

SECRET

CONFIDENTIAL FILING

Interim Report of the Working Group on
Tax and Savings

ECONOMIC
POLICY

Tax Reliefs for Housing

Part 1: March '80

Green paper of Taxation of Husband
and wife

Part 3: February '86

(Green Paper on Personal Taxation
in attached folder)

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
6.2.86							
11.2.86							
17.2.86							
21.2.86							
mag 17.86							
11.6.86							
29.6.86							
4.7.86							
10.7.86							
14.7.86							
18.7.86							
12.3.87							
18.3.87							
X ENDS X							

PREM 19/2097

Contents of attached Folder

- 1) Two copies of Green Paper on Personal Taxation.

PART THREE ends:-

FST to DRN 18/3/87

'Green Paper on the Reform of
Personal Taxation'.

PART four begins:-

ARN to HMT 6 July 1987

Tax Arrangements for Expatriates.

Cabinet / Cabinet Committee Document

The following document, which was enclosed on this file, has been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate CAB (CABINET OFFICE) CLASSES.

Reference: CC (86) 8th Conclusions, Minute 6

Date: 27 February 1986

Signed A. Dayland Date 3 September 2015

PREM Records Team

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

Cmd. 9756: The Reform of Personal Taxation
HMSO, March 1986 [ISBN 0 10 1975600]

Signed AWayland Date 28 July 2015

PREM Records Team



CCRB

Treasury Chambers, Parliament Street, SW1P 3AG

David Norgrove Esq
Private Secretary
10 Downing Street
Whitehall
LONDON SW1

18 March 1987

*Seen by P.N.
DHR
18/3*

Dear David,

GREEN PAPER ON THE REFORM OF PERSONAL TAXATION

The Financial Secretary has asked me to send you a copy of the speaking note he intends to use in his wind-up speech in the Budget Debate this evening.

I am copying this note, with attachment, to the Private Secretaries of the Lord President, the Chancellor of the Duchy of Lancaster and the Secretary of State for Social Services.

*Yours,
Jeremy*

JEREMY HEYWOOD
Private Secretary

ENCS

Last year on Budget day, my Rt Hon Friend published a Green Paper on the Reform of Personal Taxation. The Government invited comments from organisations, representative bodies and members of the public on the ideas discussed in the Green Paper. I have to tell the House that the response to the Green Paper has been disappointingly thin. Although the majority of those who responded to the Government's invitation expressed themselves in favour of transferable allowances, the Government does not yet feel that there is sufficient support to take a decision now to go ahead with so far-reaching a reform.

Nevertheless the Government considers it important both that the tax system should give women a fair deal; and that the tax penalties on marriage should be removed. We will therefore be considering the matter further and will be exploring whether there is any satisfactory halfway house to the approach in the Green Paper.

070
CONFIDENTIAL

D0723

PS/PRIME MINISTER
PS/CHANCELLOR OF THE EXCHEQUER

cc PS/Secretary of
State for Employment
Mr Dworkin, DEM
Mr D Sellwood, DEM
Mr J Calder, IR
Mr J Hibbert, CSO
Mr D Flaxen, CSO
Mr T Griffin, CSO

WBM

TAX AND PRICE INDEX

You will have already seen the briefing provided by the Secretary of State for Employment about the implementation of improvements to the Retail Prices Index in the index for February, to be released on Friday 20 March. These improvements stem from recommendations made by the RPI Advisory Committee.

You will wish to be aware that the Tax and Price Index to be released on the same day is to be re-referenced with January 1987 taken as 100, in line with the RPI. Otherwise the TPI is largely unaffected by the recommendations on the RPI made by the Advisory Committee. The only change follows from the RPI now measuring housing costs gross of housing benefit; the income base for the TPI will now include that part of housing benefit received by taxpayers. This will have a negligible impact on the index.

M. J. Erritt

M J ERRITT

Division III
Central Statistical Office

12 March 1987

CONFIDENTIAL



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

18 July 1986

David Norgrove Esq
10 Downing Street
LONDON SW1

cyBI

NBRN

Dear David

**BOARD OF INLAND REVENUE'S ANNUAL REPORT;
AND TAXPAYER'S CHARTER**

The Prime Minister and the Chancellor discussed the draft Taxpayer's Charter on 11 July. The Chancellor agreed to see what could be done to work in the fourth of Peter Warry's points (about having regard to the size of businesses). In the event, we have also been able to take some account of Peter Warry's first point (that taxpayers should not be required to pay more tax than is due). I attach a copy of the Charter in its final form, with the two additions highlighted.

As I mentioned to you and to Tim Flesher yesterday, the Charter will be launched with the publication of the Board of Inland Revenue's 128th Annual Report (for the year ended 31 December 1985). It is proposed to publish the Report including the Charter on the morning of Friday, 25 July. The Report will be laid before Parliament, but does not require any Statement in the House.

Yours ever,

Tony

A W KUCZYS



TAXPAYER'S CHARTER

JULY 1986

You have important rights and entitlements as a taxpayer. You are entitled to expect that:

Help and Information

- the staff of the Inland Revenue and Customs and Excise will help you in every reasonable way to obtain your rights and to understand and meet your obligations under the tax laws. So that they can do this, the Inland Revenue and Customs and Excise are entitled to expect that you will give them the full facts they need to decide how much tax you should pay.

Courtesy and Consideration

- the staff of the Inland Revenue and Customs and Excise will at all times carry out their duties courteously, considerately and promptly

Fairness

- you will have your tax liability decided impartially and be required to pay only the amount of tax properly due according to the law
- you will be treated in the same way as other taxpayers in similar circumstances
- you will be presumed to have dealt with your tax affairs honestly, unless there is reason to believe otherwise

Privacy and Confidentiality

- information about your tax affairs which is supplied to the Inland Revenue or Customs and Excise will be treated in strict confidence and used only for purposes allowed by law

Costs of Compliance

- the Inland Revenue and Customs and Excise will have regard to the compliance costs of different taxpayers (including the particular circumstances of smaller businesses). In applying their procedures, they will recognise the need to keep to the minimum necessary the costs you incur in complying with the law, subject to their duty to collect the tax that is due from you efficiently and economically.

Independent Appeal and Review

You may ask the Inland Revenue or Customs and Excise to look again at your case, if you think your tax bill is wrong or they have made a wrong decision, or they have handled your tax affairs badly. Your case can be reviewed by the head of the local office you are dealing with. If you are still not satisfied, you may take the matter up with the Inland Revenue Regional Controller or the Collector of Customs and Excise, or with their Headquarters. Beyond that, you have important rights to independent appeal.

For Inland Revenue taxes, you may appeal against your tax bill to an independent tribunal, the appeal Commissioners, and if necessary to the Courts.

For Customs and Excise taxes and duties, you may appeal against a VAT decision to the independent VAT Tribunals; or in the case of other taxes or duties directly to the Courts.

You may ask your Member of Parliament to take up your case with the office you are dealing with or with Treasury Ministers. Your Member of Parliament may also ask the independent Parliamentary Commissioner for Administration (the Ombudsman) to review your case, if you think that the Inland Revenue or Customs and Excise have handled your tax affairs improperly.

ECON POL
TAX + SAVINGS
PT 3

SUBJECT
cc MASTER



meeting Ech
heard
bc BG

10 DOWNING STREET

From the Private Secretary

11 July, 1986.

TAXPAYERS CHARTER

The Prime Minister and the Chancellor today discussed the draft taxpayers charter attached to your letter to me of 7 July, and Peter Warry's minute to the Prime Minister of 9 July.

The Chancellor agreed to see what could be done to work in the fourth of Peter Warry's points, to promise that the Inland Revenue would have regard to the size of a business when stipulating the administrative procedures necessary to meet Revenue requirements. The Chancellor argued that the precise words suggested by Mr. Warry could not be used, but suggested that words along the lines "the Revenue will have regard to the compliance costs of different sizes of business" might be acceptable. The words to be used would need to be further considered.

The Prime Minister urged that the charter should be expressed throughout in the clearest and simplest language possible.

David Norgrove

Mrs. Rachel Lomax,
HM Treasury.

Ech

NBPN.

TAXPAYERS' CHARTER

The proposed Charter is already a useful improvement to the taxpayers' rights, but it could be made still better if some of the points below were also incorporated.

Never knowingly to demand more tax than is due, save where the taxpayer has failed to submit accounts. (This is already implicit in the Charter's commitment to act within the law, but it could be made explicit.) Particularly in cases of suspected (but not proven) fraud, some Inspectors make large (often unwarranted) assessments in order to bring the taxpayer to terms. This is fine if the taxpayer is on the fiddle; but is a terrifying and expensive ordeal if the taxpayer is innocent.

Normally not to apply retrospectively new policies or new interpretations of the law to the taxpayer's disadvantage. This has been a major cause of complaint in the past: for example the crèche benefits case, where practices which had previously been tolerated appeared suddenly to become retrospectively taxable.

A de minimis rule whereby the Revenue would not pursue tax liabilities where the burden of assessing and collecting them was disproportionate to the amount involved. The Revenue already operate such a rule unofficially. Nevertheless, some pedantic Inspectors still pursue trivial cases, perhaps causing great worry to those (often elderly widows) ill-equipped to deal with them. As policy, the Revenue also pursue minor taxable benefits (eg subsidised canteen meals) which can involve a quite disproportionate amount of work on the part of employers. The worst situation, however, is innocent taxpayers suspected of fraud: once the Revenue's main case collapses, they often pursue all sorts of trivial issues to secure some recovery -

however small - in order to maintain their statistical success rate.

A de minimis rule could, however, result in two taxpayers with similar incomes paying different amounts of tax because of the different ways in which it was collected. (One getting the advantage of the de minimis rule and the other not.)

Have regard to the size of a business when stipulating the administrative procedures necessary to meet Revenue requirements. Many small businessmen are required by the Revenue to itemise in detail all their expense claims (who, what, where, when). In larger companies, provided they have a proper expense authorisation procedure, expenses are accepted by the Revenue on the nod. Whilst many small businesses do abuse expenses, asking for detailed information does not necessarily prevent abuse, and certainly puts a disproportionate burden on innocent small businesses compared to large ones.

Provide some independent form of appeal against breaches of the Taxpayers' Charter. (Appeal Commissioners can hear disputes about tax assessment but not about tax administration which is the substance of the Charter.) Unfortunately the Revenue, like most organisations, is unwilling to admit to mistakes, and appeals up the line are not always satisfactory. Appeal to one's MP, who can then take the matter up either with the Revenue or pass it on to the Ombudsman, is a bigger hammer than necessary to crack this particular nut. Extending the powers of the Independent Appeal Commissioners also to consider breaches of the Taxpayers' Charter would be one way of providing a simple independent route.


PETER WARRY



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cc Bly

10 DOWNING STREET

From the Private Secretary

9 July 1986

TAXPAYERS' CHARTER

Rachel Lomax wrote to me on 7 July enclosing a draft taxpayers' charter. Peter Warry has suggested some additions to this and I am, with his agreement, sending you a copy of his minute to the Prime Minister. We agreed that the quickest way of taking this forward would be for the Prime Minister and the Chancellor of the Exchequer to discuss the Charter at their bilateral on Friday.

DAVID NORGROVE

Tony Kuczys, Esq.,
H M Treasury

M

PRIME MINISTER

9 July 1986

TAXPAYERS' CHARTER

This Charter is a useful addition to the taxpayer's "administrative" right to have his tax affairs dealt with sensibly and fairly. If enforced, it should be much harder for individual inspectors to harass the innocent taxpayer.

But enforcement is the problem: whilst one can appeal to independent appeal commissioners over matters of tax law, appeal over tax administration (the substance of the Charter) is only up through the Revenue or to one's MP. Unless (say) the commissioners' powers are extended also to review administration, the Charter cannot be fully effective.

On detail, the Revenue could also give commitments in the Charter:

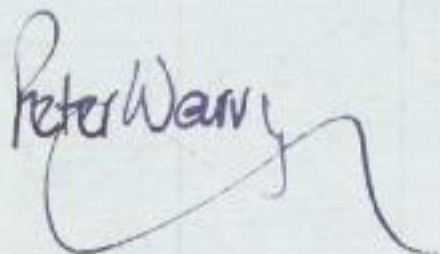
- never knowingly to demand more tax than is due, save where the taxpayer has failed to submit accounts (this is already implicit in the Charter, but could be made explicit);
- normally not to apply retrospectively new policies or new interpretations of the law to the taxpayers' disadvantage.

C
pp please
cc B/ep
✓

More controversially, the Revenue could agree to:

- a de minimis rule, whereby they would not pursue tax liabilities where the burden of assessing and collecting them was disproportionate to the amount involved (this is directed at the niggling pursuit of minor taxable benefits, but in general application it can present problems of fairness as between two similar taxpayers);
- have regard to the size of a business when stipulating the administrative procedures necessary to meet Revenue requirements (ie proportionately to place no greater administrative burden on small companies than large ones).

Even in its present form, the Charter is a significant advance on present practice, but the Chancellor could be pressed to concede some of the points above.



PETER WARRY



Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

7 July 1986

David Norgrove Esq
Private Secretary to the Prime Minister
No 10 Downing Street
London
SW1

CC B/LP
D
CBG
B=|| Any P W comments?

Dear David,

TAXPAYERS' CHARTER

at top PT2
The Prime Minister and the Chancellor agreed last year that the Policy Unit proposal for a taxpayers' charter should be considered separately from any further work on implementation of the Keith Report (your letter of 20 November).

The Prime Minister will wish to see the attached draft Charter which, he proposes, should be issued jointly by the Inland Revenue and by Customs and Excise. The Chancellor feels that it will be reasonably well received not least in so far as it spells out the rights of appeal which taxpayers have. Not all taxpayers may be aware of these at present.

It is not easy to judge the right moment to publish the charter. From a number of points of view - the effect in the media, on the public generally, and on the staff of the two Departments - it is important to present the charter positively and in a suitable context. But the Chancellor believes the timing is now right, particularly given the headway which has been made in tackling the worst of the backlog of work in Inland Revenue local offices and the Department's excellent progress on the computerisation of PAYE. The Chancellor therefore proposes that the Charter should be issued to coincide with the publication of the Inland Revenue's Annual Report later this month, in which it would feature.

The Chancellor would be grateful to know if the Prime Minister is content to proceed in this way.

Yours ever
Rachel
RACHEL LOMAX

TAXPAYER'S CHARTER

You have important rights and entitlements as a taxpayer. You are entitled to expect that:

Help and Information

- the staff of the Inland Revenue and Customs and Excise will help you in every reasonable way to obtain your rights and to understand and meet your obligations under the tax laws. So that they can do this, the Inland Revenue and Customs and Excise are entitled to expect that you will give them the full facts they need to decide how much tax you should pay.

Courtesy and Consideration

- the staff of the Inland Revenue and Customs and Excise will at all times carry out their duties courteously, considerately and promptly.

Fairness

- you will have your tax liability decided impartially, according to the law.
- you will be treated in the same way as other taxpayers in similar circumstances.
- you will be presumed to have dealt with your tax affairs honestly, unless there is reason to believe otherwise.

Privacy and Confidentiality

- information about your tax affairs which is supplied to the Inland Revenue or Customs and Excise will be treated in strict confidence and used only for purposes allowed by law.

Costs of Compliance

- the Inland Revenue and Customs and Excise will recognise the need for the costs you incur in complying with the law to be kept to a minimum, subject to their duty to collect the tax that is due from you efficiently and economically.

Independent Appeal and Review

You may ask the Inland Revenue or Customs and Excise to look again at your case, if you think your tax bill is wrong or they have made a wrong decision, or they have handled your tax affairs badly. Your case can be reviewed at a higher level in the office you are dealing with. In the case of the Inland Revenue, this normally means the District Inspector of the Collector in Charge; in the case of a Customs and Excise VAT office, the Assistant Collector in charge. If you are still not satisfied, you may take the matter up with the Inland Revenue Regional Controller or the Collector of Customs and Excise, or with the Inland Revenue or Customs and Excise Headquarters. Beyond that, you have important rights to independent appeal.

For Inland Revenue taxes, you may appeal against your tax bill to an independent tribunal, the appeal Commissioners, if you think the decision of the Inspector or Collector is wrong; and you may appeal, if necessary, to the Courts if you think that the law has been applied wrongly.

For Customs and Excise taxes and duties, you may appeal against a VAT decision to the independent VAT Tribunals; or in the case of other taxes or duties directly to the Courts.

You may ask your Member of Parliament to take up your case with the office you are dealing with or with Treasury Ministers. Your Member of Parliament may also ask the independent Parliamentary Commissioner for Administration (the Ombudsman) to review your case, if you think that the Inland Revenue or Customs and Excise have handled your tax affairs improperly.

Board of Inland Revenue

HM Customs and Excise

ECON POL

TAX + SAVINGS
PT 3

cc BSA



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

8 July 1986

David Norgrove Esq
Private Secretary to the Prime Minister
No 10 Downing Street
London
SW1

LCF
please do so, and ask PW for early comments.

Dear David

JHR

TAXPAYERS' CHARTER

I should be grateful if you could substitute the attached copy of the Charter for the one attached to Rachel Lomax's letter yesterday.

As Rachel said, the aim is to issue it to coincide with the publication of the Revenue's Annual Report. It would therefore be very helpful to have the Prime Minister's approval this week.

Yours ever

Tony

A W RUCZYS



10 DOWNING STREET

From the Private Secretary


I do not think
Prime Minister ² we need be troubled
by such stupidities
This silly piece is the
Chancellor's revenge for the Good
Housekeeping article on taxation of
husband and wife.

But, intended or not, the article
does I fear illustrate the dangers of
saying almost anything about the
exchange rate.

Your argument was symmetrical for
depreciation or appreciation, mutatis
mutandis, but the author chooses
not to recognise that.

DRS
19/6.

010



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RJ [Signature]

P 02118

From: J B UNWIN
19 June 1986

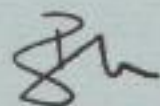
MR WICKS

REFORM OF PERSONAL TAXATION

We had a brief word yesterday about the timing of legislation. My recollection was that the 1987 Finance Bill had definitely been ruled out.

2. A check on the minutes confirms this. Cabinet decided on 27 February (CC(86)8th Conclusions item 6) that there could not "be any question of legislation on the lines of the Green Paper until after the next general election".

3. An informal check at the Treasury suggests that no one at present is seeking to rush the fences.



J B UNWIN

Cabinet Office



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

David Norgrove Esq
Private Secretary
10 Downing Street
London SW1A 2AA

19th June 1986

Sean David

The Chancellor's eye was caught by this article which appeared in the June issue of de Zoete and Bevan's Exchange Rate Monitor.

*Yours ever
Rachel*

RACHEL LOMAX

de Zoete & Bevan

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 Telex: 888221 and 883179

de Zoete & Bevan (Far East)
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Exchange Rate Monitor

Thatcher prepared to let pound collapse

In a Commons statement this week the Prime Minister rejected EMS membership again. This time though she gave the reason. The January '85 sterling crisis forced the authorities to abandon the old policy of benign neglect of sterling. But recently a bias towards lower interest rates & a lower exchange rate seems to be re-emerging. We rate the £ as high risk now that interest rates have fallen too far to offset the negatives of oil, a likely outflow of excess money & politics (see page 4). The statement warns of a return to "benign neglect". The government will not step in if the £ slides.

A GOVERNMENT WEALTH WARNING
 "When you get speculation against sterling there are two ways if you have joined to deal with it, using up precious reserves, which can only be done to a limited extent, or by sharply putting up interest rates. It denies the option of taking the strain on the exchange rate. I do not think it is right to deny us that option."

POUND SPOT RATES 1pm 12 June '86
 DAILY TOPIC COMMENT, PAGES 1680/90

		S	R	SUPPORT	T	RESISTANCE	TARGET
US\$	1.5250	S	R	1.45	T	1.55	1.55
DM	3.37	S	R	3.32	T	3.45	3.20
YEN	253.3	S	R	248	T	260	248
SWFR	2.79	S	R	2.76	T	2.85	2.70
FL	3.80	S	R	3.74	T	3.85	3.62
FRFR	10.75	S	R	10.60	T	11.10	10.30
EIRA	2320	S	R	2270	T	2360	2240
CAN\$	2.11	S	R	2.04	T	2.20	2.20
AUS\$	2.22	S	R	2.10	T	2.30	2.30

SHORT - TERM TECHNICAL VIEW

The \$ is still holding its long term downward trend against the DM & the £. Fundamentals also imply another downward leg for the \$ - probably the last. A discount rate cut could trigger that fall. Our short-term targets are the last \$ lows at \$1.55, DM2.15 and Yen160. £/ DM failed at 130day average & resistance around DM3.42. Target: DM3.32 and then DM3.20. Aus \$ is testing supports at A\$2.22 against the £ & US\$68c. We may be seeing the final sell off on the Aus\$ which could hit A\$2.30 & US\$65c before turning.



file 6

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

16 June 1986

The Prime Minister's eye was caught
by this article which appeared in the June
issue of Good Housekeeping.

David Norgrove

Mrs Rachel Lomax
HM Treasury.

10

HUSBAND & WIFE TAXES

Margaret Stone takes a good look at the Government's latest Green Paper – more like waving a red rag at working wives?

One of the longest running sagas on the family finance scene is the taxation of husband and wife. It looks as though this 'soap' has started yet another new series, but I have a feeling that for many women the next few episodes will be as unsatisfactory as was the *Dynasty* wedding massacre in the TV ratings.

At the hub of the tax debate is equality between men and women. For too long, women have been treated as their husband's chattels, at least in the eyes of the taxman. It is the husband's responsibility to fill in the tax return, and it is only in recent years that the Inland Revenue has, when a query arose, deigned to address correspondence to a married working woman.

The 1973 change in the rules which permitted high earning couples each to be taxed as separate individuals, each in receipt of a single person's allowance, helped couples whose incomes jointly exceed £25,361 (tax year 1985-86). But that was a tax-saving device, not a matter of equality between husband and wife, and anyway did little to help lower-earning families. Further reforms were drafted. They promise to be quite incendiary.

Light the Green Paper

Timed to coincide with this year's Budget – and heavily criticised in advance – the Chancellor's Green Paper (The Reform of Personal Taxation) proposes to abolish the married man's tax allowance and introduce independent taxation for both partners. There would be single allowances for all, with husbands and wives able to transfer any unused part of their allowances to each other. Meaning that all couples would get two allowances whether both partners work, or just one. (At present, only working wives are entitled to the wife's earned income relief.)

In future, suggested Mr Lawson, husbands should have the benefit of twice the single person's allowance when their wives give up a job to start a family – belated recognition, of sorts, of the unpaid vital work that women do in the home. But tax experts and women's rights groups were quick to spot flaws, the key complaint being that the long-awaited tax 'reforms' would penalise

two-earner couples and wind up discriminating against working women instead.

It is already being called a charter for 'stay-at-home' wives – wives who choose not to work as distinct from women who, because of domestic responsibilities such as looking after children, cannot go out to work. It is also bound to upset many working wives because of the implied dismissal of their contribution to the family's and the country's economy. And for wives returning to work after a period of absence, the implications are disturbing: their entire income immediately will be taxed at 29% – more, if the husband is in a higher tax bracket, which he will be if his taxable income exceeds £16,200.

Under the Lawson scheme, households with a husband and wife both working would lose, whereas families with just one earner would gain. It is small consolation to know that the Government will introduce the reform very gradually, allowing a long transitional period, during which personal allowances will be raised to the point where two allowances match the two-and-a-half allowances which dual-earner families get today. Meantime, here's how things stand for the 1985-86 tax year, and allowances proposed for 1986-87 (in italics):

Single – both working.	
Man	£2,205 (2,335)
Woman	£2,205 (2,335)
Married – both working.	
Husband	£3,455 (2,655)
Wife's earned income allowance	£2,205 (2,335)
Married – both working and joint income over £25,361.	
Husband	£2,205 (2,335)
Wife	£2,205 (2,335)
Married – wife not working.	
Husband	£3,455 (3,655)
Wife	nil
Married – husband not working.	
Husband	nil
Wife	£3,455 (3,655)
plus wife's earned income allowance	£2,205 (2,335)

The crucial contrast at the moment is between the ordinary working couple who between them at the moment have two and half times the ordinary single person's allowance, and the household in which the wife doesn't work, where the allowances

are only one and half times the single person's allowance. Clearly, the tax treatment of these two sets of married couples is unbalanced compared with the 'norm' of the tax treatment for single men and women.

Attempts at reform

Debate and discussion on how to redress this imbalance began back in what almost qualifies as 'the good old days' when Jim Callaghan was Prime Minister and Denis Healy his Chancellor of the Exchequer. The Conservatives inherited the issue, and when Sir Geoffrey Howe was Chancellor, the first important Green Paper on the taxation on husbands and wives was published.

The prevailing impression, then, was that Sir Geoffrey favoured individual taxation for husbands and working wives, but that money saved on the abolition of the married man's personal allowance should be diverted to boost child allowances instead of being given to the non-working wife to transfer back to her husband. But the lobby in favour of giving an extra fillip where it is most needed – the child benefit – instead of paying women to stay at home, seems to have lost ground to the more generalist campaigners in favour of the 'family', and a woman's right not to work outside the home.

Full implementation of the proposed new system – assuming it survives without modification the pent-up antagonism and any possible change in Government – will certainly not be until the Inland Revenue is fully computerised at the end of the decade. It is amazing that so many of our tax returns are not yet held on computer; but by the end of this decade, we should have push-button rather than pen-pushing tax officers.

Other Green Paper points: investment income will be the responsibility of the recipient; mortgage interest tax relief (currently available to each of two single persons living together) probably will be reduced to £30,000 per residence; capital gains tax to be charged separately, too.

And a further change afoot for the working women, of course, is the latest Government proposal to let her carry on working right up to the male retirement age if she wishes. □



TF

To note

then pa

Mr. Norgrove, holo

As I told you on the

phone, the publication of

two papers this afternoon

will be announced by

William Anonov. It is hoped

to connect with a PSP

presentation at the Stock

Exchange tomorrow,

where the Chancellor + PST

will be introducing Re 12/5



PERSONAL EQUITY PLANS

Proposals on how
the scheme will work

A PROSPECTUS FOR POTENTIAL PLAN MANAGERS

Board of Inland Revenue
May 1986

INTRODUCTION

The purpose of this prospectus is to indicate, for people interested in becoming plan managers, the proposed shape of the Personal Equity Plan Scheme announced by the Chancellor of the Exchequer in his recent Budget Statement. It does not represent the Government's final views. These will be set out in due course, in the light of further consultations.

The scheme provides a new fiscal incentive for share purchase in British companies by ordinary people. The main criteria to be satisfied will be as follows:

- Qualifying investment will be confined to ordinary shares in UK-incorporated companies quoted on The Stock Exchange.
- There must be a clear link between the investor and his or her shares - so that investors may attend company AGMs, exercise voting rights, receive company information and benefit from shareholders privileges.
- Dividends on investment must be ascribed to individual investors.
- Limits on holding assets in liquid form in plans.
- Charges by plan managers must be transparent.

Special arrangements will, however, be made to allow investment, up to a low limit, in investment and unit trusts.

The principal features of the scheme will be:

- Shares may be registered in owner's name or in the name of a plan manager's nominee company but in either case, certificate to title to be held by plan manager
- A maximum investment of £2,400 a year.
- Tax relief to be given on build-up of investment (ie no capital gains tax and no income tax on reinvested dividends) subject only to the investment being retained within the plan for a short qualifying period of between 12 and 24 months.
- Once the qualifying period has ended, investments may be realised at any time without loss of relief.

PART II : HOW THE TAX RELIEFS WILL WORK

Qualifying period

Tax relief will become unconditional once a plan has been maintained for a minimum qualifying period. Interest rolled up on instalments made before the first shares are acquired will be free of tax if subsequently used to buy qualifying shares. A plan made in one calendar year must be kept throughout the whole of the following calendar year.

Thus, shares acquired by an investor between 1 January and 31 December 1987 would qualify for tax relief provided no withdrawal from the plan was made before 1 January 1989.

Portfolio management

Investors (or plan managers, on their behalf) will be able to switch investments from one qualifying share to another without any CGT liability (or allowable loss) provided the proceeds are reinvested within four weeks. If the four-week rule is broken during the qualifying period, the plan will be void: if broken after the qualifying period, the shares disposed of will be regarded as withdrawn from the plan (but tax relief up to the date of disposal will not be lost).

The proceeds of any disposal may be reinvested. So if, for example, a £2,400 plan has grown to £4,800, that amount can be reinvested. The same will apply if the plan has declined in value: if the value has halved, the permitted reinvestment will be £1,200.

Transfers from one plan manager to another will not be prohibited.

Treatment of dividends

Distributions from qualifying shares will be exempt from tax only if reinvested. Companies will pay them under the normal ACT rules to plan managers, who will then claim payment of the tax credit from the Inland Revenue and hold the dividend and credit within the plan until used to buy qualifying shares.

If the investor chooses instead to receive the dividend income, it will be taxed in the normal way.

Stock dividend options will be treated in the same way as reinvested dividends.

Premature withdrawals

If, during the qualifying period, any shares in a plan are withdrawn, the plan will come to an end. The investor will be liable to CGT on any gain arising from the start of the plan. By the same token, any loss will be allowable.

Any dividend paid to the investor (rather than reinvested) during this period will be treated as a withdrawal - so that the plan will be closed. The investor will be taxed in the normal way, and any tax credit previously claimed by the plan manager (because the original intention was to reinvest dividends) will be repaid to the Revenue.

Withdrawals after end of minimum holding period

Withdrawals from a plan after the qualifying period may be by way of cash or shares. But if the shares are retained outside the plan, their acquisition cost for CGT will be their market value at the point of withdrawal.

Part withdrawals will be permitted, but plans cannot be subsequently topped up.

Once the qualifying period has been passed, all plans may be combined to keep down management expenses.

Death of investor

In general, plans will not be transferable. But on the death of an investor, the plan will be treated for CGT purposes as if it had been acquired by personal representatives at market value.

PART III : HOW THE PLANS WILL BE ADMINISTERED

Who may act as plan managers?

Plan managers must be registered with the Inland Revenue. They must be authorised, under the Prevention of Fraud (Investments) Act 1958, to carry on the business of dealing in securities (and in due course authorised to carry on investment business under the Financial Services Bill). Currently those eligible to act as plan managers are:

- members of The Stock Exchange
- members of recognised associations of dealers in securities (eg NASDIM)
- other firms licensed or exempted by DTI

The definition of 'authorised institution' could include an employer if he satisfied the other conditions and was registered by the Inland Revenue as a plan manager.

Role of plan managers

Managers may act either as agent on the instructions of the investor, or on a discretionary management basis. They will be required to operate within the normal regulatory rules. Where the institutions concerned are not authorised or exempt under the Banking Act, arrangements will be needed to segregate cash held on behalf of investors.

Charges

It will be for plan managers (and their investors) to arrange how charges are to be dealt with. But all the manager's charges and other remuneration from clients' business should be explicit.

Supervision

A plan manager's registration would have to be withdrawn if he lost authorisation under the Financial Services legislation or if the rules of the scheme are broken - eg if he knowingly allowed investors to exceed the £2400 limit. In such circumstances, plans would be transferred to another manager.

Audits of plan managers will be carried out from time to time by the Inland Revenue to ensure that the scheme is being operated correctly.

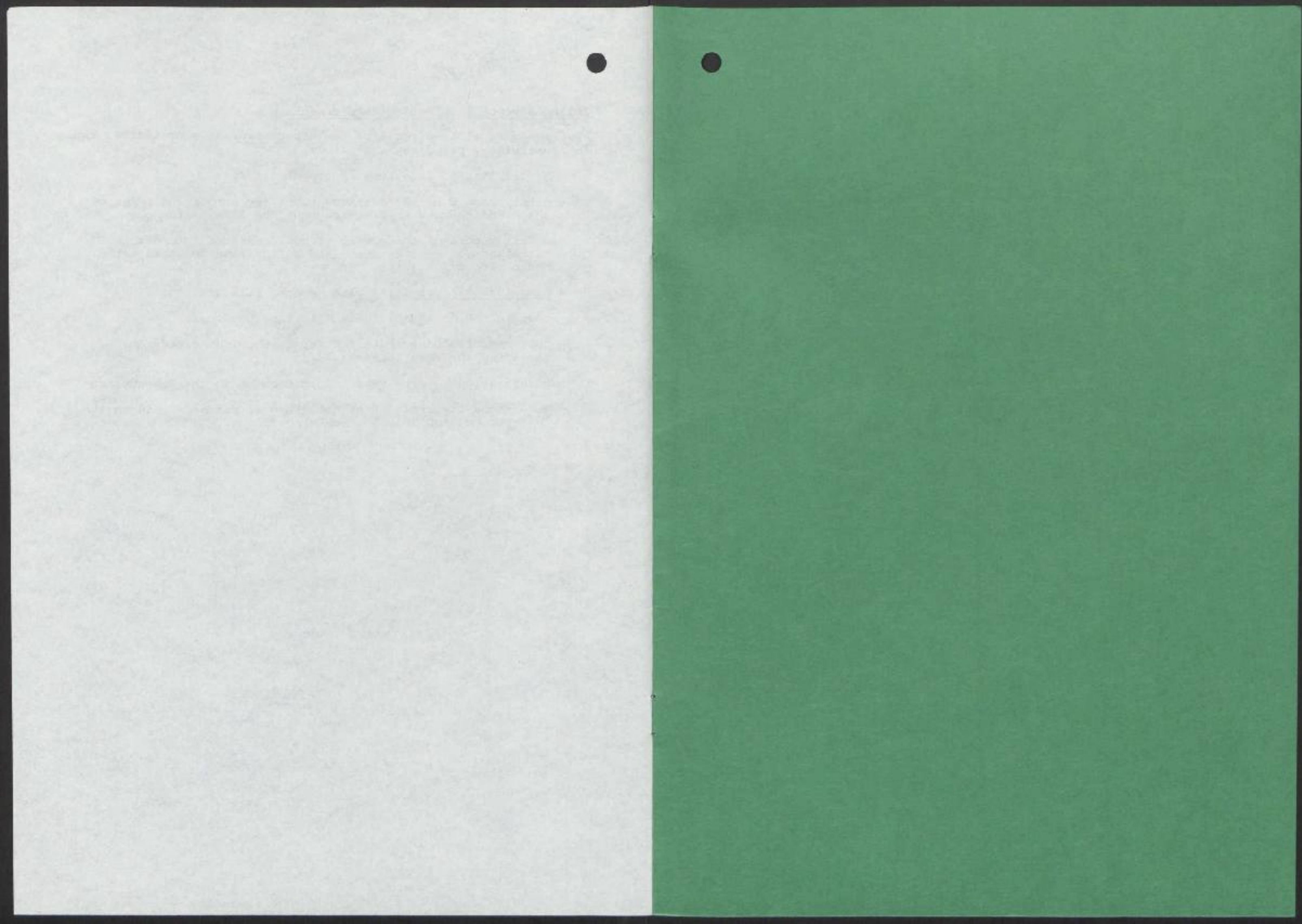
Inland Revenue information requirements

Plan managers will be required to keep records in a prescribed form for supervisory purposes, including:

- a full list of investors in computer form
- a full record of share transactions (eg number and price of shares bought and sold) throughout the life of the plan
- a full record of the amount of dividends and interest earmarked for reinvestment (and so entitled to attract the basic rate tax credit).

On a premature withdrawal, a plan manager will have to:

- compute the chargeable gain (or allowable loss);
- determine the basic rate tax foregone on the dividends earmarked for reinvestment;
- within a month, pass this information on to the Revenue; and
- deduct the tax credit from the disposal proceeds paid to the investor and repay it to the Revenue.





PRIME MINISTER

GREEN PAPER ON PERSONAL TAXATION

Mr. Fowler's office believe that he will not press his arguments at Cabinet tomorrow. They think he is likely to state his position and then hope that other colleagues will support him. They also say that he would be much reassured to be told that no legislation is in prospect for this Parliament.

The Chancellor's paper says:

"none of the ideas in this Green Paper are for this Parliament".

I have pointed this out to his office and asked that the Chancellor should confirm that he will not be proposing legislation for this Parliament.

The Chancellor is also prepared in the last resort to consider including reference to child tax allowances in the Green Paper, and he has thought about some words which could be used. But he would be deeply unhappy to have to bring them in. Nevertheless, if a wrangle is developing in Cabinet, you could invite the Chancellor and Mr. Fowler to try to agree some words.

DN

(DAVID NORGROVE)

26 February 1986

SRWAPW



N.H.

BB
BU

PRIME MINISTER

No way in this Parliament
- - before 1980 - computer
Priority - on view at that time
could be achieved by phasing

GREEN PAPER ON PERSONAL TAXATION

I am in favour of publishing the Green Paper on Personal Taxation circulated under cover of C(86)7 so that we can see what the public response is to the Chancellor's proposals, but I am opposed to legislation in this Parliament to introduce the changes.

In presenting these proposals we should be clear that, if they were to be implemented, there would be a very substantial price tag indeed - up to £5 billion a year. It would pre-empt resources that could go to reducing taxation in other ways. And it would add to the pressures to contain public spending in areas like health care.

I have yet to be convinced that what we are going to achieve through the Chancellor's proposals will be worth the high price - or that the public generally will think that it would be money well spent. It will be evident that the extra resources are not being targeted in a discriminating way. In particular, although most one-earner working couples do have children, over a million without children would also gain - mostly by £10 or more a week. Indeed, on average one-earner couples without children will gain more (£11.58 a week) than those with children (£10.75). And over 7 million single people would benefit - on average by £3.44 a week.

There is no doubt about the importance which our own supporters attach to helping families with children. It was very evident in the response in the House to my statement on Monday on the uprating of social security benefits. There was a clear welcome for the uprating of child benefits in line with prices - and pressure to restore the 35p deducted from last November's uprating.

E.R.

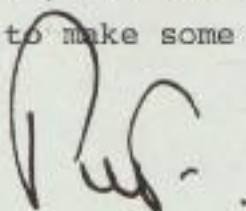
As you know, against this background I have seen considerable political advantage in acknowledging in the Green Paper that there is an approach which combines a smaller transferable allowance with a new Family Tax Allowance, available to all families with children whether the wife was at home or at work. If the Family Tax Allowance was set at, say, £750 it would be possible to meet almost all the Green Paper's stated objectives to a greater extent than with transferable allowances alone. As I pointed out in my minute of 11 February, for the same total cost,

- around 1.4 million more families with children would gain than under transferable allowances alone;
- the numbers in the poverty and unemployment traps would also be reduced by even more, thus further strengthening work incentives;
- there would be a bigger reduction in "churning" compared with transferable allowances alone. The number in this position would be reduced to 200,000;
- childless couples where both couples were working would be net losers, but the losses would generally be very small (under £2 a week) and would affect families on average earnings.

would

A combined reform on these lines show/that we were committed not only to removing discrimination in the tax systems but also to targeting available resources where possible on families with children. This would fit well both with our general support for families and with our planned improvements in help for low-income families through the social security system. Above all by showing that we had not overlooked the particular needs of families with children, it would avoid handing a very powerful weapon to our opponents.

I am copying this only to the Chancellor, the Chief Whip and to Sir Robert Armstrong but I shall want to make some of these points in Cabinet tomorrow.



N F

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Ref. A086/672
PRIME MINISTER

Green Paper on Personal Taxation
FLAG AC(86)7

BACKGROUND

The Chancellor of the Exchequer announced in last year's budget statement his intention to issue a Green Paper "later this year" on the reform of personal income tax. He made it clear that the Green Paper would favour a system of transferable allowances (TA) between husband and wife; and that it would also discuss a range of further options that would be available by 1989, when the computerisation of PAYE had been completed, such as non-cumulation and closer integration between the tax and benefit systems. There is therefore wide anticipation of the contents of the Green Paper, which the Chancellor of the Exchequer proposes should be published with the Budget.

2. Part I of the draft discusses the case for a reform in personal allowances, and how a TA system might work; Part II discusses the more detailed implications for other allowances and taxes; and Part III discusses the tax system in the longer term, with particular reference to the relationship between taxes and benefits and the case for closer integration of national insurance contributions and income tax. The present draft has been settled following discussion in three meetings of an ad hoc Group of Ministers under your chairmanship. At those meetings a good deal of disquiet was expressed at:-

- the effect on the markets of an apparent commitment to a £5 billion "give away" in the early 1990s, which could preempt the scope for other fiscal changes for several years;
- the contrast between the Chancellor's "no loser" proposals, and the social security reform (with some 2.5 million cash losers), which could make the task of getting the current

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social security Bill through the House more difficult;

- doubts as to the political appeal of the reform in view of its treatment of professional women as opposed to non-working wives, and the disincentive to the latter to resume work.

3. As a result, extensive changes have been made to the original draft to meet these points. In particular:-

- the draft is now very much greener. It is made clear that the reform would only be introduced as and when resources permitted, and that if necessary it could be phased in over a number of years (eg to ensure that no revenue loss occurred beyond what would have been required for statutory revalorisation of personal allowances). The Group also agreed that there could be no question of legislation before the next election;
- the presentation of the distributional effects (in the tables attached to Annex 4) is now consistent with the social security presentation. There are two sets of tables: the first shows the effects of introducing the change in one year on a no cash losers basis (on this assumption the real effects would be the same as the cash effects); the second shows the real effects of phasing in the change over a period long enough to ensure that there was no loss of revenue beyond what would have been required for indexation of allowances. The text makes it clear, however, that the second presentation is "an extreme one" and that a move to TA should be seen as part of the process of tax reduction, in line with the Government's declared objective of reducing the total burden of taxation.

MAIN ISSUES

4. Given the endorsement of the text by your Group, and the improve-

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ments to its contents and presentation, it should not be necessary (subject to the point at (iii) below) to discuss the draft at length in Cabinet. Discussion might, however, focus on some of the following issues:-

(i) Extent of Commitment: The potential cost of this reform, depending on a number of factors such as inflation, the basic income tax rate, and the phasing in period, is considerable. The table in chapter 3.7, for example, shows that a two year transition at 2.5 per cent inflation could cost some £4 billion at 1985-86 prices. Some Ministers may be reluctant to allow the Chancellor to pre-empt amounts of this kind for a tax reform that is unlikely to be universally popular - the more so in view of the pressures on their own expenditure programmes. If such arguments are mounted, it will be necessary to reinforce the point that publication of the Green Paper does not imply any Government commitment either on substance or timing; and that, more specifically, it is not the intention to legislate before the next election. You may also wish to remind the Cabinet of the Government's commitment to reducing the burden of income tax, of which public expenditure restraint must remain a prior condition;

(ii) Political Appeal: it may also be argued that there is likely to be little political advantage in the reform. The changes will be unpopular with those who consider themselves disadvantaged (eg professional women and wives wishing to resume work), whereas no credit will be gained from those who can expect to be better off. It would therefore be unwise to move into the next election with such an implied commitment, however green, round the Government's neck. Against this it can be argued that the present personal allowances system is widely agreed to be indefensible and unfair; and that there is likely to be considerable support for arrangements that respect privacy as between husband and wife, are better attuned to the life cycle of families, and would make

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future increases in allowances more cost effective in terms of taking people out of the poverty and unemployment traps. Given the widespread expectations, not to publish the Green Paper would also be difficult to explain;

(iii) Distributional Implications and effects on Families: Although the reform is primarily justified as an overdue structural change in the tax system, the Chancellor also claims substantial social and distributional advantages for it. For example, depending on the duration of the phasing, it will take substantial numbers out of the poverty and unemployment traps; reduce the number of families entitled to Family Credit and Housing Benefit and of those liable both to pay tax and receive social security benefits; and concentrate the gains on families with only one spouse working (both with and without children). It may be argued, however, that, such objectives could be achieved more cost-effectively by more specific "targetting" on the relevant groups, particularly families, whether through the tax or the social security systems. This has been the burden of the Social Services Secretary's criticism of the proposal, and I understand that he proposes to repeat his views in a further minute to you (with limited circulation) this evening. This is likely to renew the proposal for a Family Tax Allowance (FTA) which would still be consistent with the main structural reform. Compared to the Chancellor's TA system, an FTA of £750 would concentrate the benefits on families with children (some 1.4 million more families with children would gain) and have a larger impact on the poverty and unemployment traps and on the numbers caught in both the tax and benefits net. It would thus reinforce the Government's policy towards families and perhaps help to mitigate some of the criticism of the recent child benefit uprating. On the other hand, there would be corresponding losers - some 2.5 million (though mostly less than £2 a week) among childless couples where both partners are working; and it would add a fresh complication to the

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tax system at a time when the Government's aim is to simplify it. It might also be criticised as reversing the policy that support for children should be concentrated in the social security benefit system and not duplicated in the tax system, although both approaches have coexisted without serious problems for many years.

If the Social Services Secretary still wishes to press this option, you will wish to seek views on whether it should be displayed in the Green Paper. The Chancellor of the Exchequer will argue that it would be wrong to mention just one alternative, and that it would in any case undesirably reopen the whole issue of child support. There might, however, be some advantage in at least including a brief reference to the possibility of an FTA in the text in order to show that the Government had not overlooked the option and was still concerned about families. The possibility will certainly be raised by commentators when the Green Paper is published. In the time available it would not be possible to work the option up in detail. But a few sentences would suffice and could quickly be provided and I understand from the Treasury that such a limited change could be incorporated in the text in time for publication.

5. Subject to any discussion on the above issues, particularly (iii), you may be able to reach agreement fairly quickly that the Chancellor should be authorised to publish the draft Green Paper on Budget Day subject to any detailed drafting amendments and to revision of the figures to take account of the taxation measures to be announced in this year's Budget.

HANDLING

6. You will wish to invite the Chancellor of the Exchequer to introduce his paper and the Social Services Secretary, as the Minister most closely affected by it, to comment. You may then wish to invite

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comments only from those Ministers who have any points of substance to make.

CONCLUSIONS

7. You will wish to invite the Cabinet to decide whether the Chancellor should be authorised to publish the Green Paper, subject to detailed drafting amendments and updating of figures to take account of the Budget, on Budget Day.

RA

ROBERT ARMSTRONG

26 February 1986
Cabinet Office

CONFIDENTIAL

MR NORGROVE

26 February 1986

PERSONAL TAX GREEN PAPER

At the last meeting on the Green Paper, Norman Fowler asked the Chancellor to add a paragraph on a Family Tax Allowance. A Family Tax Allowance is not a stupid idea. But the Chancellor threatened that he would rather not have a Green Paper at all than have one including the offending paragraph. So the meeting went against Norman Fowler, and he will now be raising the issue at Cabinet tomorrow.

The problem now is to avoid an acrimonious dispute. The Chancellor can win tomorrow, but at a double cost:

- The DHSS are likely to brief the press against the Chancellor, and thus weaken the impact of his Green Paper on Budget day.
- Floating the idea of a Family Tax Allowance may make it easier to hold Fowler to politically difficult cuts in the real value of Child Benefit.

Would the Chancellor therefore be prepared to consider some even more innocuous form of words which might just say that "there are, of course, other ways of changing the tax system which would particularly help families. If the main argument for fully transferrable allowances is thought to be distributional, then these other options - such as a Family Tax Allowance - would merit further consideration."

David Willetts

DAVID WILLETTS

SECRET

hle

DGQAWB



bc BG

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10 DOWNING STREET

From the Private Secretary

19 February 1986

INCOME TAX: RATES VERSUS THRESHOLDS

The Prime Minister has seen and noted the Chancellor's minute of 18 February. This was touched on at the bilateral today, and the Chancellor pointed to the help which had been given to people at the top and bottom of the income distribution. The Prime Minister offered no comment.

David Norgrove

A handwritten signature in black ink, appearing to be 'DN' or similar initials.

Mrs. Rachel Lomax,
H.M. Treasury.

SECRET



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

PRIME MINISTER

INCOME TAX: RATES VERSUS THRESHOLDS

I thought you put up an excellent show on Panorama last night. But it is unfortunate that your remarks on taxation have been misinterpreted by some in the press as indicating your support for channelling any available scope for tax reductions into raising tax thresholds rather than reducing the basic rate of tax. We have discussed this before and, as you know, my own view is that the case for raising thresholds has been considerably over sold. Indeed I see a strong case for making a reduction in the basic rate our next priority, as and when we can prudently afford to reduce the burden of income tax.

Press comment has gone well beyond what you actually said. You pointed out that the Government had done pretty well by the people in the top half of the income distribution, and it was right to reward success, adding "but I don't think the Government should take money for the top half due to the bottom half. I feel that we owe quite a debt to people in the bottom half. We have taken in my view too high a proportion of their income in tax."

In practice, of course, we have done a great deal for those right at the bottom of the income scale, as well as for those at the very top. Tax thresholds have been raised by 20 per cent in real terms since 1979. In the 1985 Budget we introduced reduced National Insurance contribution rates for the lowest paid so that the combined marginal rate for those earning less than £60 a week is now 35 per cent and, for those earning less than £100 a week, 37 per cent, rather than the full 39 per cent that applies to those around average earnings.



The true picture is that while we have done a great deal for those both at the top and the bottom, we have not done enough for those in the middle; the burden of tax and National Insurance contributions for those on average earnings is still higher than it was in 1978-79 (29 per cent as against 27.8 per cent). This affects very large numbers of people, including the unmarried nurse you quoted on £140 a week who still pays £40 a week in tax.

In fact, even in static terms, the nurse would be helped more by a reduction in the basic rate than an increase in tax allowances costing the same amount. The same would be true of any single person or working wife earning more than about £120 a week; the equivalent "crossover point" for a married man is also below average earnings at about £180 a week.

But it is not the static position that matters most. What is of critical importance to incentives is the marginal rate of tax. Again, this is something we have reduced significantly both for those at the top - through changes in the higher rates - and at the bottom - through taking some people out of tax altogether and by introducing reduced rates of employee NICs. For the great majority in the middle, however, there has been little change. The combined marginal rate when we took office was 39½ per cent (33 per cent income tax plus 6½ per cent employees NICs); today - nearly 7 years later - it is still 39 per cent (30 per cent income tax plus 9 per cent employee NICs).

It seems clear to me therefore that our top priority must be to reduce the basic rate of tax, as and when we have the scope to afford it - which is not of course this year. As a result of what we have done so far, our tax thresholds, as a per cent of average earnings, are not low by international standards - they are close to the international average, and actually



higher than in Germany and the US. It is interesting that President Reagan believes that thresholds should not be set too high, so as to give as many people as possible an interest in lower marginal tax rates. That is why he has concentrated his tax reform proposals on reducing tax rates. Much the same reasoning led us to argue that everyone should make some contribution to local taxation.

What is unusual about the UK tax system is our initial rate of tax, which is among the highest in the OECD; our rate of 30 per cent compares with 22 per cent in West Germany, 15 per cent in Japan, and only 11 per cent in the US. And, under our present system, the starting rate can only be reduced by lowering the basic rate of tax.

While there is of course merit in raising tax thresholds, the case for doing so has been greatly exaggerated and a sense of proportion is badly needed. As David Howell recently pointed out, only a minority of those taken out of tax by threshold increases are "needy"; about 20 per cent are married men, and the remainder are juveniles, pensioners and working wives. Norman Fowler's Social Security reforms will further weaken the case for raising thresholds as a way of improving incentives for the lowest paid. Once means tested benefits are calculated on a net income basis, tax reductions will be offset in part by reduction in benefits. This will be equally true of cuts in tax rates and increases in allowances. What this means is that the choice between rates and thresholds should turn on their effect on the majority, not on those at the bottom of the income scale, who will be helped by the Social Security reforms.

I appreciate that some people are concerned that reductions in the basic rate of tax would give disproportionate benefits to the rich. But that does not follow at all. The tax burden on



the rich is largely determined by the structure of higher rates. This, if we see fit, can always be changed independently of any change in the basic rate to limit the gains to those at the top.

All in all, I believe we have reached a point where we have already done a great deal of what needed to be done on thresholds. Our next priority should be to reduce the basic rate. Once we have made a significant reduction there, it will be time to look again at thresholds.

If you agree with this, it is important that we start to alter the climate of opinion in this direction. As I said earlier, this might be best achieved by pointing out how much we have done not merely for those at the top, but also for those at the bottom - and also perhaps by stressing the importance of marginal rates of tax. A cut in the basic rate would reduce marginal rates for 14 million working taxpayers - 95 per cent of the total. The basic rate is also the marginal rate for the vast majority of unincorporated businesses and for the self employed. And while incorporated businesses have seen corporation tax on their profits reduced from 52 per cent to 35 per cent (and 30 per cent for small companies) unincorporated businesses have had no reduction at all in their marginal tax rate on profits since the 1979 Budget. At the least, we must make it clear that the Government's aim is to make progress on both fronts as and when we prudently can - both by raising thresholds, and by cutting the basic rate.

A handwritten signature in dark ink, appearing to be 'N.L.' with a flourish.

N.L.

18 February 1986



10 DOWNING STREET

From the Private Secretary

17 February 1986

**INCOME TAX: DIFFERENTIATION BY
FAMILY CIRCUMSTANCES**

The Prime Minister was grateful for your letter of 14 February and for the note by the Inland Revenue about the way the income tax system has taken account of family circumstances over the years.

(David Norgrove)

A.W. Kuczys, Esq.,
H.M. Treasury.



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

14 February 1986

David Norgrove Esq
10 Downing Street
LONDON SW1

ms

Prime Minister

*DRS
14/2*

*See paragraph 10
in particular.*

Dear David

INCOME TAX: DIFFERENTIATION BY FAMILY CIRCUMSTANCES

- ... I attach a short note by the Inland Revenue about the way the income tax system has taken account of family circumstances, since its
- ... first introduction in 1799. As you requested, I also enclose copies of the Reports of the two Royal Commissions on Income Tax this century. The Revenue would be grateful for their return in due course.

Yours ever,

Tony

A W KUCZYS
Private Secretary

INCOME TAX: DIFFERENTIATION BY FAMILY CIRCUMSTANCES

Income Tax

1. A form of income tax was first introduced by Pitt in 1799. The provisions were recast and extended in 1805-1806 but repealed in 1816. They were then reintroduced in 1842.

2. The ways in which income tax has taken account of family circumstances have varied, since its first introduction in 1799.

Basic System

3. The income tax introduced in 1799 made the husband accountable for returning his wife's income. But the incomes of husband and wife were not aggregated for tax purposes, and the wife could have her own set of reliefs.

4. Since 1805, however, a married woman's income has been "deemed" to be her husband's for tax purposes. Subject to the wife's earnings election introduced in 1971, tax has always been charged on the joint income.

Personal Allowances

5. From 1805 to 1894, the joint income of a married couple was taxed in exactly the same way as the income of a single person - there were no special exemptions or reliefs to reflect marriage.

6. In 1894, a separate relief was introduced for a wife's earnings up to a certain limit.

7. There was no special allowance for a married man until 1918, when a very small allowance was introduced.

The married man's allowance itself was introduced in 1920, with about the same lead in percentage terms over the single allowance that it has today.

8. The wife's earned income allowance was introduced in 1920. For much of the inter-war period, the married man's allowance and wife's earned income allowance together amounted to roughly double the single person's allowance. The wife's earned income allowance was increased to the same level as the single allowance in 1942.

Children

9. Children's income has never been aggregated with that of their parents, except for the period 1969-72, when investment income was aggregated.

10. Child tax allowances were given in 1799, but were withdrawn when the provisions were recast in 1805 and did not reappear until 1910. They remained a feature of the system until 1979, when child benefit replaced them. It was recognised at the time that a tax-free child benefit, which had been a part of the tax credit proposals, served to reflect the reduced taxable capacity of people with children, and thus subsumed that function of child tax allowances.

PRIME MINISTER

Mr Noyce

I have told Rasmussen
+ Stark's office (Jul).

GREEN PAPER ON PERSONAL TAXATION

N.C.W.

14.2

The Chancellor may want to delay the Cabinet discussions on the Green Paper from 20 February to 27 February because:

- (i) the Foreign Secretary will be with The Queen in Nepal on 20 February. The Chancellor believes his support will help the Cabinet discussions;
- (ii) Mr. Fowler may circulate his own paper. The extra week might enable the Treasury to accommodate his views into their draft and avoid the need for his paper;
- (iii) the Cabinet on 27 February is likely to take the legislative programmes for 1986/87 and 1987/88. This will help fill the Agenda and avoid too much discussion of the Green Paper. (It will not be easy to find extra items for the 20 February Cabinet without making it appear that the Agenda is being deliberately packed.)

Do you agree that the Chancellor of the Exchequer should have the discretion, if he so chooses tomorrow, to delay the circulation of his draft Green Paper until the following weekend with a view to Cabinet discussion on 27 February?

Yes

N.C.W.

NIGEL WICKS

13 February 1986

cc: Mr. Stark, Cabinet Office.

SECRET

Reform of Personal Taxation

4
File
Seen by DN
MASTER cc SUBJECT

Note of a third meeting
at 10 Downing Street on
Wednesday 12th February
1986 at 9.00am

PRESENT

Rt Hon Margaret Thatcher MP
Prime Minister

Rt Hon Viscount Whitelaw
Lord President of the Council

Rt Hon Norman Fowler MP
Secretary of State for
Social Services

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

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

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer

Rt Hon Norman Tebbit MP
Chancellor of the Duchy of
Lancaster

Rt Hon John Wakeham MP
Parliamentary Secretary,
H M 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 had before it a minute of 10 February from the Chancellor of the Exchequer to the Prime Minister, covering a revised draft of the proposed Green Paper on the Reform of Personal Taxation. The Group also considered further minutes of 11 February to the Prime Minister from the Secretary of State for Social Services and from the Chancellor of the Exchequer, covering the possibility of mentioning in the Green Paper the introduction of a system of Family Tax Allowances (FTAs) along side Transferable Allowances (TAs) for married couples.

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2. THE CHANCELLOR OF THE EXCHEQUER said that the Group had asked him, at their previous meeting on 29 January, to make three important changes to the draft: to make the whole presentation much 'greener', to meet the concern that there should be no specific Government commitment to large scale net tax reductions in the context of the introduction of TAs, and to present the distributional affects on the introduction of TAs in a way consistent with the presentation of the comparable affects of the changes in social security to be effected by the Bill currently before Parliament. With the sole exception of the possible mention of FTAs, he had reached agreement with the Secretary of State for Social Services on all the outstanding points, so that the present draft could be regarded broadly as an agreed document. There remained some minor outstanding points on Annex 4, but there should be no difficulty in settling these at official level. It would be essential to complete the text quickly, in order to make possible publication on Budget day. So far as FTAs were concerned, he rested on the arguments in his minute of 11 February; there was not time to undertake a full analysis of these possibilities, and a mere mention of them would reopen the whole question of the provision of family support and the future of Child Benefit. It would be a mistake to move back to a situation in which there were separate systems of tax allowances and social security benefits applicable to children; if the Government concluded that present arrangements for family support were inadequate, it would be better to build on the existing Child Benefit System and the new Family Credit arrangements.

3. THE SECRETARY OF STATE FOR SOCIAL SERVICES confirmed his agreement with the Chancellor of the Exchequer on all issues apart from FTAs. He was satisfied with the presentation of the distributional affects of the change to TAs, noting that there was no question of early legislation to implement the changes, and no commitment to the changes being put into effect on any particular timescale. He supported the objective of achieving a more equitable tax system, but doubted whether it was possible to leave aside completely the wider aspects of tax changes. He was not proposing any sort of Government commitment to the

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introduction of FTAs; but the Government would need to be able to show that they had considered how available resources (in this case the available fiscal adjustment) could be used to best effect, and on that basis the possibility of introducing FTAs deserved a mention. His Department had prepared an illustration of the affects of introducing an FTA of £750 alongside a move to TAs for married couples. Because personal allowances had to be reduced somewhat to make room for FTAs within the same overall cash cost, there would be some relatively small cash losers among two-earner couples; but compared with the Chancellor's proposals, 1½ million two-earner families with children would gain, there would be further reductions in the numbers caught in the poverty and unemployment traps, and the extent of 'churning' would be reduced by a third. Nothing would be lost through mentioning this possibility; indeed, commentators would particularly notice its omission.

4. In discussion of FTAs, the following further points were made:

(a) such a mention would detract from the general theme of the Green Paper, which was greater equity in the tax system, and justice for married women. The fact that there would be 2½ million cash losers under the Social Services Secretary's illustration would undermine support for the move to TAs. The family support lobby would not be satisfied with FTAs: they wanted big increases in Child Benefit unambiguously paid to the mother, and not reaching the family through the father's wage packet. It would be better to leave the social security system to meet the Government's objectives in terms of family support.

(b) Under the arrangements proposed by the Chancellor, childless one-earner couples gained relatively more than one-earner couples with children; over one million childless couples gained more than £11 a week. Insistence that family support was the job of social security benefits

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would draw attention to the fact that by the time of the Budget there would have been two successive announcements of social security benefit upratings in the course of which Child Benefit had been frozen in money terms, and it was unlikely that there would be resources in the social security programme for any significant increase in Child Benefit even in April 1988. In view of this it was essential that at the least the first sentence of paragraph 3.17 should be cut out of the text.

5. The following further points were made in discussion:

(c) it remained doubtful whether the change to TAs would have substantial political appeal. Two-earner couples would be bound to realise that they would be bearing a larger share of the burden of taxation, and that they might well face real losses. Professional women would see themselves as disadvantaged in relation to non-working wives, many of whom were childless. Against this it was argued that the position of individuals should be considered over their whole life-cycle; most families moved at some point from having two incomes to having only one, and then reverted to two incomes again as children grew up. The large majority of non-working wives were either looking after children or dependent relatives, or were already over 50.

(d) The change to TAs would not have any substantial impact on the problem of incentives. Even the £20 a week subsidy under the Job Start Scheme to encourage people to accept work at less than £80 a week was proving inadequate. Ministers would need to tackle the incentives problem separately; it was arguable that a mistake had been made when all benefits had been put onto a flat-rate basis, and the wage stop abolished - the maintenance of incentives required benefit levels to be earnings-related. The Green Paper should be seen as directed essentially towards equity in taxation; it did not constitute an effective Government response to the problem of incentives. It was, however,

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pointed out that a system providing FTAs as well as TAs would be significantly more effective in reducing the extent of the incentives problem than the Chancellor's proposals.

6. THE PRIME MINISTER, summing up the discussion, said that the Group endorsed the publication of the Green Paper broadly on the lines proposed by the Chancellor of the Exchequer, emphasising that there was at this stage no question of any Government commitment either on substance or on timing. The Green Paper should not, however, say that the Government regarded family support as entirely a matter for the Social Security system, and paragraph 3.17 should be amended accordingly. In view of the importance of the issues raised by the Green Paper, the Chancellor of the Exchequer should ~~therefore~~ circulate the full text for ^{consideration} ~~discussion~~ by the Cabinet on 20 February.
 approval STET

7. The Group -

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

2. Invited the Chancellor of the Exchequer to circulate the full text of the draft Green Paper to the Cabinet for ~~discussion~~ on 20 February.

consideration (STET).



Prime²
Mover

MR NORGROVE - No 10

David,

The Chancellor thought
the PM might like to see Sam
Brittan's piece on thresholds in
yesterday's FT (second page below).

Rus^{11/2}

Time to forget yesterday's slogans

By Samuel Brittan

No/3



Sir Lawrence Airey

How Social Security Reform affects the poverty trap

Married man and his non-working wife, with two children of primary school age, living in rented accommodation for which they pay rent of £20 p.w. and rates of £6 p.w.

	£ per week					
	70.00	85.00	100.00	115.00	130.00	145.00
Wage						
Less: Tax	1.07	5.57	10.07	14.57	19.07	23.57
Nat. Insurance	4.90	5.95	9.00	10.35	11.70	13.05
Plus: Family Credit	29.23	22.61	17.40	10.99	4.59	—
Child Benefit	14.00	14.00	14.00	14.00	14.00	14.00
Hosng. Benefit	6.01	4.32	2.98	1.33	—	—
Net income after White Paper	113.27	114.41	115.31	116.40	117.82	122.38
Net income, current system	117.42	116.90	114.19	114.44	117.26	122.38

Source: Andrew Dilnot and G. K. Stark; Fiscal Studies, Feb 1986

It used to be said: "Every dark cloud has a silver lining." But this useful adage has been reversed by professionally gloomy financial commentators, who predicted the end of the world when the price of oil shot up in 1973-74 and 1979-80 and are again predicting the end of the world now that Opec is collapsing.

My own view is that the two earlier oil price explosions did set off the prolonged bout of "stagflation" from which many countries have been suffering, although they were not its fundamental cause. Similarly the collapse of the Opec cartel is the best world economic news we have had for many years.

Interestingly enough, the two most optimistic—but also realistic—appraisals come from two different sides of the political spectrum: from the Simon and Coates Economics Analyst, whose staff is headed by a former Callaghan economic adviser, Gavyn Davies; and from the Foghall Review edited by Lawrence Kudlow, adviser to the former Republican US Budget Director, David Stockman.

Both emphasise supply side effects. With much lower energy prices, both profits and the value of workers' output should increase, thereby moving real wages nearer to market-clearing levels. UK non-oil trading profits, which have already shot up rapidly since

1981, are expected by Simon and Coates to rise by a further 16 per cent in 1986 and another 10 per cent in 1987, partly reflecting lower oil prices and partly the recent depreciation of sterling.

There are also immediate worldwide benefits on the conjunctural front with less inflation and more output for any given growth of nominal demand. Mr Kudlow has now raised his 1986 real growth forecast for the US to 5 or 6 per cent and abated his inflation forecast down to 3 per cent.

The more cautious London Business School expects that OECD economic recovery "now three years old" will be prolonged into 1986 and reach a growth peak in 1987 on account of lower oil prices (as well as the fall in the dollar and the trend to lower nominal interest rates already in the pipeline).

It is scarcely credible that the specific problems of oil-producing developing countries, or US banks which have lent to the energy sector, cannot be kept at bay by some stretching out of interest payments and lender of last resort operations. The US has always looked after Mexico and will continue to do so.

Fears (if that is the right expression) that oil prices will fall to the level of marginal extraction costs are misguided and alarmist.

It is irrational to extract oil beyond the point where its value in the ground is likely to

rise faster than the rate of interest. Taking these factors into account the "competitive" oil price is estimated by Jeremy

Hale (also a Simon and Coates analyst) to be between \$11 and \$16 per barrel, with a bias towards the lower figure.

There are thus the supply side and conjunctural gains. But to offset them, the UK as a net oil exporter, whose exports amount to over 2 per cent of GNP, stands to lose. It will also need a terms-of-trade reduction to sell more non-oil products overseas. It is a reflection of the craziness of the British labour market that these aspects, which ought to be adverse, may actually be beneficial to output and employment.

Because of the oil price fall, some of the real depreciation of sterling, expected to occur very gradually as North Sea production tails off, has been compressed into the last few weeks, giving UK manufacturing exports and import substitutes a boost. Moreover, because of the oil price crash, the normal inflationary effects of a lower exchange rate have been held in abeyance.

The UK is not yet out of the wood on interest rates and sterling. Should the fall in sterling get out of phase with the fall in oil prices, base rates will have to rise, however hot under the collar industrialists and politicians get. So will they if next month's banking figures suggest that bank credit and

property prices are once more on the rampage.

The point about not looking at one month's figures in isolation applies just as much when they are good (as in the case of the January monetary and reserve numbers) as when they are bad.

The same applies to the unemployment figures. The December and January rise may be a statistical blip (after the earlier falls in underlying unemployment), the beginning of a new severe adverse movement, or simply indicate that over the past six to 12 months

unemployment has been rising by about 6,000 a month. If I were the Chancellor I should feel much more handicapped by having to finalise my Budget after only one more month's unemployment figures than after only one more month's money supply statistics.

Even if base rates do not rise further than their present 12½ per cent, they already represent at that level a real (but pre-tax) interest rate of 8½ per cent, if one takes seriously inflation forecasts of 4 per cent or less. British real short-term rates are about 6 per cent above German real interest rates and make sense only if it is thought that sterling will continue to depreciate in real terms against the mark at that rate.

The Chancellor might be tempted to raise his PSBR target both on the grounds of "a little Reaganomics"—that is offsetting monetary stringency, with fiscal ease—and on grounds of smoothing out the effects of

fluctuating oil revenues.

The last stated objective for the 1986-87 PSBR was £7bn, published in last year's version of the Financial Strategy. The estimated outturn for 1985-86 is £8bn.

Nevertheless a PSBR objective of £7bn to £8bn will already represent a dose of Reaganism. This is because it embodies an estimated £4bn of asset sales, compared with £1bn of such sales in 1983-84, and £2bn in the current financial year.

These assets, however, are wicked even when made to Americans, and we can forget the aristocratic collectivism of the "family silver." Nevertheless, they represent ways of financing the Budget deficit and not reducing it; and if you want to measure the fiscal stance on Budget Pay forget the PSBR and look instead at the PSFD (Public Sector Financial Deficit).

The heavens will not neces-

sarily fall in if the Chancellor borrows an extra £1bn. The market reaction will depend far more on international financial forces, the vagaries of UK bank lending and the Government's general political standing than on fiscal arithmetic. Moreover, tax concessions which encourage structural change — above all more jobs and lower pay settlements — will be better received than generalised largesse.

It would be foolish, however, to throw away the potential gains in lower inflation — and even more lower inflationary

expectations, with the possibility the latter hold of a virtuous circle of lower prices and higher output — by raising petrol duties or other indirect taxes simply to make room for income-tax cuts.

The actual tax burden would be no lower with a switch from direct taxation. Such a course would be to repeat in a minor key, and on the inflationary downslope, the error of the Thatcher government's first Budget in 1979, which mistakenly raised indirect taxes to finance an unappreciated reduction in the basic rate.

TAX THRESHOLDS ARE OUT OF DATE

THE CAMPAIGN being launched by some Tory "wets" for an increase in tax thresholds rather than a basic rate reduction shows a characteristic failure to catch up with changes taking place in the real world, namely the consequences of the Government's Social Security reforms, which are planned for 1988.

As a result, tax changes will make virtually no difference to families of modest means over a very wide range of incomes.

The table above shows that the old poverty trap, under which increases in pay led literally to lower income, has gone. But there is a "new poverty trap" over a wider range of gross income from about £70 to £145 a week for a typical family, in which take-home income rises very little with earnings.

Such high marginal rates are an unavoidable outcome of the desire to concentrate help on those in most need,

combined with the desire to limit net outlays.

The essence of the new system is that entitlement to benefit depends on net income after tax. This means that a reduction in income tax, which had no effect under the old system, will under the new regime, reduce entitlement, both to family credit and housing benefit. The result is that families in the poverty trap region will gain very little from a reduction in income tax, however brought about. A family in receipt of both Family Credit and Housing Benefit, which was taken out of income tax completely by an increase in thresholds, would see its implicit marginal "tax" rate fall only from 96 to 94 per cent.

Whereas an increase in allowances previously gave more proportional benefit to poor tax payers than to other basic rate payers, the position is now reversed. Tory "wets" please note.

But not only "wets." Precisely the same objection applies to the reintroduction of a lower rate tax band, said to be favoured by the Prime Minister. She might note that this was a TUC idea, imposed over the not quite dead body of the Treasury during the last Labour Government in return for hoped-for wage restraint which of course never materialised. It was rightly abolished by Sir Geoffrey Howe in 1979.

To reintroduce it now would be ersatz compassion, with the bulk of the gain going to those well above any conceivable lower tax bands. The one effective way of helping poor families will be via the benefit system.

There is, however, a technical case for a modest reduction in the basic rate. It is that a freeing of the married person's allowance is required in the transition to individual independent allowances,

whether transferable (as the Chancellor favours) or not. Both would be an improvement over the present system which discriminates in favour of families with two breadwinners. A slightly lower basic rate would be financed from the freeing of the married allowance; and this would itself reduce the cost of moving to transferable allowances. These are matters on which Inland Revenue chairman Sir Lawrence Alrey is presumably working.

If critics of Government economic policy on the back benches and in the Cabinet were more on the ball, they would concentrate neither on thresholds nor on jingoistic anti-Americanism in industrial policy, but on the Department of Employment's unmerited cold-shouldering of special measures suggested by the Commons Employment Committee for the long-term jobless.

Contrary to some reports,

the suggestions would not cost £3.3bn this year but that sum phased over three years. The suggestions are basically for more community service projects and for a subsidy to employers for each net hiring of long-term unemployed (I am sceptical of singling out building for special attention). The aim would be a job guarantee for all the long-term unemployed, involving some 750,000 extra jobs.

The Committee pulls too many punches and mistakenly urges that community services should pay the union "rate for the job" (no doubt to bring in the Labour Members). Its report makes the same mistake as many of the Chancellor's statements in being too short, without the supporting argument, calculations and tables, which may theoretically already have been published elsewhere but which the reader is most unlikely to have by his side.

The basic argument is that for paying people a modest wage, a little above the dole to "do something," rather than the dole for doing nothing. That is why the net Exchequer cost per job of special measures has been estimated at £4,000 to £5,000 a year compared with £25,000 to £50,000 for capital spending or conventional tax cuts.

The clue to faster real growth and more market related jobs remains, however, more market-related — and usually lower — growth of both nominal and real wages. The Treasury has been saying this in various different languages since 1944; and the problem is now more with the employers than the unions.

The task of the Budget is to send them a decisive signal that low pay settlements and more jobs are now preferred to the opposite and more comfortable combination. Compared with this need, the basic rate of tax and the thresholds pale into insignificance.

CBS
BU

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

PRIME MINISTER

GREEN PAPER ON PERSONAL TAXATION: FAMILY TAX ALLOWANCE

I have seen Norman Fowler's minute of 11 February proposing that a new system of family tax allowances should be grafted on to the existing proposal for transferable allowances.

I am afraid that I cannot accept this last minute suggestion, which would amount to nothing less than a fundamental transformation of the logic and nature of the Green Paper. Our principal aim in the Green Paper is to outline a better structure of income tax, which would achieve a number of objectives. As it happens, transferable allowances would benefit families with children, because the great majority of non-working wives are looking after children. But that is not its main purpose, which is to equalise the treatment of one and two earner couples.

The question of whether it is right to help families with children any further raises afresh the whole issue of child support. Following thorough discussion, the Government decided that the right answer was to retain the existing system of child benefit and augment it by a new family credit: this was set out in Norman's Green and White papers, and is now in the process of enactment. If we are now to make the somewhat damaging admission that we believe this to be inadequate, the right approach must be to build on that structure, not to change - and complicate - the tax system, whose purpose is not that of a surrogate social security system.



Moreover, Norman's proposal would greatly exacerbate the distributional problems. This can be seen by the fact that, on the basis on which the existing proposals would produce no cash losers, Norman's proposal would mean some 2½ million cash losers, some of them on low incomes.

Then there is the question, to which I have already alluded, of the relationship between the proposed family tax allowance and child benefit. We have been here before. Abolition of child benefit is not on politically; but the bureaucratic nonsense of having dual arrangements for child tax allowances and cash family allowances was one of the reasons we supported the introduction of child benefit in the first place.

And even if we were, notwithstanding the complications, to have family tax allowances as well as child benefit, to whom would we give the allowance? Giving it to the father would reopen the "pay packet versus purse" argument. It would be widely seen as a retrograde step, especially if introduced in the context of a move towards greater independence for married women. This problem is already rearing its head over the new family credit: we do not want to stir it up further.

The staffing implications of parallel arrangements for family tax allowance and child benefit payments would be horrendous. Payment of the latter already involves a large number of DHSS clerks. At present, it would not be technically possible for DHSS to communicate automatically with Revenue to provide a basis for giving family tax allowances. Developments in both Departments should make this possible some time in the course of the 1990s, but not in 1990 or 1991. Pending such developments, payment of family tax allowances would involve a very substantial number of extra clerks in the Revenue.



Finally, it would be distinctly odd just to mention this one variant in the Green Paper. Why not mention other variants such as mandatory separate taxation? But if we did introduce these other options we should be virtually reproducing the 1980 Green Paper. People might find this curious, to say the least. The point about this Green Paper is that it takes account of reactions to the earlier one and, having considered those reactions, puts forward a positive proposal in some detail, as a possible alternative to the status quo.

I am copying this minute to Willie Whitelaw, Norman Fowler, Norman Tebbit, David Young, John Wakeham, John Moore, Tony Newton and Sir Robert Armstrong.

N.L.

N.L.

11 February 1986

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PRIME MINISTER

REFORM OF PERSONAL TAXATION

The Chancellor's Green Paper is certainly now rather greener, though its tone still creates a strong presumption in favour of making the change.

I suggest you concentrate on Chapter 3, but you will also want to look at paragraphs 5.13 - 5.16 about mortgage interest relief.

Within Chapter 3, paragraphs 3.5 - 3.9 are most important, and probably the most important in the whole Green Paper.

I have suggested one small change on paragraph 3.5.

I remain concerned about the way the costs are presented in paragraph 3.6 and in the table. The assumption made in both places is that all of the money from indexation would be devoted to paying for the move to transferable allowances. The figures in the table show the amount which is left over, after using up the money from indexation, which is needed to finance the transfer. Or, to put it in another way, the figures show the amount of fiscal adjustment which is needed after the money from indexation has been used up. That is why the apparent costs in the table fall as the rate of inflation rises.

But it seems entirely unrealistic to assume that over a five-year transition period with inflation at 5% a year, the real value of the married man's allowance would not be increased at all, which I believe is what the table implies. To place so much emphasis on using up the money for indexation is surely not a good way of winning a constituency for tax cuts. (The sentence marked X in paragraph 3.8 is surely disingenuous: it refers to holding allowances unchanged

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in cash terms over a period of a year or more, while the table illustrates a position in which allowances would be held unchanged for five years.)

An alternative presentation would be to include a table which took only the first line from each of the three sections of the table. The result would be to show how the cost varied with the basic rate of income tax and the length of the transition period. This table is shown on the sheet attached. In effect, this would be a table showing the cost of introducing transferable allowances financed entirely out of the fiscal adjustment, with no reduction in the real value of allowances. (When inflation is zero, indexation is of course also zero.)

The text would then refer to the possibility of using money from not fully indexing the allowances if there were a widespread acceptance that a more rapid move to fully transferable allowances was desirable. The amounts of money which could be gained by less than full indexation at various rates of inflation could be shown if the Chancellor wished, but the presumption would be that the cost of introducing transferable allowances would be found in the first place from the fiscal adjustment.

My only other suggestion is that the first sentence of paragraph 3.23 should not state so firmly that the "Government's priority is to reduce the tax burden on one-earner couples". (Stated this way it looks like a priority with or without transferable allowances.) This is not stated in Chapter 2, and it may be better to say:

"Chapter 2 explains why it is important to reduce the tax burden on one-earner couples."

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I have mentioned these points to Mr. Tebbit's Office.

Monaghan
Duty Clerk

PP DN

11 February, 1986.

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Phasing in Transferable Allowances
Average annual cost

<u>Period of Transition</u>	<u>Basic rate of income tax</u>		
	25%	27½%	30%
Two years	2.3	2.5	2.7
Three years	1.6	1.7	1.8
Five years	0.9	1.0	1.1

CONFIDENTIAL

PRIME MINISTER

Green Paper on Personal Taxation
Meeting of Ministers at 9 am on Wednesday, 12 February

BACKGROUND

At the last meeting of the Group on 29 January the Chancellor of the Exchequer was asked to reconsider, in consultation with the Social Services Secretary, the presentation of the economic and distributional effects of the proposed change to transferable allowances, and to submit a revised text of the complete Green Paper for consideration at tomorrow's meeting. Particular concerns expressed at the discussion were:-

- the importance of reconciling the presentation with that of the social security changes, so as not to add to the problems faced by the Social Services Secretary in steering them through the House;
- continuing concern also about the reaction of the financial markets to the apparent commitment to a very large tax "give away".

2. The text has now been extensively revised following discussions between the Treasury, Inland Revenue, DHSS and the Cabinet Office, and, subject to the one major outstanding point discussed in paragraphs 5 to 10 below, has now largely been agreed between the Chancellor and Mr Fowler. They have, for example, resolved their differences on the presentation of the relationship between the tax and benefit systems in Part III of the draft, and on the treatment of the Additional Personal Allowance (APA) in Chapter 4 of part II (Chapter 4.16 now exhibits the DHSS favoured alternative of linking entitlement to the receipt of one parent benefit(OPB) rather than replacing it by OPB). However, the most important changes are to Chapter 3, which sets out

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the case for a system of transferable allowances, and I suggest you concentrate discussion on this Chapter.

Chapter 3: Transferable Allowances

3. This Chapter has been recast to meet the objections that it put excessive weight on the distributional rather than the "equity" case for the reform, did not in any case come clean on the distributional effects, and went dangerously close to committing the Government to a £5 billion give away in 1990 or thereabouts, which would preempt any other major tax or expenditure reforms. Thus:-

- the chapter has been re-ordered so that the husband and wife "equity" case is stated before the distributional arguments;
- although the text (Chapter 3.3) states that the Government would aim to make the change in such a way that no one suffered a loss in cash terms, Chapter 3.6 onwards makes it very clear that the change could be phased in over a period and that decisions on introduction could only be taken nearer the time "in the light of economic circumstances at the time and in particular the scope for tax reductions";
- the presentation of the distributional implications is now consistent with that of the Social Security Reform. Annex 4 show two pole cases. The first (tables 1 to 3) gives the effect of making the change in one year. There are no losers, and the real gains are the same as the cash gains. The second (tables 4 and 5) shows the real effects of phasing in the transferable allowances over time and financing this by using the indexation allocation (ie a revenue neutral option). The Government could not, therefore, fairly be accused of not showing a full range of

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possibilities, but paragraph 6 of Annex 4 again makes it clear that in practice the revenue neutral option is an extreme one and that the Government would not intend to be in the business of increasing the real burden of taxation;

- there is now no reference to the likely date of legislation (you will recall that at the last meeting you opposed the then proposal to use the 1987 Finance Bill which would be likely to put the scheme on the statute book before the next election).

4. In general, therefore, I think the Chancellor can fairly claim to have gone a long way to meet the concerns expressed by the Group - in particular by the Social Services Secretary and yourself - in the previous discussions, and unless other Ministers still have problems, you may be able to conclude fairly quickly that the revised text is acceptable. This is, however, subject to the one important outstanding issue discussed in Mr Fowler's minute to you of today's date.

OUTSTANDING ISSUE: FAMILY TAX ALLOWANCE (FTA)

5. Although this issue has been extensively discussed between both Ministers and officials, the Chancellor's covering minute of 10 February avoids any reference to it. It has therefore been left to Mr Fowler to raise it in his minute of today. In brief, DHSS have consistently argued that the Government would be criticised if they failed at least to acknowledge in the Green Paper that, in contemplating such a major change, they had considered (and had had good reason to reject) alternative options for securing the same objectives. More specifically, they argue that there is a good case for considering a family tax allowance (FTA) which could be combined with transferable allowances but target the benefits more specifically at families with children (a Government policy priority).

6. Mr Fowler therefore proposes in his minute to you that, for the

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same £5.3 billion cost as the Chancellor's "no losers" option, there might be:-

- a single transferable allowance of £2,700 (instead of £2,830);
- a FTA of £750.

The advantages claimed for this are summarised in Mr Fowler's minute. Nearly 1.5 million more families with children would gain (mostly in the £2-£5 category); there would be beneficial effects on the poverty and unemployment traps, and on the numbers caught in both the tax and benefit nets; and the numbers in receipt of family credit would also be reduced.

7. As he hints in the second paragraph of his minute, the Social Services Secretary is also concerned about the contrast between the Chancellor's proposals as they affect families and the interim uprating statement he is due to make on 24 or 25 February, which will take effect from July prior to the first April uprating next year under the new uprating timetable. So far as child benefit is concerned, the uprating is likely to include either no increase, or an increase of 10p at most. The issue will need to be decided when the relevant RPI figure (covering price movements between May 1985 and January 1986) is available next week. If the figure is more than 1%, Mr Fowler may wish to argue that this would justify a rounded up increase of 10p, on the basis that he would find from another source the expenditure savings on child benefit to which he is committed. But in either case, the Government's posture (so Mr Fowler would argue) would not sit easily with Green Paper proposals which ignore the possibility of directing further help to families in a manner consistent with their main objectives.

8. The main arguments against the Social Secretary's proposal (which I understand the Chancellor is likely to rehearse in a further minute to you later today) are:

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- while admittedly benefitting families, there would be some 2.5 million cash losers (though mostly less than £2 a week) mainly among childless couples where both partners are working;
- to introduce a FTA would add a new complication to the tax structure at a time when the Government's aim is to simplify it. It would also appear to reverse the policy accepted since the introduction of child benefit that support for children should be concentrated in the social security benefit system and not duplicated in the tax system;
- a number of alternative options were displayed in the 1980 Green Paper. The time has come to concentrate in this new Green Paper on a single preferred option which the Government clearly favour (conversely, it might look odd only to display one alternative);
- under present and foreseeable arrangements (at least until sometime into the 1990s) a FTA would present serious operational problems, requiring many additional staff;
- it would be impossible to work out this option fully and properly for a Green Paper to be published with the budget.

9. You will want to seek the Group's views on whether this option should be displayed. There is little doubt that it will be canvassed when the Green Paper is published, and the Government will be asked whether they have considered it. Although not mentioning this particular variant, the recent (6 February) Financial Times article by Michael Prowse discussed a number of alternatives to the Chancellor's (expected) proposals and put emphasis on the need to help families. On the basis of the work done by DHSS economists (though we have not yet seen the detailed figures), the FTA option also appears to have

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considerable attractions. So far as married couples are concerned, it would achieve the Chancellor's equality and privacy objectives; and it would at the same time target help more effectively on families. It is true that time is short to work the options out properly; but the Treasury must take some responsibility for this as a result of their failure to consult DHSS more thoroughly at an earlier stage in preparing the Green Paper. Inclusion of this option would also add to the "greenness" of the Green Paper, and prepare the ground for moving in this direction if the consultation process elicited strong support for tilting the reform more in the direction of families with children. On the other hand, the Government would be faced with a problem of cash losers among (mainly) childless couples; an FTA would not sit happily with child benefit; and it can be argued that, having canvassed a wide range of possibilities in 1980 (though not this specific one), the time has now come for the Government to focus on a single preferred option and not muddy the waters further.

10. On balance, I think there is a case for at least acknowledging the option in the Green Paper. The Chancellor of the Exchequer is, however, strongly opposed to it and it would not be necessary to display it as fully as Mr Fowler suggests. A possible compromise, if the Group support Mr Fowler, would be to include in the text at most the draft paragraph attached to Mr Fowler's minute but without adding to Annex 4 the detailed exemplification he suggests. A compromise of this kind would meet the Treasury objections that there is not time to work out the option in detail in time for publication with the Budget; but it should meet Mr Fowler's point by showing that the possibility had not been overlooked, and (hopefully) enable an agreed text to be taken to Cabinet.

NEXT STEPS

11. The Chancellor of the Exchequer proposes that, if the draft is agreed tomorrow, he should circulate it to the Cabinet. You will no doubt want the Cabinet to have an opportunity of discussing it. That is clearly not possible this week (nor very sensible given the likely tenor of the pre-Budget macro-economic discussion). I suggest,

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therefore, that, subject to the discussion tomorrow, you invite the Chancellor to circulate the draft to Cabinet for consideration on 20 February. Although time would be very short, this should still enable the Treasury, assuming Cabinet approval, to get the Green Paper out on Budget Day (a real difficulty for the Treasury is that the figures in the present draft will need to be revised to take account of the Chancellor's Budget tax proposals).

HANDLING

12. You will wish to invite the Chancellor of the Exchequer to introduce the revised text, and the Social Services Secretary to comment on it and to explain his proposal for including a family tax allowance option. You will then wish to seek the views of the other members of the Group, starting with the Lord President, on whether the text is now generally acceptable to them.

CONCLUSIONS

13. You will want the Group to decide:-

(i) whether the draft Green Paper is now broadly acceptable for publication with the Budget;

(ii) specifically, whether it should include a reference to a family tax allowance option, and if so in what form;

(iii) subject to decisions on the above, to invite the Chancellor of the Exchequer to circulate the full revised text for consideration by the Cabinet on 20 February.



J B UNWIN

11 February 1986
Cabinet Office



CeB/s

Prime Minister

REFORM OF PERSONAL TAXATION

Nigel Lawson and I have held further discussions on the Green Paper on personal taxation and have resolved most of the detailed questions which were outstanding after the last meeting of your Ministerial Group. There is, however, one important general issue which I thought it right to raise in advance of tomorrow's meeting: whether we should recognise in the Paper the possibility of combining transferable allowances - the Paper's main proposal - with a family tax allowance. The latter would be specifically aimed at families with children; the necessary information would be provided through computer links between the Revenue and my Department.

Transferable allowances clearly have major attractions. But, taken on their own, their distributional results appear to be in conflict with much of what we have said about focussing more clearly on the needs of families with children. Not only did the proposals produce over a million substantial gainers amongst couples without children where the wife is not working, but such couples gain more than couples with children where the wife is not working. Critics will inevitably seize on this, especially in view of the controversy about our recent decision in last November's uprating to reduce the value of child benefit. We shall certainly be asked whether other options have been considered and why we have rejected them.

Our further analysis suggests a positive way through this might be to illustrate a reformed system based, as Nigel proposes, on single transferable allowances but with an element of the relief going in the form of a family tax allowance, payable to families with children (or even more widely to families looking after disabled relatives). We have modelled the effect of a scheme applying to families with children. This would combine smaller transferable allowance than Nigel's proposal with a family tax allowance of £750. For the same cost as Nigel's "no cash loser" option, this approach would meet almost all the Green Paper's stated objectives to a greater degree than the transferable allowance proposal alone. Compared to transferable allowances alone:

- around 1.4 million more families with children would gain, 650,000 of them by more than £5;
- most of the new gainers would be in the £2 - £5 category;
- the numbers caught in the poverty trap would fall even more markedly - there would be 40 per cent fewer (180,000) with marginal rates of over 80 per cent;
- the impact of the unemployment trap would be reduced by rather more;
- "churning" would be reduced by much more. Only 200,000 families would be left paying tax and receiving income-related benefit.

- Under transferable allowances alone, the figure would be ~~700~~³⁰⁰,000;
- there would be 30,000 fewer families in receipt of family credit.

Against these clear advantages, I recognise that this option would also entail some losers. These would be overwhelmingly childless couples where both partners are working; most of the losses would be very small (less than £2 a week), and would affect families on above average earnings. In a phased programme of change it may be possible to reduce this problem still further.

In summary, transferable allowances with a family tax allowance produce results which are in many important respects more attractive than transferable allowances alone, and which can be presented as more consistent with the Government's overall social objectives.

I suggest therefore that such an option is mentioned and illustrated in the Green Paper. I attach a draft paragraph which might be added after para 3.31.

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

N F

3.32 The introduction of transferable allowances would not rule out further changes to the tax structure, designed to meet specific social or economic objectives. If, for instance, it was desired to provide more directly targetted help to families with children, it would be possible at a given revenue cost, to combine a slightly lower level of transferable allowance with a family flat allowance payable specifically to families responsible for children (or other dependents such as aged relatives). Targetting available relief in this manner would mean additional help for such families, whether or not the wife was working, but could provide relatively less help to single people or families with non-working wives who were not caring for children. Such a combination would also reduce further the number of families in the poverty and unemployment traps. The effects of such an illustrative package, are discussed in Annex 4.



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

PRIME MINISTER

REFORM OF PERSONAL TAXATION

At your meeting on 29 January you invited me, in consultation with Norman Fowler, to reconsider the presentation of the economic and distributional effects of the change to transferable allowances and to submit a revised text of the complete Green Paper taking into account the points that were made at the Group's first two meetings.

In the light of these and of my discussions with Norman, I now attach a substantially revised text. The distributional analysis discussed at your last meeting appears in Annex 4, and shows both the real and cash effects of moving to transferable allowances. Norman and Tony are content with this presentation, which follows closely that used in the Social Security White Paper.

As you will see, the text is much greener than the earlier draft, and the difficult question of costing the change has been approached by illustrating the effects of phasing-in the new system over transitional periods of differing lengths against a range of assumptions for inflation and the basic rate of tax. On other issues, we are in full agreement on the treatment of single parents (in Chapter 4) and on the longer term issues raised in Part 3 of the Green Paper.

The Green Paper is necessarily, I am afraid, rather bulky. You and colleagues will probably wish to concentrate particularly on Chapter 3, which outlines the case for a system of transferable allowances. This presentation has changed substantially since the last version you saw, and I think it now meets the points made on that earlier version by yourself and other members of the Group.



I am sure that I need hardly say that the timetable for processing this Green Paper is now extremely tight. I very much hope that we can reach agreement on the new text at your meeting on 12 February. I would then propose to circulate the draft to Cabinet in the form agreed at that meeting. The figures in Annex 4 still require some further checking, and all the figures in the final published version will of course need to be amended to allow for any income tax changes in the Budget.

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

N.L.

10 February 1986

CONFIDENTIAL

cebb



Prime Minister ²
Sent over (surprise,
surprise) by the Chancellor's
Office. Sent with a plan.

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

FROM: A J G ISAAC

DATE: 6 FEBRUARY 1986

DLV
10/2

CHANCELLOR OF THE EXCHEQUER

no per with
pro on
personal
format

MEETING WITH MR FOWLER: THE PROWSE ARTICLE

1. You have asked for quick comments on the article by Michael Prowse in today's Financial Times.

attached

General

2. In general, the line of criticism is familiar - from earlier articles by the Institute for Fiscal Studies, the Equal Opportunities Commission and the European Commission.

The pragmatists

4. Mr Prowse christens his first line of attack "pragmatic". Can we not remove the "sexist" element in the present legislation, without producing so many losers?

5. Certainly, it would be possible to make cosmetic changes, cleaning up the language in the Taxes Acts, without making

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Mr Cassell
Mr Byatt
Mr Monger
Mr G P Smith
Mr Cropper
Mr Scholar

Sir Lawrence Airey
Mr Isaac
Mr Lewis
Mr Painter
Mr Mace
Mr Pinder
Mr Eason
Mr Hudson
PS/IR

a substantive change in the tax liabilities. This was an option floated in Sir Geoffrey Howe's Green Paper on taxation of husband and wife. Virtually everyone* who responded (though they differed on what was the right solution) agreed that this would be a waste of time.

6. Any substantive reform has to tackle the married man's allowance, and its consequence that the two-earner couple get more than the equivalent of two single allowances. Any reform therefore must either cost money or produce losers.

Arguments of principle

7. Mr Prowse then goes on to argue that a system of mandatory separate taxation (MST), combined with increased cash benefits for children and others, would provide a better tax regime than transferable allowances. He develops four main arguments:

- value for money
- effect on low incomes
- effect on incentives
- the treatment of marriage.

Value for money

8. This is the familiar argument that the Chancellor would be "throwing away money" by giving tax relief for "idle wives": the rich stockbroker's wife who chooses to stay at home for coffee mornings and golf. It would be better - and more consistent with Mr Fowler's approach - to target relief by confining cash benefits to those with children etc.

9. The main reply to this is given by the important Chart 2.5 in the draft Green Paper (copy attached). This shows:

*from the Conservative WNAC through to the TUC and EOC.

- Certainly, looking after children accounts for the largest number of women not working - 63 per cent.
- But there are another 12 per cent who are permanently unable to work, looking after relatives, etc.
- And a further 12 per cent who are now over 50, whom no-one would reasonably expect to enter the labour market for the first time, or after a long absence (for example, Mr Fowler's own White Paper recognises that the widow's pension should be paid to someone who is widowed over 45, or has drawn widowed mother's allowance until she is over 45).

10. Thus, there are only 12 per cent of wives under 50, not working or caring for children etc, or not disabled. So, if you are not going to penalise the "deserving" cases at paragraph 9 above, there is no enormous pot of gold to redistribute to families with children. And some would say that there are "deserving" cases even in this final 12 per cent. For example, suppose that a girl is married to a coal miner working in the Valleys. There is precious little work for women at home. If she was single, she could leave Wales and look for work elsewhere. But do we expect her to leave her husband in Wales? Or him to leave his job?

11. Underlying all this is the question whether it is any business of Government - or civil servants - to decide which wives are "deserving" and which wives are "idle".

12. Finally, there would be technical or administrative problems under MST in stopping income splitting between married couples (so as in effect to transfer income between each other, rather than allowances).

Effect on low income families

13. Mr Prowse says, correctly, that increases in tax thresholds will do relatively little to raise the net income

if people claim the benefit to which they are entitled (which some do not).

of poor families in the post-Fowler world, where family credit etc are calculated by reference to net income after tax.

14. This is the familiar argument of poverty versus the poverty trap. Even on a revenue neutral basis, transferable allowances would take 100,000 people out of the poverty trap: on a "no losers" basis, they would take 200,000 people out of the trap.

15. By contrast, in the post-Fowler world, increases in child benefit would (as now) add to the net income of poor families but would not help with the poverty trap.

16. On a revenue neutral basis, the Prowse approach (mandatory separate taxation) would reduce the tax threshold for some 10 million married men of working age by some £1,250 a year. This would bring an additional ½ million families into tax for the first time - most of these in the poverty trap.

17. There would be similar unhappy consequences for the elderly - with no cheap and easy way of compensating them.

Incentives

18. This is the familiar argument that transferable allowances would be a disincentive for married women seeking work.

19. Certainly, the change would remove the present special incentive for married women to go out to work. Virtually everyone who responded to the Green Paper agreed that there was no justification for the present arrangements - which are more generous to a 2-earner couple than those in any other country.

20. You will already be very familiar with the argument here.

Treatment of marriage

21. The final familiar argument is that it is wrong in principle for the tax system to recognise marriage. We do not propose to give transferable allowances between brother and sister. So why give transferable allowances between husband and wife?

22. It seems to me that there are three main answers to this line of argument.

23. First, the Government believes in marriage.

24. Second, the argument breaks down when you try to apply it in the real world, and to the capital taxes. For example, it would be absurd to impose capital transfer tax if the ownership of the family home is transferred from the husband's name to the couple jointly. The tax system cannot completely ignore the fact that marriage exists and affects how people behave. And the old Estate Duty regime showed how much injustice and hardship resulted, when tax was imposed on the widow who wished to go on living in her old family home.

25. Finally, ~~for these reasons~~, no tax system in the civilised world adopts Mr Prowse's approach of mandatory separate taxation or tries to pretend that marriage does not exist.

A.J.G.

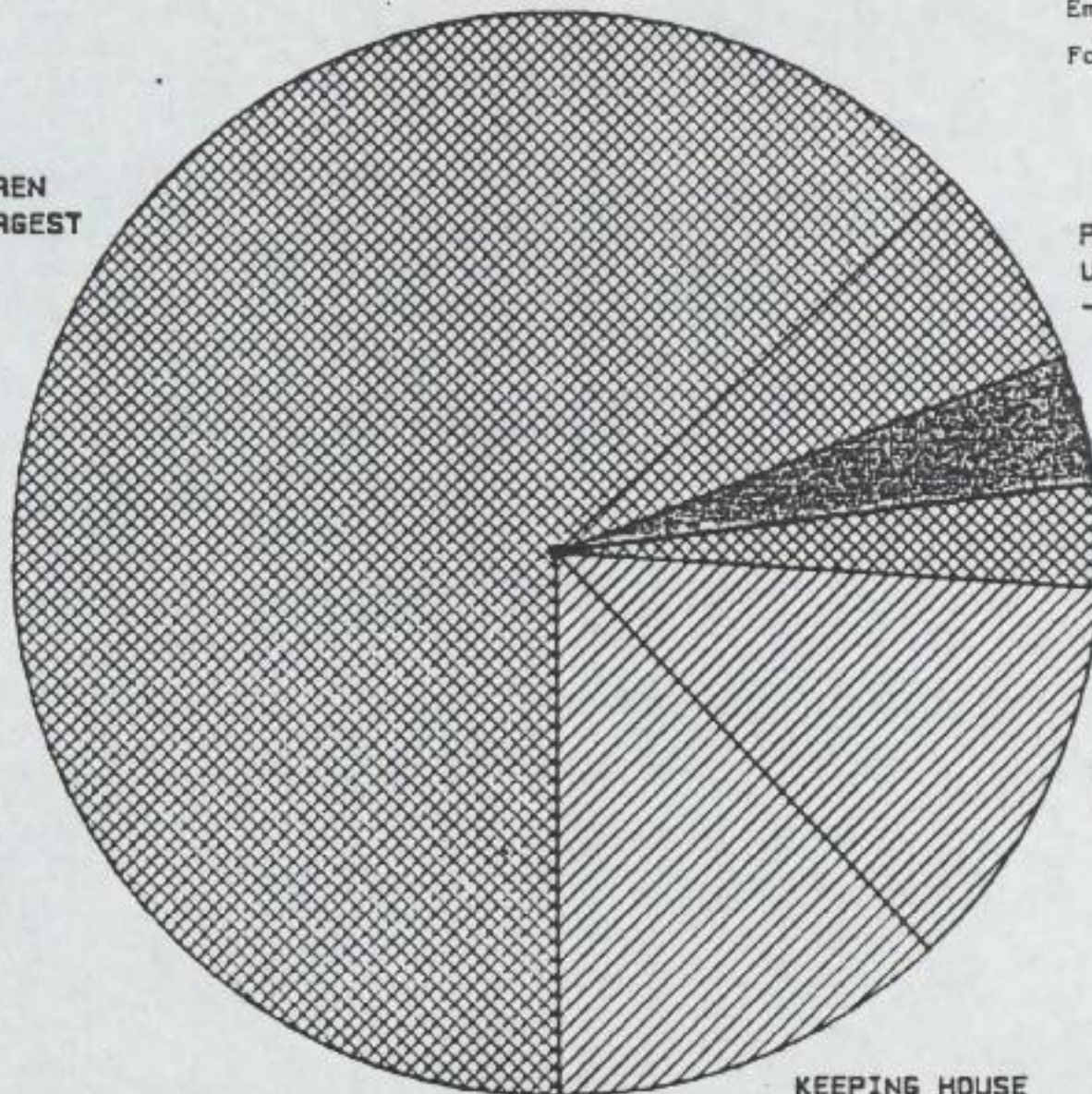
A J G ISAAC

CHART 2.5 : REASONS GIVEN BY MARRIED WOMEN FOR BEING ECONOMICALLY INACTIVE

Source: DE/DPCS 1980 Women and Employment Survey

For detailed figures see Annexe 6, Table

LOOKING AFTER CHILDREN
ACCOUNTS FOR THE LARGEST
NUMBER OF WOMEN
NOT WORKING - - 63%



PERMANENTLY
UNABLE TO WORK
- - 5%

OTHER REASONS
- - 4%

LOOKING AFTER
RELATIVES - - 3%

KEEPING HOUSE
AGED UNDER 50 - - 12%

KEEPING HOUSE
AGED OVER 50 - - 12%

Mr Lawson is paddling towards the wrong rapids

Michael Prowse raises some practical and philosophical objections to next month's green paper on personal tax reforms

Abbey Ashwood



IT LOOKS as though Mr Nigel Lawson—through his proposals for personal tax reform—may be about to do a Kenneth Baker. Enslating the Treasury Secretary, the British Chancellor is shortly to issue a discussion paper containing plans so contentious and implausible as to render even their implementation improbable.

Mr Baker's implausible scheme involved turning the fiscal clock back several centuries and replacing domestic rates with a poll tax—the sort of feudal levy Henry VIII might have approved.

Mr Lawson believes passionately that tax allowances should be transferable between marriage partners. The UK system, he told the Conservative Party conference last autumn, is "distorted" because wives who stay in the home cannot transfer their allowances to their husbands.

The scheme for transferable allowances is to be set out in detail in a long-delayed green paper now expected on March 18th (Budget day). The main elements were laid out in last year's Budget address.

This said that every adult would get the same standard tax allowance irrespective of sex or marital status. Husbands and wives would be taxed separately on earned and unearned (including investment) income. But if either was unable to make full use of his or her allowance, the unused portion could be transferred to the other.

Absurdities

At first sight, this may sound an admirable scheme. It would, after all, eliminate absurdities in the present matrimonial tax regime which dates from Napoleonic days. The symmetrical treatment of husband and wife would replace today's blatant sex discrimination under existing law: a wife's income is regarded for tax purposes as her husband's; he is legally responsible for the joint return.

A standard allowance for all adults would also sound a long overdue death knell for the biased married man's allowance (MMA). Just by walking up the stairs, a man can qualify for an allowance that is almost 1.6 times the single allowance—1985-86, £3,455 against £2,206.

Under present rules, married couples fall into three arbitrary categories. In the traditional family, where only the husband works, a couple gets only the MMA. If both spouses work, the couple gets 1.6 times the single allowance—the MMA plus the wife's earned income allowance (technically a concession granted to the husband).

Odder of all, in a "role reversal" family where only the wife works outside the home, the couple still receives 1.6 times the single allowance. Since the wife's earnings belong to the husband under the MMA and the wife's allowance are available as add-ons.

Mr Lawson's proposed reform would simplify things. Every married couple, courtesy of transferability, would qualify for the equivalent of two single allowances. It would be immaterial for tax purposes whether one or both spouses worked. The sex of a lone breadwinner would not matter. Two adults, simply by virtue of marriage, would never be able to qualify for more than the overall allowance of two single, working adults.

Almost everybody agrees the existing regime of household taxation is begging for reform. The debate has raged for more than a decade. Sir Geoffrey Howe, Mr Lawson's predecessor, produced an agonised, inconclusive green paper in 1980. The difficulty is that people do not agree what should be done. There is no sign of a consensus behind the Lawson plan.

The Chancellor is likely to come under fire from two directions—from those with pragmatic and those with philosophical objections.

The pragmatists will say: "By all means eliminate sex discrimination from the code but don't risk your neck with anything more ambitious. Give husbands and wives dual responsibility for the couple's tax affairs, remove the MMA, the married couple's allowance but don't contemplate a reform that would result in a radical redistribution of income. The last thing we want are millions of disgruntled losers."

The scale of potential gains and losers is alarming. Note first that the reform could not be phased in on a "revenue-neutral" basis—so that the Exchequer did not lose money. Revenue neutrality would imply a standard transferable allowance of £2,400. Married couples who both earned would then lose £250 a year; single earner couples, £250.

Reform could be contemplated only, as Mr Lawson has conceded, on the basis of "so cash losers." This would mean closing the yawning £1,250 gap between the MMA and the single allowance by raising the latter. The cheapest option would be to freeze the MMA in money terms—so that inflation ate away its real value, while simultaneously over-indexing the single allowance.

The goal might be a standard

allowance of £2,880—roughly midway between the present MMA and single allowance. Inflation at 5 per cent a year would whittle the MMA down to this level in four years. The single allowance would have to be raised by 30 per cent over the same period, or by 7 per cent a year, which would be roughly in line with expected

phasing, there would be no way of obscuring the fact that two-earner married couples would lose steadily and substantially; their 1.6 allowances would dwindle to only 2.

What of the philosophical objections? The political storm at the transition would be worth weathering only for a very attractive destination. Yet

MMA would have to be phased out. The big difference is that the standard allowance would not be transferable in any circumstances.

The central charge against the Chancellor's scheme is that it is wasteful and arbitrary. Every married man, regardless of circumstances, would have potential access to two standard tax allowances. What is the rationale for this?

Mr Lawson says it would end "discrimination" against the family with young children where the wife has to stay at home. Perhaps. But it would do so in a grossly inefficient way: every single-earner married couple would gain—see just those with special needs.

Much of the revenue raised by scrapping the MMA would be thrown away in quite unjustifiable tax concessions. The Chancellor would, for example, be granting extra tax allowances to childless stockbrokers whose wives stay at home because they enjoy coffee mornings and tennis.

By contrast, the IIT approach is more austere and logical. It is neutral towards the institution of marriage: a spouse who stays at home is treated like anybody else outside the labour market; he or she does not get an allowance to set against somebody else's income. All single-earner couples would receive just a single tax allowance.

But IIT is quite consistent with the sensible dictum that the tax and social security system should respond to need. If a couple has children or other dependants (and demographic trends means the number of households supporting the elderly will rise sharply), it deserves assistance. But this need is quite independent of marital status: all households

with dependants need special help, not only married couples.

Under the IIT alternative, all the money raised by phasing out the MMA (and more if the Chancellor were generous) would be available to meet need wherever it occurred. Unlike the Lawson plan, it would be consistent with the Fowler doctrine that relief should be carefully targeted. It would be possible, for example, to finance a substantial increase in benefits for children and for disability.

A supposed advantage of transferable allowances is that they alleviate the poverty trap—a description of the way poor families lose most, if not all, of a rise in income through high taxes and lower benefits. The force of this argument weakens anyway because the trap affects less than 2 per cent of taxpayers and so cannot justify changes affecting every household. It has been much reduced by Mr Norman Fowler's social security reforms. Transferability would give the single earner households that dominate the trap a bigger overall allowance but this might leave them little better off.

Under the new social security rules, benefits are based on net income. This means that a higher total allowance due to transferability will be less effective in reducing poverty. As Mr Andrew Dilnot of the Institute for Fiscal Studies has pointed out, if higher allowances result in a £1 increase in net income, many poverty trap families will end up only 6p better off (under the new rules, withdrawal of family credit disposes of 70p; withdrawal of housing benefit absorbs 21p of what is left).

The Lawson plan has other disadvantages. A wife's allowance would be available to a family whether or not she worked. Thus if she did work, the family's extra earnings would be taxed at 50 per cent from the first penny. Many women might regard this as a new and considerable disincentive to seek paid employment. The Treasury is thought to like this implication because it might slow growth of the labour force and improve the unemployment figures. The Prime Minister, however, is said to have taken a dim view of this tax on female enterprise.

Vulnerable

The Chancellor's scheme is vulnerable to criticism even from those who favour transferability. It does not show much respect for the individual that the privilege is granted to married partners only. There are many other stable household types. Why, for example, should a brother living with his sister not be able to exploit her tax allowance if it is unused? In Mr Lawson's world, this couple would deserve only half of the tax allowance of a single-earner married couple. Why?

At bottom, the Chancellor's plans look like straightforward fiscal discrimination in favour of marriage. The traditional male breadwinner household which goes to get two instead of 1.6 allowances could be forgiven for believing that Mr Lawson's intention is to enhance rather than abolish the MMA.

Like Mr Baker, the Chancellor looks set to make proposals that are politically controversial yet lack much economic merit. Why not accept that the tax system should be kept as simple as possible through the adoption of IIT, and the social security system fashioned to cope efficiently with need wherever it occurs?

Almost everybody agrees the existing, dotty regime of household taxation is begging for reform. The difficulty is that people do not agree what should be done.

Growth

The cost of the expense would be some £1bn-1.6bn; reform would thus preempt a large slice of future tax cuts. But could any Chancellor survive a four-year transition during which some tax payers gained so much at the expense of others?

The process would be further complicated by the need either to phase in the transferability of allowances or gradually to raise the single-earner couple's allowance. Otherwise, at the end of the transition, such couples would suddenly enjoy a windfall—two single allowances in place of only 1.6.

But however ingenious the

a whole raft of tax experts, pressure groups and official bodies (including the European Commission, a House of Lords Select Committee, the Equal Opportunities Commission, the Child Poverty Action Group and many others) believe Mr Lawson's goal is misconceived. He is paddling towards the wrong rapids; he has overlooked a simpler, cheaper and fairer alternative.

This alternative is known as "individual, independent taxation" (IIT). The idea is that every adult should be taxed separately and should have the same standard tax allowance. As under the Lawson plan, the



THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

FROM: A J G ISAAC

DATE: 6 FEBRUARY 1986

CHANCELLOR OF THE EXCHEQUER

MEETING WITH MR FOWLER: FAMILY TAX ALLOWANCE

1. You have asked for additional defensive briefing on Mr Fowler's proposals for a family tax allowance, combined with transferable allowances.

2. The DHSS are proposing that, for the same £5.3bn cost as your "no real losers" basis, you should have

- a single transferable allowance of £2,700 (instead of £2,830);
- a family tax allowance of £750.

In the time available, we have not been able to check their arithmetic (it is probably of the right order of magnitude); or to rework the figures on a "revenue neutral" basis.

ADVANTAGES

3. Mr Fowler will probably say that this package would combine two advantages:

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Mr Cassell
Mr Byatt
Mr Monger
Mr G P Smith
Mr Cropper
Mr Scholar

Sir Lawrence Airey
Mr Isaac
Mr Lewis
Mr Painter
Mr Mace
Mr Pinder
Mr Eason
Mr Hudson
PS/IR

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- giving independent treatment, equality and privacy to husband and wife (eliminating tax penalties on marriage);
- targeting help more effectively on families with children.

ARGUMENTS AGAINST

Distributional effects

4. As the draft Green Paper acknowledges, anyone proposing tax reform has to accept some distributional effects. But Mr Fowler's are much more severe than anything proposed in the Green Paper.

5. For example, Mr Fowler's own arithmetic shows that, even if he spends £5.3bn on the change, he still leaves over 2½ million cash losers (of whom over ½ million lose more than £2 a week).

6. As I have said, we have not seen the "revenue neutral" figures. But they would seem likely to be pretty horrific.

Relationship between tax and benefit

7. Public opinion is running strongly in favour of further integration between tax and benefits. Both Mr Fowler's Green/White Papers and your draft Green Paper, bow in this direction.

8. Support for children is perhaps the one area in which integration has been achieved in practice.

9. The Tax Credit Green Paper of 1972 sparked off a violent argument about how integration should be achieved.

- Should support be given through the tax system, in the father's pay packet?

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- Or should it be given by way of cash benefits to the mother?

In the end, the Government bowed to the poverty and women's lobbies, and agreed that support should be given to the mother. That may, or may not, have been the right decision. But the one point, on which everyone agreed, was that the earlier regime - with a mixture of child tax allowances and cash family allowances - was a bureaucratic nonsense.

10. To set the clock back to the 1960s at this late stage - after all the words that have been spent on integration of tax and benefits - would risk derision.

Balance of the Green Paper

11. At present, the Green Paper (like Mr Fowler's) focuses on only one alternative to the present system rather than the range of possibilities canvassed in 1980. This is an accepted approach to consultation. But if we were to go beyond this, a lot of people would find it odd if only one further option were canvassed, and if that were the new idea of a family tax allowance, rather than the usual alternatives of partially transferable allowances, or mandatory separate taxation with higher cash benefits (Michael Prowse's IIT).

Operations

12. In present circumstances, a child tax allowance or family allowance would be operationally absurd. DHSS employ an army of clerks to receive benefit claims from families and issue cash order books to the mother. But there is no way in which they can effectively communicate with our tax offices, in a way that would enable us to award a family tax allowance on the basis of DHSS information. Amazingly, the child benefit records do not even use the standard national insurance reference number (which we use for tax purposes and which DHSS use for most other purposes). So, we should have to employ a second army of clerks to receive tax claims from families and award allowances to the father.

13. As the Green Paper recognises in Chapter 6, developments in information technology (both here and in DHSS) should in due course make it easier for DHSS to pass information to us, in a form in which it can be directed reasonably cheaply and effectively to tax offices. Certainly, our hope is that this kind of facility should begin to emerge in the course of the 1990s. But not even the optimists expect to have this kind of facility on stream in (say) 1990 or 1991.

(In this section I am talking only of what could be done: paragraphs 7 to 9 above have discussed what should be done.)

EFFECTS ON THE GREEN PAPER TIMETABLE

14. If you decide that it is necessary to include a "family tax allowance" option in the Green Paper, we should of course provide a draft of text and figures accordingly. But I think I have to say that, at this late stage, it would carry a significant risk to the Budget timetable. I (and I think Mr Cassell) are already conscious of how much work remains to be done to bring the existing text and figures in line with the new approach (adopted in the Prime Minister's Group) on cost and phasing; and then to bring all the figures and commentary on to a 1986 Budget basis. Much of this work will have to be done at the same time as the peak of last minute work for the Budget itself. To work up and analyse a major new variant, within the few days remaining, would put a significant new strain on already-stretched resources. We might find ourselves slipping until after the Budget.

Write that
the Group
agreed
to this
because
it clearly
recorded
the reasons
for making
the Group
see back
of the day

A.J.G.

A J G ISAAC

● PART TWO ends:-

Recd of Meeting ⁽¹⁴⁾ on
Wednesday 29 January 86

PART THREE begins:-

Board of Inland Revenue to Chan. Exchq.
6.2.86.



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