidance. The minimum length of the commencement/cessation cycle described above would be increased from five to nine years.

30. The advantage of this approach would be that it would be simple and require little change from the existing rules: in practice its existence would probably have the indirect effect of ensuring that many firms remained permanently on a previous year basis. The administrative burden for the Revenue and the compliance costs for firms would be broadly unchanged.

31. On the other hand, this approach would entail different rules for partnerships from those for other unincorporated businesses and it might be thought to impose an undue burden in cases where the mismatching of profits arose from the normal operation of the rules rather than from the contrived arrangements which the Public Accounts Committee sought to prevent. The latter objection could itself be met by

extending the use of the current year basis only in those cases where the profits of the opening year of a new partnership were abnormally low compared with the previous and succeeding years: however clearly the simplicity of this approach would then be lost in the detailed rules needed to determine what were abnormally low profits.

Balancing adjustments

32. A fourth approach would be that suggested by the Public Accounts Committee. The present election arrangements would be left as they are, but the mismatching between profits earned and profits assessed over the life of a parternship would be overcome by a balancing charge or credit in the final year of assessment when there was a cessation for tax purposes.

33. A difficulty in this approach is that many larger partnerships elect for the continuation basis to be applied on a change of partner so that they would not therefore be affected for very many years. When in due course they were - and if the records were then available - the partners in the business at that time would have to bear the liabilities which had accrued many years before. To alleviate this problem the pattern of earnings and assessments could be reviewed at regular intervals - say every five or ten years - with balancing charges or credits made accordingly. Nonetheless it might still be argued that new partners could find themselves bearing liabilities which had properly accrued to their predecessors, but that they had had no means of indemnifying themselves against these liabilities at the time that they entered the partnership. Similarly they might effectively receive repayments of tax actually paid by their predecessors.

34. It could also be argued that this solution would go further than was strictly necessary since it would deal with the mismatch between profits earned and taxable profits which may apply to all businesses and not simply to partnerships. On this argument, if the possibility of a balancing charge or allowance is to be pursued, it should apply to all businesses and not just to partnerships. In any event there would be a substantial administrative burden both for the Inland Revenue and for the firms themselves.

A CONVENTIONAL BASIS OF ASSESSMENT

Use of a conventional basis

35. So far this document has been concerned only with partnerships which take advantage of the commencement/cessation cycle to reduce their taxable profits, either by arrangement or in the natural course of events. Some partnerships, however - in particular medium size and big professional firms - remain permanently on a preceding year basis. While in these cases there will be no mismatching the full amount of earnings made by the firms may not be brought within the tax charge. This is because professional firms not infrequently draw up their accounts on what is known as a conventional basis. Perhaps one in four or one in five of the larger firms do so; so that when account is also taken of firms who use the commencement/cessation cycle less than one firm in two is assessed on the full measure of its profits.

36. The most usual reason why a firm on a conventional basis may not be assessed on a full earnings basis is that professional work in progress will be left out of account. The result is that any increase in its value year by year is not brought into the tax charge nor is a deduction given for any reduction in it. Before the introduction of modern accounting techniques it was more difficult to value work in progress and it may often have been simpler for both the

firm and the Revenue if work in progress were ignored: before the war or even in the 1950s the expectation was that, for an established business, taking one year with another, such a conventional basis would produce broadly the same tax results as the full earnings basis. It was therefore a useful measure of simplification. In practice however the result has generally been to favour the taxpayer so that by now there is a shortfall, running into seven figures in some of the largest cases, in the accumulated profits which have been charged.

37. Although a conventional basis of computing profits may be used by all professional businesses, whether partnerships or sole practitioners, in practice it is mainly in the large partnerships that the difference between profits on a conventional and on an earnings basis is most marked. Moreover the use of this basis is more objectionable in the case of partnerships, since it is inevitable that a business run by a sole practitioner will one day come to an end and (leaving on one side questions of cash flow as well as the mismatch to which reference has already been made) any amounts which have not previously been assessed will then be brought into charge. This is not the case with partnerships where the accumulated profits unassessed may never in practice be brought into the tax charge unless mandatory cessation (see paragraph 25 above) were to be introduced.

Withdrawing the use of a conventional basis

38. There is then a case for discontinuing the use of conventional bases of computing profits for professional partnerships at the time that the commencement/cessation cycle is tackled. Firms which are no longer able to benefit from that cycle may otherwise look to a conventional basis as an alternative means of reducing the charge below that on

their full earnings; while those firms which have paid tax on the full measure of their partnership earnings over the years may consider that the time is ripe for all firms to be assessed on the same basis.

39. There would be no difficulty in requiring that all new partnerships should use the earnings basis. Indeed for some time the Revenue has required that the profits of a profession for its first three years should be computed for tax on a full earnings basis. At the same time a conventional basis could be discontinued for future years for partnerships which are already using it. The question which arises however is whether special provision is needed to deal with the transition since the effect of so doing would not merely be to put these businesses onto the full earnings basis, in future. It could also give rise to a substantial charge in the year of change as the opening work in progress now brought into account would immediately become subject to tax under Case VI of Schedule D.

40. This would seem to require some alleviation, particularly since, if the full earnings of these firms had been assessed in the last ten years, stock relief would have been available to cover that part of any increase in the value of work in progress attributable to changing prices. Moreover the partners who would now have to meet the tax charge would not necessarily be the same as those who had previously enjoyed the benefit of the use of a conventional basis. And there may very well be no means by which the new partners could obtain recompense from the old ones. On the other hand there will be many other cases in which the existing partners will be the same as those who enjoyed the benefits of a conventional basis and it is by no means clear why they should be enabled to retain the benefit while partners in other firms have paid tax on the full amount of their earnings.

41. There are a number of ways in which some means of tempering the change could be found. For example, the charge might be limited to any increase in the value of work in progress over say the last six years, possibly after taking into account the stock relief which would have been due - in this way the extent to which new partners would effectively be called upon to pay the liability of the old partners would be reduced. An alternative would be to spread the liability, and thus also the payment, for the additional amount over the following six years. It might be suggested that the amount falling due should be put into cold storage until such time as the business ceased. However, in particular in the case of large established partnerships, this last course could in practice be tantamount to exemption and this would seem to be going too far.

Sole Practitioners

42. It was suggested in paragraph 37 above that the case for withdrawing the conventional basis from partnerships was greater than it was in the case of sole practitioners. Nonetheless if it were to be withdrawn from partnerships, it would be for consideration whether it should be withdrawn from unincorporated businesses generally. The problem arises very largely with partnerships, but where there are sole practitioners on a conventional basis there would be less difficulty in bringing its use to an end; for example, there would be no conflict between the interests of different partners. On the other hand any business run by a sole practitioner will inevitably come to an end in due course so that the matter is of less importance than it is in the case of partnerships.

43. In any event barristers provide a special case. There have always been special rules for members of the Bar which flow from their inability to sue for their fees. Subject to any consideration of the way in which the transition on the ending of a conventional basis is dealt with generally, there may be a case for leaving their tax treatment as it is.

SUMMARY AND QUESTIONS FOR CONSIDERATION

44. During the 1970s the Public Accounts Committee twice drew attention to the extent to which some partnerships were avoiding tax through the use of the commencement/cessation cycle and recommended that action should be taken to bring it to an end. The question arises therefore how this use of the present rules might best be brought to an end, bearing in mind the clear need for partners to be able to carry on their ordinary work without unreasonable burdens being placed on them.

45. There is also a good case for bringing to an end at the same time the use of a conventional basis of computing profits for tax. As a result of its use some professional partnerships have accumulated substantial amounts of income which have not borne tax and which are in practice unlikely to do so under the present rules.

46. The questions for consideration on which comments are sought are whether the commencement/cessation cycle should be brought to an end by:

a. individual assessment of partners (paragraphs 17 and 18);

b. mandatory continuation (paragraphs 19 to 21);

c. mandatory continuation where there is substantial common interest between the old and new partnerships (paragraph 22);

d. mandatory cessation (paragraphs 25 to 27);

e. the use of the current year basis where continuation treatment could have, but had not been, claimed (paragraph 28);

f. extending the application of the current year basis within the existing commencement/cessation rules (paragraphs 29 to 31); or

g. the use of balancing adjustments in the last year of a business or at regular intervals (paragraphs 32 to 34)?

47. Should the use of a conventional basis of computing profits for tax be brought to an end at the same time:

a. for all partnerships (paragraph 39);

b. subject, for existing partnerships, to one of the transitional provisions discussed (paragraph 41); or

c. for sole practitioners as well (paragraph 42)?

FILE 57

10 DOWNING STREET

From the Private Secretary 10 January, 1984

The Prime Minister has asked me to thank you for your letter of 23 December with which you sent her a copy of a recent article on the effects of taxes and benefits on household incomes.

The Prime Minister was very interested to see this, and most grateful to you for sending it.

DAVID BARCLAY

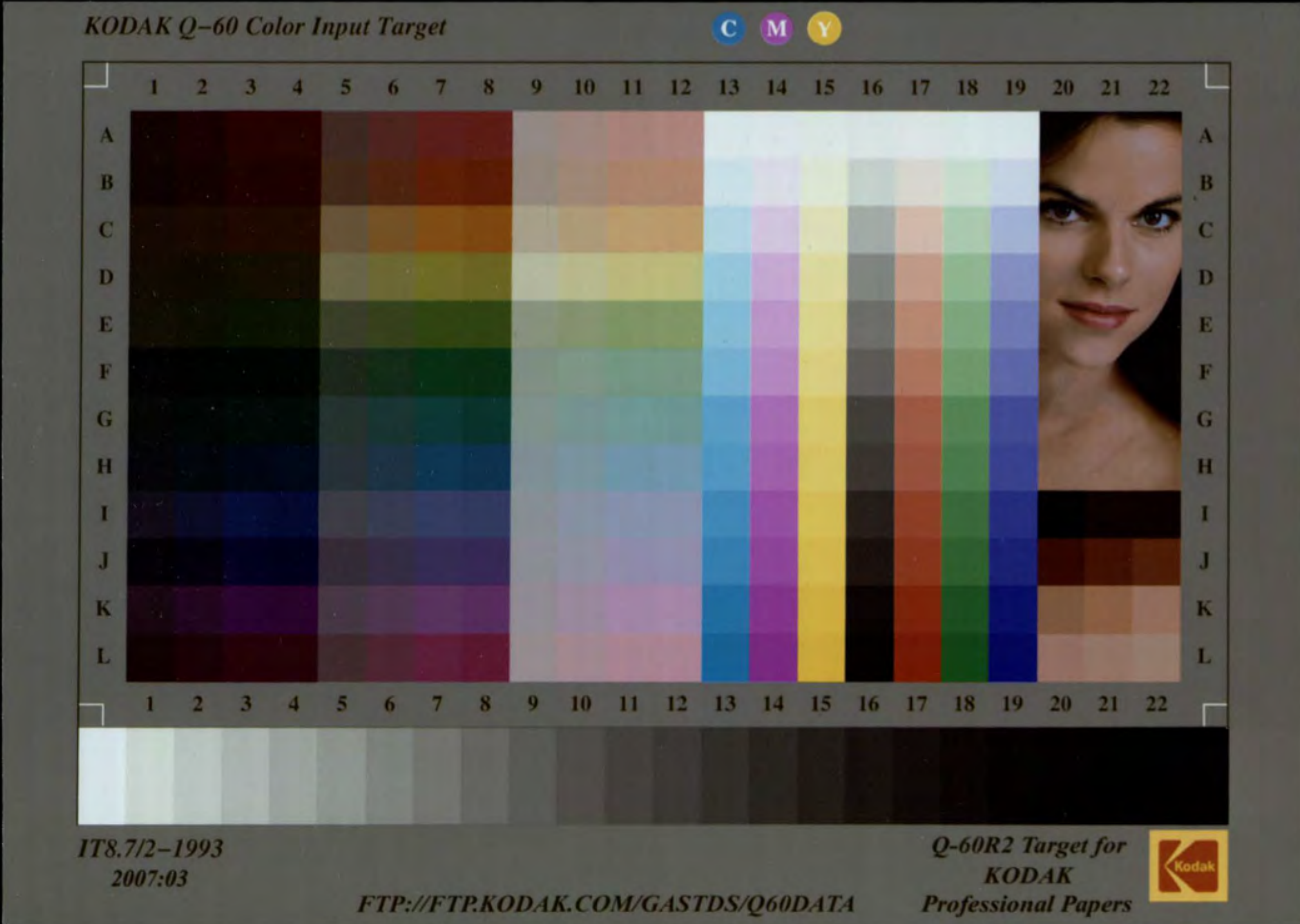
Sir John Boreham, K.C.B.

PART 1 ends:-

Sir J Boreham to PM 23.12.83

PART 2 begins:-

DB to Sir J Boreham 10.1.84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