

PREM 19/2603

32/92

CONFIDENTIAL FILE #6

REIMBURSEMENT OF HOME TO OFFICE
TRAVEL

CIVIL SERVICE

Taxation of Civil Service
Allowances.

FEBRUARY 1983

| Referred to | Date | Referred to | Date | Referred to | Date | Referred to | Date |
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| 9.5.83 | | 11.4.89 | | | | | |
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PREM 19/2603



CEPU

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218

MO 4/4/4E

11th April 1989

NBRM
REC
12/4

Dear Norman,

Taxation of Boarding School Allowances and Detached Duty Payments

Thank you for your letter of 21st March in reply to mine of 2nd March which asked you to consider again the exemption of Boarding School Allowance (BSA) and long term Detached Duty Payments (DDP) from tax. I note, with regret, your conclusion that we should not proceed with this.

In 1985, when it was agreed that tax exemption of these allowances was the best route, we were all, I believe, aware of the political problems that stood in the way. However, given the complexities and possibilities for error in compensation arrangements, we felt that the exemption option was the most sensible: I am still firmly of that opinion.

I agree that the situation has been eased somewhat by the introduction of the single higher rate of tax and that the independent taxation of husband and wife to be introduced next year will help further. The fact still remains, however, that exemption from tax provides the simplest, fairest and most error free solution to the problem

The Rt Hon Norman Lamont MP



That said, I am prepared to accept that the situation should remain as it stands.

I am sending copies of this letter to the Prime Minister, Geoffrey Howe and John Wakeham and to Sir Robin Butler.

Yours wv.

George.

George Younger

CIVIL SERVICE : Taxation of Allowances

Feb 83



bc B9

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

23 March 1989

Dear Brian,

**TAXATION OF BOARDING SCHOOL
ALLOWANCES AND DETACHED DUTY PAYMENTS**

The Prime Minister has seen your Secretary of State's letter of 2 March to the Chancellor and the subsequent responses from the Foreign Secretary and the Financial Secretary. In view of the points raised by the Financial Secretary the Prime Minister agrees with him that it would be preferable to retain the present grossing up arrangements rather than to introduce a tax exemption.

I am copying this letter to Stephen Wall (Foreign and Commonwealth Office), Alex Allan (HM Treasury), Robert Satchwell (Financial Secretary's Office) and Steven Catling (Lord President's Office).

*Yours,
Paul*

(PAUL GRAY)

Brian Hawtin, Esq.,
Ministry of Defence.

8

PRIME MINISTER 1

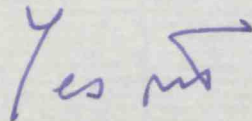
TAXATION OF BOARDING SCHOOL ALLOWANCES AND DETACHED DUTY
PAYMENTS

You will recall that some three years ago consideration was given to exempting public servants from tax in relation to Boarding School Allowance and Long Term Detached Duty Payments. This was judged to be impractical, but arrangements were introduced to compensate the personnel concerned by grossing up the allowance payments to take account of the tax liability.

George Younger has now written to the Chancellor (flag A) arguing that the administrative arrangements for grossing up are complex, and urging him to reconsider introducing exemption from tax liability via a provision in the 1990 Finance Bill. Geoffrey Howe (flag B) also supports this change.

But the Financial Secretary (flag C) argues strongly that the existing arrangements should remain. He points out that the administrative complications of grossing up will reduce over time, e.g. as a result of independent taxation of married women. But he suggests that the tax policy difficulties of introducing a tax exemption just for public servants remain as great as they were in 1986.

Content to agree that the present grossing up arrangements should remain and that no change should be made towards tax exemption?

Yes 

Recg.

PAUL GRAY

22 March 1989

EL3DKN

Robert 01.17.3.89



cepu
C

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger MP
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
London SW1A 2HB

21st March 1989

Dear George

TAXATION OF BOARDING SCHOOL ALLOWANCES AND DETACHED DUTY PAYMENTS

at top
You wrote to Nigel Lawson on 2 March suggesting that further consideration be given to an exemption from income tax for Boarding School Allowances (BSA) and long-term Detached Duty Payments (DDP). You propose that measures be introduced in either this, or next, year's Finance Bill.

Following the decision not to exempt these payments in 1986 it has proved possible to introduce - as the Prime Minister wished - compensation arrangements to ensure that individuals who receive these payments, and pay tax on them, are not out of pocket. I appreciate that some of these arrangements - in particular those which compensate for the "knock-on" effects of grossing-up for the tax payable - are not straightforward. But most Departments seem to have coped with them reasonably well and have kept the administrative costs involved to a minimum.

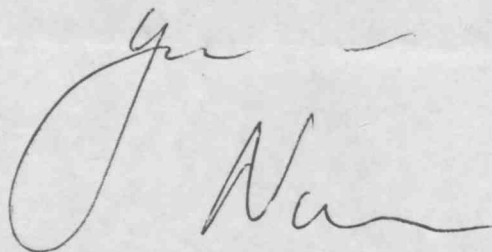
In the future, these compensation arrangements should become much simpler. The position has already been eased by the last year's introduction of a single, higher rate of income tax. And next year the independent taxation of husband and wife will remove one of the more troublesome "knock-on" effects.

It is obviously right that we should all look for ways of reducing administrative costs for Government Departments. But I do not believe that in this instance the savings at stake are worth the political difficulties which the tax exemption for these payments would involve. Those difficulties are no less now than they were in 1986. It is still the case that an exemption would be seen as privileged treatment for Crown Servants and there is no doubt in

my mind that it would provoke calls for a wider exemption for similar payments received by people in the private sector. I do not think that would be desirable, since such demands could be difficult to resist and their cost would be high.

For these reasons, my conclusion is that the judgement made in 1986 not to proceed with the tax exemption you propose remains the right one. Nor, I am afraid, is it likely that circumstances will change sufficiently to make that course any easier in the future.

I am sending a copy of this letter to the Prime Minister, Geoffrey Howe and John Wakeham.

A handwritten signature in dark ink, appearing to read 'Norman Lamont', written in a cursive style.

NORMAN LAMONT

CIVIL SERVICE: Taxation of

CS Allowance

Feb 85





Foreign and Commonwealth Office

London SW1A 2AH

15 March 1989

From the Secretary of State

WBA at his stage.

Dear Nigel

*Rach
15/3*

I should like to support very strongly George Younger's proposal, in his letter of 2 March, that Boarding School Allowances (BSA) and detached duty payments (DDP) paid to staff in the UK should be removed from tax liability.

Our problems with regard to BSA are, of course, on a much smaller scale than those of the MOD and we do not pay DDPs; but the arrangements for compensation are time-consuming and take up scarce resources which could be better employed elsewhere.

I very much hope, therefore, that you will agree to make an appropriate amendment to the Finance Bill, if at all possible this year, so that these payments can be made free of tax. This would not only lessen the administrative burden on us but would considerably simplify procedures for the staff who receive this allowance.

I am sending a copy of this letter to the Prime Minister, George Younger, John Wakeham and Sir Robin Butler.

GEOFFREY HOWE

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer

CIVIL SERVICE : Taxation
of Civil Service

Feb 83





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MINISTRY OF DEFENCE WHITEHALL LONDON SW1 2HB

MO 4/4/4E

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

2nd March 1989

BF *NBPA with Treasury*
recd. BF 3 weeks.
REC 6/1

Dear Nigel,

file attached

You will recall that in 1985/86 we considered the problems which related to the need for recipients of Boarding School Allowance (BSA) and long-term detached duty payments (DDPs) in the UK to pay tax on these allowances. We agreed then, in conjunction with the Foreign and Commonwealth Secretary, on the desirability, on administrative grounds, of removing these payments from the liability through an amendment to the Finance Bill. However, your advice at that time was that such an amendment would be politically sensitive and should not be proceeded with.

We also agreed that, notwithstanding the long-term aim of seeking to amend the tax legislation, we would take steps to compensate personnel for the 'knock-on' effects of grossing-up their allowance payments to take account of the tax liability. This action was strongly supported by the Prime Minister. However, the compensation arrangements resulting from the disparate nature of individuals tax circumstances, are necessarily complex and are administratively onerous. This additional workload at a time when the Departments' Service pay and finance staffs are already under extreme pressures resulting from the implementation of our new financial management strategy is most unwelcome. Quite apart from

The Rt Hon Nigel Lawson MP



the very significant administrative advantages, removing the tax liability from UK BSA has the added advantage of removing the misconceptions held by some in respect of the current arrangements for the grossing up of BSA in the UK. In these circumstances I believe the time has now come when we should reconsider the position on amending the tax legislation.

My purpose in writing is to establish whether or not you now feel it would be possible to make an appropriate amendment to the Finance Bill to exempt BSA in the UK and DDPs from tax liability. I accept that it now may be too late in the day to include such an amendment in this year's Finance Bill, and, if this is so, I should be glad of your agreement to include the change in the 1990 Bill.

I am sending a copy of this letter to the Prime Minister, Geoffrey Howe, and John Wakeham.

Yours sincerely,

George Younger

CIVIL SERVICE: Taxation & Allowances
Feb 83



CONFIDENTIAL

C/BG



Treasury Chambers, Parliament Street, SW1P 3AG

David Ball Esq
Private Secretary to the
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
London
SW1A 2HB

N BPN.

17 November 1986

*Dear David***TAXATION OF BOARDING SCHOOL AND DETACHED DUTY PAYMENTS**

Your letter of 10 November refers to discussions which have been taking place at official level about the arrangements for dealing with knock-on effects from taxation of Boarding School Allowances and Detached Duty Payments.

I understand that the technical matters to which you refer came up in discussions in September, and that they have since been resolved with Inland Revenue. The Chief Secretary therefore notes that the situation remains as stated in his letter of 31 October.

I am copying this letter to David Norgrove (No. 10), David Reddaway (Foreign and Commonwealth Office) and Murdo Maclean (Chief Whip's Office).

Yours sincerely,

JILL RUTTER
Private Secretary

CIVIL SERVICE: Taxation of allowances.



ccBG



MINISTRY OF DEFENCE
 MAIN BUILDING WHITEHALL LONDON SW1
 Telephone 01-~~938 2022~~ 218 2111/3

MO 4/4/4E

10th November 1986

New Jiu,

NBM

TAXATION OF BOARDING SCHOOL AND DETACHED DUTY PAYMENTS

The Defence Secretary has seen David Reddaway's letter of 14th October to Alex Allan recording Baroness Young's views on the need to move quickly to introduce further compensation arrangements to counter the knock-on taxation effects of Boarding School Allowances (BSA) on other personal income and the proposed parallel arrangements for Detached Duty Payments (DDPs). He has also seen the Chief Secretary's letter of 31st October.

Whilst Mr Younger shares Lady Young's view that we should proceed with all speed, he feels that it is important that we should not underestimate the complexity of the changes involved, which will require substantial co-operation from the Inland Revenue if we are to achieve them as efficiently as possible. I understand that, at present, the Treasury's interpretation of what the current income tax coding machinery provides by way of compensation for other income differs from that of both my own Department and the Foreign and Commonwealth Office. Until these differences are resolved my Secretary of State believes that it would be unwise to set a firm date for the adoption of new arrangements. That does not mean that we regard a start date of 1st April next year as unattainable, but simply that we would prefer to have a much clearer idea of the implications in, for example, the field of computers, before accepting it as a realistic target.

I am glad that officials of our Departments have been making progress in discussions to settle these differences. Once the outcome is known, we will, of course, need to take stock of the budgetary implications of any revised scheme of compensation. On this point, the Defence Secretary has noted the Chief Secretary's reluctance to make additional funding

Miss J K Rutter
 HM Treasury



available to meet the further costs arising from the expanded grossing-up arrangements. He will wish to look carefully at the position once the extent of the commitment has been more clearly established.

I am sending copies of this letter to David Norgrove (No 10), David Reddaway (Foreign and Commonwealth Office) and Murdo Maclean (Chief Whip's Office).

Yours sincerely

David Ball

(D C J BALL)
Private Secretary

CIVIL SERVICE

ALLOWANCES

2/83



CONFIDENTIAL

CCBG



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger TD MP
 Secretary of State for Defence
 Ministry of Defence
 Main Building
 Whitehall
 London
 SW1A 2HB

31 October 1986

Dec George,

NBP

**TAXATION OF BOARDING SCHOOL ALLOWANCE (BSA)
 AND DETACHED DUTY PAYMENTS**

You wrote to Nigel Lawson on 30 September about the arrangements for grossing-up Boarding School Allowances for UK Service personnel serving at home, and Civil Service Detached Duty Payments.

I am glad that you agree that MOD should come along with the FCO and other departments in arrangements that will in the absence of legislation remove so far as is possible unfairness caused by grossing-up of these allowances. You will have seen Janet Young's helpful comments (her Private Secretary's letter of 14 October) which show that the FCO accepts that it would be more equitable to introduce new arrangements across the board for all Crown Servants, when Detached Duty Payments start to be taxed next April. I understand that our officials have already made good progress towards agreeing the details of what will be involved.

As to finance, I regret that I cannot accept your bid for support from the Reserve to cover the effects of grossing-up DDPs or for the provision of any further compensation for BSA. We have throughout been working on the assumption that any extra costs must be met from within agreed PES provision and (where appropriate) running costs ceilings. This applies to all departments. I have agreed to restore the £1.4 million which was cut from the FCO's baseline in anticipation of BSA grossing-up being brought to an end, but I have rejected their request for additional resources. I must do likewise with you, not least in view of the block budget arrangements for defence expenditure.

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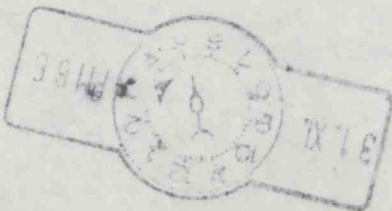
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CIVIL SERVICE
TAXATION OF
ALLOWANCES
2/VS

I am copying this letter to the Prime Minister, Janet Young
and John Wakeham.

Yours,
JH

JOHN MacGREGOR



CONFIDENTIAL

CCBC



Foreign and Commonwealth Office

London SW1A 2AH

14 October 1986

NSM

Dear Mr Anon

In the Foreign Secretary's absence, Lady Young has seen a copy of the Secretary of State for Defence's letter of 30 September to the Chancellor of the Exchequer about the taxation and grossing-up of Home Boarding School Allowance (HBSA) and Detached Duty Payments (DDPs).

Lady Young regrets any further delay in the introduction of new arrangements to compensate officers for the effect of grossing-up HBSA on all sources of income, which the FCO could introduce immediately.

Lady Young accepts, however, that the Minister of Defence and other Home Civil Service Departments face particular problems over the greater number of officials who will now be affected by the decision to tax and gross-up DDPs. She recognises that it would be more equitable to try to agree new arrangements across the board for all Crown Servants. She is therefore prepared not to press for the FCO to introduce new arrangements in advance of their introduction by all Departments with effect from the beginning of the next financial year. She is concerned, however, that this date should not slip. If there continue

/to

Private Secretary to the
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG



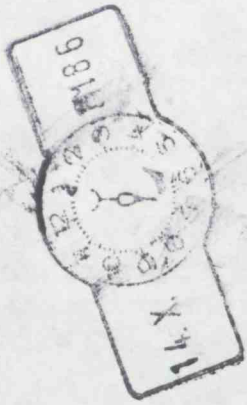
to be difficulties over the arrangements for the grossing-up of DDPs, the FCO would want to go ahead with arrangements for paying extra compensation to FCO officers on 1 April 1987.

I am copying this letter to David Norgrove (No 10), John Howe (Ministry of Defence) and Murdo Maclean (Chief Whip's Office).

Yours sincerely

David Reddaway

David Reddaway
Private Secretary to
Baroness Young



CONFIDENTIAL



CBS

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000

DIRECT DIALING 01-218

MO 4/4/4E

30th September 1986

NBP7

Dear Nigel,

You wrote to me on 4th July 1986 restating the difficulties that have precluded our proceeding, in this year's Finance Bill, with the planned exemption from taxation of Boarding School Allowance (BSA) payments made to UK service personnel serving at home. A corollary to that decision is the requirement, to conform with current tax law, to tax and gross up Civil Service Detached Duty Payments (DDPs), hitherto exempt from taxation.

I accept these decisions with the same reluctance as Geoffrey Howe (his Private Secretary's letter to yours of 5th August), and strongly endorse his view that we should pursue legislation to reverse them at the earliest opportunity. I also share your own concern that, until such a change can be made, everything possible should be done to relieve the knock-on penalties for those who receive BSA or DDPs.

The Rt Hon Nigel Lawson MP

CONFIDENTIAL



Because of the appreciably greater numbers affected in my own Department, I have some difficulty with some of the Foreign and Commonwealth Office proposals. As I have mentioned previously, at any one time we have some 10,000 personnel based in the United Kingdom in receipt of BSA - against the Foreign and Commonwealth Office's 250 or so; and about 1500 staff drawing DDPs, whereas they have none. It is in the interests of equity that any changes should be introduced simultaneously in both Departments, and I believe it must therefore be the pace at which my Department can resolve its difficulties that determines the timescale for implementation.

I have relatively few practical problems with the proposals for DDPs. I would suggest that the first step here should be to align our practices with these at present in force for BSA. That is, the new tax would be introduced concurrently with a scheme to compensate for the effects of grossing up both on ERNIC contributions and on the level of LEA student awards. Our officials are already in close touch on this, and there is general agreement that to allow time for all the necessary work to be completed, and for the obviously important negotiations with the Trades Union side, taxation of DDPs should not start until the beginning of the next financial year. A short breathing space of this kind should ensure a smoother transition, and deflect some of the more unwelcome reactions.



As to extending compensation arrangements beyond these first two knock-on effects to take account of the additional tax liability on wives' earnings, investment income and income from property (so that recipients of both BSA and DDPs in future obtain relief where grossing up pushes part of overall income into a higher tax band) I am clear that the principle is entirely right. I am less happy about the practical prospects of achieving this improvement quickly, given that income tax is individually calculated and a matter of great detail, which falls properly to be sorted out between each individual and his tax office rather than via the routine pay office machinery. Such factors are further compounded, in the case of my Department, by the problems of scale I have noted above - we could not sensibly hope to match the Foreign and Commonwealth Office's proposal to effect the extra compensatory payments during the current financial year. I suggest, therefore, that action in both Departments be held, and discussion resumed urgently between your Treasury and Inland Revenue officials and mine, with a view to framing recommendations on both the machinery and the timescale for handling these additional effects, so as to minimise both the considerable inconvenience to the recipients of BSA and DDPs and the extra workload that will inevitably fall on the Ministry of Defence and the Inland Revenue.

Geoffrey Howe also mentioned that he would be seeking restoration from the Reserve of cuts (£1.4 million) made in the



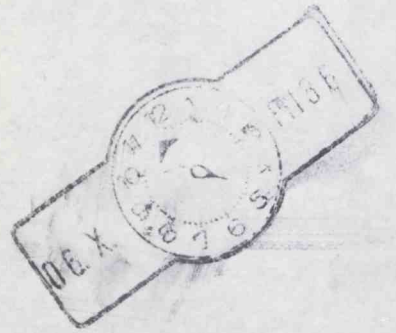
Foreign and Commonwealth Office's baseline in 1986/87 and beyond on the assumption that grossing up of BSA would be discontinued. Officials in my Departments have not made such an adjustment to expenditure plans, but we will still require support from the Reserve from 1987/88 for the effects of grossing up DDPs as well as any further compensation arrangements for BSA which might be devised, if these impose an extra financial burden on the Department. The figure for DDPs alone is of the order of £1.2 million a year, while the BSA figure of course cannot yet be assessed.

I am sending a copy of this letter to the Prime Minister, Geoffrey Howe, and John Wakeham.

Yours ever,
George

George Younger

CIVIL SERVICE: Taxation of allowances: Feb. 1983.



CONFIDENTIAL

FILE

CAJ(79)



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

24 September 1986

TAXATION OF HOME BOARDING SCHOOL ALLOWANCES

The Prime Minister was glad to be assured (your letter of 22 September) that the vast majority of claimants will be properly compensated when new arrangements for grossing-up home boarding school and detached duty allowances are introduced. She has noted that a safety net will be brought in if necessary. She has asked me to repeat to you her concern that the system should be fair.

DAVID NORGROVE

Miss Jill Rutter,
H.M. Treasury

CONFIDENTIAL

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PRIME MINISTER

TAXATION OF HOME BOARDING SCHOOL ALLOWANCES

You will remember that the Treasury seemed to be trying to slide out of the agreement to tackle unfairness in the grossing-up arrangements for home boarding school allowances.

The letter from the Treasury below is reasonably reassuring. They have accepted the need for new and improved arrangements and recognise that there may be a need for a safety net to catch the very small number of particularly hard cases.

The problem for the FCO is more one of the cost of the administration than the cost of the payments themselves (less than £50,000). Peter Kemp thinks the FCO are now overplaying their hand. But he has assured me that the Treasury are very aware of your concerns on this.

This problem is now entangled with the survey discussions and I do not think it would be right for you to intervene directly at this stage. I suggest you simply repeat your concern that a fair system should be introduced. The Treasury will get the message.

Agree?

Yes

DNS

DAVID NORGROVE
23 September 1986

BM2AVJ

CONFIDENTIAL

C/BS



Treasury Chambers, Parliament Street, SW1P 3AG

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

22 September 1986

*Dear David,***TAXATION OF HOME BOARDING SCHOOL ALLOWANCES (HBSA)**

Your letter of 8 September asks for an estimate of the cost of removing any remaining unfairness caused by grossing-up Boarding School Allowances for MOD staff, the Armed Services and FCO employees.

The Treasury has recognised and accepted the need to introduce new arrangements for grossing-up Detached Duty Payments and to improve the arrangements for grossing-up Boarding School Allowances so as to remove unfair side-effects as far as possible. Discussions are taking place between departments which aim at having new arrangements agreed well before next April, when long-term Detached Duty Payments will start to be taxed.

The simplest and most effective scheme will require a reasonable degree of co-operation from the individuals concerned, and there is every prospect of coping in this way with all but the rarest of circumstances. Although some sort of safety-net may be needed, the vast majority of claimants should be properly compensated when the new arrangements are introduced.

The extra cost of any necessary refinements is not at present known but is likely to be very small and readily absorbable by the departments concerned. For example, the specific contingency referred to in Robert Culshaw's letter of 5 August would cost the FCO less than £50,000 if met in full. The immediate difficulty with the FCO's proposal was not the level of payments, but the administration problems that it might have created for the MOD and other departments.

*Yours,**Jill*

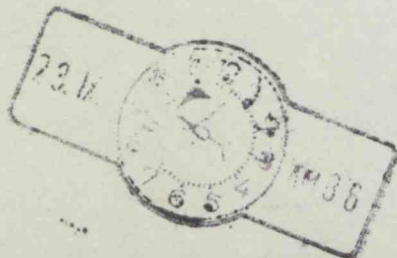
JILL RUTTER
Private Secretary

Civil Service; Taxation of Allowances - Feb '83



Director, Income Tax, Government of India, New Delhi

FORWARDED TO
DIRECTOR, INCOME TAX
GOVT. OF INDIA, NEW DELHI



CONFIDENTIAL

SPWALL

SPW



FUE

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

8 September 1986

TAXATION OF HOME BOARDING SCHOOL ALLOWANCES (HBSA)

The Prime Minister has seen your letter to Robert Culshaw of 1 September about taxation of home boarding school allowances.

The Prime Minister believes it is important so far as possible to remove unfairnesses caused by grossing-up of home boarding school allowances and detached duty allowances and sees it as part of the decision not to legislate that this should be done, both by improving the administrative arrangements and by paying additional compensation where necessary.

I should be grateful for an early assessment of the costs of paying additional compensation to remove any remaining unfairness caused by grossing-up, for MoD staff and the armed services as well as for FCO employees.

I am not at this stage copying this letter beyond the Treasury.

(DAVID NORGROVE)

Miss Jill Rutter,
Chief Secretary's Office,
HM Treasury.

CONFIDENTIAL

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Treasury Chambers, Parliament Street, SW1P 3AG

R N Culshaw Esq
Private Secretary
Foreign and Commonwealth Office
King Charles Street
London
SW1A 2AL

Prime Minister 2

The Treasury are refusing 1 September 1986

to find extra money needed
to remove unfairness in the
grossing up arrangements. Would you like me
to promote this with them (privately at this stage)?

Dear Robert,

Yes - it seems to me they
are trying to pass back the
original
what the
Robert
to look
& put

TAXATION OF HOME BOARDING SCHOOL ALLOWANCE (HBSA)

You wrote to Tony Kuczys on 5 August about the continuation of FCO grossing-up arrangements now that it has been decided not to proceed with legislation to exempt HBSA from tax.

We agree that the savings which were scored in the 1986 Survey, in anticipation of the legislation, should now be added back to the FCO baseline as you propose in sub-paragraph (a) of your letter. This will need to be recorded as an agreed addition in the figure for the current PES discussions.

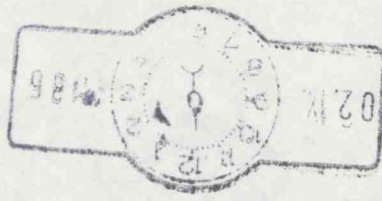
We cannot accept, though, that the circumstances require the allocation of further resources, over and above those amounts, to expand the existing coverage of the grossing-up arrangements. Reinstating the 1985 cuts will restore the original position. While we recognise your wish to make certain improvements, there are no resources available to do so in the present context.

The case for improvements in the system would, of course, be easier if any costs could be accommodated without additional allocations; but even then, we would be concerned to ensure that there should be a consistent approach across the board to the timing of future grossing-up arrangements.

I am copying this letter to David Norgrove (No. 10), John Howe (Ministry of Defence) and Murdo Maclean (Chief Whip's Office).

Yours,

JILL RUTTER
Private Secretary





Foreign and Commonwealth Office

London SW1A 2AH

5 August 1986

Dear Tony

Taxation of Home Boarding School Allowance (HBSA)

You wrote to Tony Galsworthy on 12 June about this and we have seen David Norgrove's letter of 26 June conveying the Prime Minister's views and the Chancellor's response to the Defence Secretary on 4 July, confirming the decision not to proceed with the legislative route to exempt HBSA and DDA from tax.

The Foreign Secretary was naturally disappointed by this decision, but reluctantly accepts it. He believes that the taxation of HBSA is nevertheless an unjust and inefficient anomaly which should be tackled by legislation as soon as possible. The best time would probably be in the first post election budget.

Meanwhile there are several immediate consequences for the FCO of the decision to maintain grossing-up:

- (a) The £1.4 million reduced requirement subtracted from FCO's baseline in the 1985 Public Expenditure Survey will have to be restored from the Reserve in 1986/87 and in the PES plans in the next three Survey years.
- (b) We should now take measures to pay additional compensation to remove the unfairness caused by grossing-up. At present we compensate officers for the effect of the inclusion of HBSA in their taxable income on their qualifications for student grants. We do not, however, compensate them in other areas where there are knock-on effects. The taxation of wives' income and Building Society interest at a higher tax rate are the main causes of complaint. A number of officers have already asked for compensation. As in the case of university grants, the main sufferers are relatively junior low paid officers who find that the tax rate at which they are assessed is raised to around 40% or 45% by grossing-up.
- (c) Other Diplomatic Service programmes should not suffer in order to provide this additional compensation (required because of a change of Treasury policy). Once we have calculated the extra costs, we will require an increase in resources to cover them from central funds.

/(d)



(d) The procedure for bringing DDA into taxation and the further grossing-up of HBSA were discussed at an Interdepartmental meeting in the Treasury on 16 July. FCO are not affected by DDA but have some 250 officers at any one time in receipt of HBSA. We believe that we should be able to effect the further compensation endorsed by the Prime Minister so that unfairnesses caused by the grossing-up system will be kept to a minimum. We are however concerned that the difficulties foreseen by MOD in paying additional compensation to the greater number of their staff affected should not call into question the commitment to provide further compensation.

(e) We also cannot accept that the timing of future arrangements for the grossing-up of HBSA should be linked to the proposed taxation and grossing-up of DDA (which may take months). The FCO could administer the extra compensatory payments quickly and in fact would wish to do so immediately to include extra compensation for those affected in the 1985/86 financial year.

(f) The steps needed to bring DDA into taxation must be agreed with the Trade Union Side and this may lead to unwelcome publicity. It is likely that the Trade Union Side will react adversely to the grossing-up of DDA and a connection may be made with the continued grossing-up of HBSA.

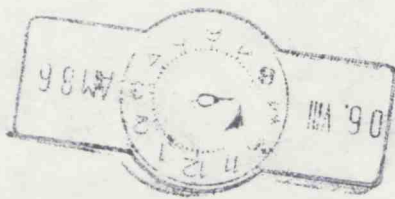
I am copying this letter to David Norgrove, John Howe and Murdo Maclean.

Jans

R N Culshaw

(R N Culshaw)
Private Secretary

A W Kuczys Esq
HM Treasury
Parliament Street
LONDON SW1P 2AG



CCBG



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

4 July 1986

The Rt. Hon. George Younger MP
Secretary of State for Defence

NBPN

John George

TAXATION OF HOME BOARDING SCHOOL ALLOWANCES ETC

Many thanks for your letter of 23 June about this, and to Geoffrey Howe for his of 25 June. You will now also have seen the letter of 26 June from the Prime Minister's Private Secretary.

withdrawn? - no - we need a copy for the file.

I can understand - and indeed share - your disappointment that it has not proved possible to pursue the option of exempting these allowances from tax. But as the Prime Minister has noted, the political and other problems would have been extremely difficult. And, while the object would have been to simplify matters administratively, exemption would in practice have brought few savings in administrative staff.

For the future, therefore, we must continue the existing arrangement of grossing-up, and taxing, the boarding and day school allowances. We must also put in hand arrangements for grossing-up and taxing the relevant detached duty payments. We need to make progress as quickly as is reasonably possible with the latter - in law, these payments are taxable but they are not at present being taxed and we must now regularise the position.

I have asked Treasury officials to sort out next steps and to get in touch with yours and those in other Departments concerned. Departments will be expected to contain any additional cost within whatever provision is settled for their overall running costs.

As the Prime Minister has said, we must also make every effort to minimise any resulting unfairness in individual cases. (In fact, the present arrangements already take account of any higher rate liability of the individual on his own income, and of the first two of the knock-on effects of grossing-up that you mention - higher contributions to ERNIC and parental contribution to student grant.) Our officials can consider how best in the grossing-up process to take account of this and of the other factors that you mention.

CONFIDENTIAL

Taxation of Civil Service Allowances; CIVIL

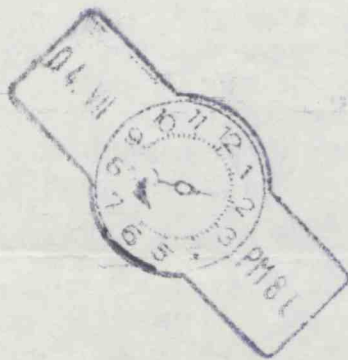


SERVICE
Feb 83

I am copying this letter to the Prime Minister, Geoffrey Howe and John Wakeham.

NIGEL LAWSON

A handwritten signature in dark ink, appearing to be "Nigel Lawson", written over the printed name.



CONFIDENTIAL



DCR
[Handwritten signature]

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

26 June 1986

Dear Tony,

TAXATION OF HOME BOARDING SCHOOL ALLOWANCES

The Prime Minister has seen your letter of 12 June and related correspondence about taxation of home boarding school allowances.

The Prime Minister very much shares the concern of the Foreign Secretary and the Defence Secretary that the people who receive these allowances and detached duty allowances should be fairly treated. However with regret she agrees with the Chancellor that to legislate now to exempt the allowances from tax would be politically extremely difficult, quite possibly resurrecting controversy about the 1985 TSRB award and stirring up other issues which would be better left alone.

The Prime Minister recognises that grossing up is likely to lead to unfairness in some cases if disproportionate administrative costs are to be avoided. But if grossing up is the only option without legislation she believes every effort must be made to keep these to a minimum.

I am copying this to Tony Galsworthy (Foreign and Commonwealth Office), John Howe (Ministry of Defence) and Murdo Maclean (Chief Whip's Office).

John,
David.

(DAVID NORGROVE)

Tony Kuczys, Esq.,
HM Treasury.

CONFIDENTIAL



FCS/86/170

NBPA.

CHANCELLOR OF THE EXCHEQUER

Taxation of Boarding School Allowances and Detached Duty Allowances

1. George Younger ^{WITH ON?} has sent me a copy of his letter to you of 23 June about the taxation of Boarding School Allowances (HBSA) and detached duty allowances (DDA).
2. As you know, I fully agree with him about the need to resolve this issue quickly. I foresee serious difficulties arising from the proposal to bring DDA into taxation. I therefore share his conviction that we should, after all, proceed with the amendment to this year's Finance Bill.
3. I am sending copies of this minute to the Prime Minister, George Younger and John Wakeham.

(GEOFFREY HOWE)

Foreign & Commonwealth
Office

25 June 1986





C 403

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

MO 4/4/4E

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

23 June 1986

Dear Nigel,

Handwritten squiggle

*Prime Minister 2
Mr Younger still wants to
legislate on taxation of boarding school
allowances etc. No need to read.
at trap*

*DRS
24/6.*

I was very sorry to see from your Private Secretary's letter of 12th June 1986 that it has not proved possible to devise a satisfactory administrative solution to the very real problems arising from the taxation of Boarding School Allowance (BSA) for those serving in this country, on the lines we discussed at our meeting on 13th May, and that we are therefore driven back to having to consider a legislative solution. I appreciate your reasons for considering that it would be inopportune to table a further amendment to the Finance Bill for the purpose at this stage, and I do not underestimate the political and presentational difficulties of this course. But since we have already accepted that there is a strong and valid case for changing the law so as to provide a complete and permanent remedy, to back down now would be a thoroughly unsatisfactory outcome. I consider that we should have the courage of our convictions on this matter and proceed accordingly, tabling the amendment which I understand has already been prepared in accordance with the original plan and dealing with any objections as they arise.

The Rt Hon Nigel Lawson MP



The various arguments for taking corrective action to deal with the problems arising from the present tax regime were fully deployed in Geoffrey Howe's and my predecessor's letters to you in January and February 1985. I am sure you are familiar with them but, briefly, the unfortunate side-effects are that:

- a. Lower paid personnel may become liable for higher ERNIC contributions than would normally be the case in those months in which BSA is paid in addition to salary.
- b. LEA student grants may be significantly reduced because BSA is regarded as income by local authorities for the tax year on which the grants are based.
- c. When BSA payments are aggregated with income from other sources, eg spouse's earnings, investment income or income from letting one's own house when occupying public accommodation at a place of duty, such income may become liable to a higher rate of tax.

The present arrangements are a source of legitimate grievance for a significant number of Service personnel (some 10,000 of whom at any one time are in receipt of BSA while serving in UK.) I should not wish to see the problem extended by making Detached Duty Allowance (DDA) taxable and consequently inflicting the same adverse financial effects on Home Civil Servants. My



department depends on long term detached duty to staff its more isolated, but essential operations and the imposition of tax on an allowance which has hitherto been tax-free would be most damaging and might even bring postings to a halt . Moreover, when bureaucratic procedures are rightly under attack, it is difficult to see any justification for the unproductive additional staff effort and extra expenditure needed to administer grossing-up arrangements if DDA becomes taxable (in my Department extra clerical staff and an estimated additional bill of £1.2M a year for which there is no provision in my budget).

We have, of course, all already recognised the force of the case against taxation of these allowances and you accepted some 12 months ago that legislative action should be taken to deal with it. Your subsequent proposal on the Parliamentary handling, to have the necessary amendment tabled by one of our backbenchers was agreed by the Prime Minister and colleagues concerned, although my predecessor felt that it would have been more appropriate and preferable to include the provision in the Government's published bill. I do not myself think that we need to or should abandon the intention to take this step for fear of controversy since I believe that we have a good case to deploy for a change in the law and that we ought to be able to deal effectively with any objections on that score which may arise. It surely ought to be possible to ensure that any debate is



concentrated on the merits of the particular proposal and does not stray into unrelated and irrelevant issues. I appreciate that it is very late in the day to be introducing yet another amendment to this year's Finance Bill and that it may therefore attract more attention than it might have done if you had proceeded as you originally planned. Nevertheless I would be most reluctant to lose this opportunity to put right an unsatisfactory situation and I therefore very much hope that you will on reflection feel able to take the necessary action, if need be by tabling the provision as a Government amendment.

I am sending a copy of this letter to the Prime Minister, Geoffrey Howe and John Wakeham.

*Yours truly,
George*

George Younger



10 DOWNING STREET

Prime Minister 2

You asked whether what
is proposed will add to the
burden on civil servants.

The answer is yes, but
without controversial legislation
this is unavoidable.

DHS

16/6

MT

PRIME MINISTER

TAXATION OF HOME BOARDING SCHOOL ALLOWANCES

This rumbles on.

You will remember that there are in fact two problems. First, under the present rules Civil Service home boarding school allowances are grossed up and then taxed. But the grossing up is in some ways inadequate and the arrangement is bureaucratically hard to handle. Secondly, detached duty allowances are not taxed at all for civil servants if the detachment lasts more than a year. Similar allowances are taxed in the private sector. (The reason is that the Inland Revenue accept that the privilege will not be abused by the Civil Service whereas they cannot scrutinise it so easily for the private sector).

Last November you agreed that a clause should be introduced in the Finance Bill by a backbencher to exempt these allowances from tax altogether in the case of the Civil Service. The Chancellor and the Chief Secretary now believe that to introduce this clause would cause great controversy, particularly because the Opposition have had a thin time in attacking the Government on this Finance Bill. They believe the controversy could then extend to state subsidies for education.

The Treasury have considered with the Foreign Office, Defence and the Chief Whip what alternatives there might be. One possibility might be a form of composite rate by which Departments paid a lump sum each year to the Inland Revenue. The Treasury want to rule this out on grounds of complicated legislation and the risk of abuse if it was made available to the private sector, as they believe it would have to be.

The Chancellor and the Chief Secretary have reached the conclusion that home boarding school allowances will need to continue to be grossed up and taxed and that detached duty

allowance will have to be given the same treatment.

There is no need for you to intervene unless you think the Chancellor and Chief Secretary are wrong in not wanting to legislate.

DLV

David Norgrove

13 June 1986

*Will this not release the
= burden on civil servants?
=*

not

JALAVT



ccBG ✓

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

A C Galsworthy Esq, CMG
Private Secretary to the Secretary of State
for Foreign and Commonwealth Affairs

12 June 1986

*Dear Tony***TAXATION OF HOME BOARDING SCHOOL ALLOWANCES**

The Chancellor of the Exchequer has seen your letter of 5 June and has discussed it with his Treasury colleagues. ✓

Treasury Ministers have tried very hard indeed here to find a solution through the Composite Rate route. Despite its apparent attractions at first study, this route is unfortunately fraught with difficulties. It would require complex legislation, and if it were also made available to the private sector - which the Chancellor believes it would have to be if the Government were to avoid accusations of discrimination in favour of its own employees - it could run the risk of widespread abuse and consequent revenue loss. In any case it is clear that it could not be prepared in time for this year's Finance Bill.

The Chancellor considers that this leaves us with a straight choice between legislating to exempt HBSA and DDA from tax, and staying with the status quo, which would require no legislation but would mean treating DDA in future like BSA - grossing up and taxing.

The Chancellor believes that the political problems with the first course at the present time could be horrific. A new clause put down now and accepted by the Government will almost certainly be highlighted by the Opposition, and would therefore have all the makings of a major political banana skin at a time when we are all agreed that any more of these must be avoided.

The background is that while on the one hand our progress on most parts of the Finance Bill this year has been swift, we have been introducing a number of new clauses at a late stage and making changes to other parts of the Bill which have required further new clauses which are only just going down. A row with the Opposition is simmering on this aspect and could erupt at



any moment. Any further new clauses would be seized upon as evidence of further 'bouncing' and lack of notice; and since the Opposition have been short of issues out of which to make political capital in this year's Bill, the Chancellor and Chief Secretary are sure that they would be delighted to be presented with one which would enable them to do just that.

And they would have plenty of material - that it would extend preferential treatment to civil servants which the Government is not prepared to accord to employees in the private sector. We have only just managed to avoid further sensitivities over the TSRB award this year. This would re-open all of that. The Small Business Lobby would be alerted by the publicity and would be bound to be hostile. And tax exemption for boarding-school allowances would provoke a major row over state subsidies to private education, and would therefore spill over into the entire current education debate.

So it is very likely that raising this issue now would get maximum adverse publicity, would draw public attention to what would be regarded as considerable fringe benefits to public servants in this area and might therefore prove to be counter-productive to those we were intending to help.

Reluctantly, therefore, the Chancellor and Chief Secretary have concluded that we must take the second course. The practicalities of bringing DDA into tax are by no means insuperable (this is, after all, how the private sector has always operated), but it will need a reasonable time to get it operationally and managerially right. The Inland Revenue see no difficulty with this further delay, provided a firm announcement can be made before too long.

The Chancellor would of course be happy to discuss this further if your Secretary of State would like to do so.

I am copying this letter to David Norgrove (No. 10), John Howe (Ministry of Defence) and Murdo Maclean (Chief Whip's Office).

Yours ever
Tony Kuczys
A W KUCZYS

CIVIL SERVICE
TAXATION OF
ALLOWANCES

2/13

CONFIDENTIAL

cc/BG



Foreign and Commonwealth Office

London SW1A 2AH

5 June 1986

Dear Tony,

NBM

Taxation of Home Boarding School Allowance

Many thanks for your letter of 23 May.

The Foreign Secretary was glad to know that action is being taken to achieve the practical result which he and the Secretary of State for Defence wanted, without the need for primary legislation. A point which should be remembered is that DDA are currently treated as we want HBSA to be. Diplomatic Service officers do not qualify for DDA but if the proposal formally to exempt both HBSA and DDA from tax were not to proceed and DDA had to be grossed-up like HBSA, we imagine this would require a substantial increase of staff in the Home Civil Service.

If neither an amendment nor a "composite rate" are possible, the alternative is to continue with grossing-up for HBSA. We would, however, be bound to do this in a way which compensated individuals for the effect on all their taxable income. This would produce a bureaucratic nightmare. First, we would have to look at grossing-up or compensating for the effect of HBSA in putting certain officers in a higher tax bracket in respect of wives' or investment income. Secondly, the payments we are now making to compensate for the effect of HBSA on student grants have to be declared as income, thus further reducing the student grant. Logically, we would have to offer further compensation to take account of this. The "bureaucratic nonsense" would thus be compounded to the point where we would be compensating further for the effect of compensation. This complicated procedure would certainly require extra staff here.

For all these familiar reasons the Foreign Secretary continues to regard it as essential to find an answer to the problem of the taxation of HBSA whether by means of the amendment to the Finance Bill or by a Composite Rate. Time is now beginning to press since an early decision will be necessary for the new arrangements to be put into effect by the beginning of the coming academic year.

/I am

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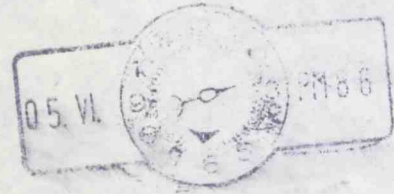
I am copying this letter to David Norgrove (No 10),
John Howe (Ministry of Defence) and Murdo Maclean (Chief
Whip's Office).

Am, ev,
Tung Galsworthy

(A C Galsworthy)
Private Secretary

A W Kuczys Esq
HM Treasury

CIVIL SERVICE Taxation & Civil
Service Allowances Feb 86





NBN.

D.H. - for info.

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

22 May 1986

A C Galsworthy Esq CMG
Private Secretary to the
Secretary of State for Foreign and Commonwealth Affairs

Dear Tony

TAXATION OF HOME BOARDING SCHOOL ALLOWANCES

Treasury Ministers discussed this subject with your Secretary of State, the Defence Secretary and the Chief Whip, in the Chancellor's room at the House on 13 May. As the discussion was very political I did not write to you recording it. However, your Secretary of State's minute of 20 May to the Chancellor suggests there may be some misunderstanding about the outcome. I am therefore writing to you now to avoid any confusion.

The Chancellor began by saying that two things had changed since the decision had been taken to exempt boarding school allowances (BSA) and detached duty allowances (DDA) from tax in the 1986 Finance Bill. First, action had now been taken to take account of the "knock-on" effects on National Insurance Contributions and student grants. Second, the political climate had changed in the last few months. Treasury Ministers were very concerned at the way the proposed New Clause would be received in Standing Committee. He fully accepted the logic of exempting the allowances, but political considerations pointed the other way. It was right now to reassess the decision which had been taken last year. Effectively the choice lay between:

- (i) legislating to exempt BSA and DDA from tax; and
- (ii) continuing to gross up and tax BSA, while bringing the treatment of DDA into line.

The choice between these two was a purely political judgement.

Your Secretary of State said his views remained unchanged. He stressed the effect on morale of Foreign Office staff if there were now to be a change of mind. The Defence Secretary also thought the present position unsatisfactory, although he could see the presentational difficulties.



In discussion the following points were made:

- (i) Although the grossing up procedure had been described as a "bureaucratic nonsense", the total staff cost appeared to be only 1 unit in the FCO, and none in MOD.
- (ii) Taking the Law Officers' advice would not be helpful: it could raise questions about the present position.
- (iii) Many of the Foreign Office and MOD staff affected were quite junior.
- (iv) It would be difficult to get the New Clause through Committee. Even Government backbenchers would not understand. It could be a banana skin like the 1985 TSRB awards.
- (v) Analogies would be drawn, unfavourably, with the private sector and with worthy groups like the life-boatmen. In particular smaller businesses would argue that they were much less well equipped to cope with grossing up than large Government Departments.

The Chief Whip wondered whether it might be possible to achieve the practical result which the Foreign and Defence Secretaries wanted, without the need for primary legislation, by means of a sort of "composite rate". The Financial Secretary undertook, without commitment, to look into this idea. He also undertook to investigate whether the problem of wives' income and investment income could be dealt with by a closely targeted concession. The Chancellor would write to the Foreign Secretary to let him know whether in fact these ideas would solve the political dilemma.

I am copying this letter to David Norgrove (No.10), Richard Mottram (Ministry of Defence) and Murdo Maclean (Chief Whip's Office).

Yours sincerely
Tony Kuczys

A W KUCZYS
Private Secretary

Civil Service Taxation of Allowances
Feb 83.





010
FCS/86/138

NRBN

CHANCELLOR OF THE EXCHEQUER

Taxation of Home Boarding School Allowances

1. I am glad that we were all of one mind at last week's meeting about the importance of coming to acceptable arrangements to remove the injustice to low paid civil servants caused by grossing up of their taxable pay as a result of payment of Home Boarding School Allowances.
2. I can appreciate the political reactions which were foreseen with the proposed amendment to the Finance Bill, though I was naturally disappointed that we were unable to proceed with this after the extensive discussions and correspondence last year culminating in agreement by all concerned.
3. I was therefore glad that you were ready to go ahead with work on the alternative solution envisaged at the meeting; this was to empower Departments by administrative fiat to make bulk payments of tax on the Home Boarding School Allowance to the Inland Revenue on behalf of their employees. I was pleased that the Inland Revenue are now able to contemplate this procedure: the difficulties have never seemed to me to be insuperable.
4. The only alternative course is that of additional grossing up of Home Boarding School Allowance, or devising some special compensation payments to cater for not only the effect of grossing up on students grants and National

/Insurance



Insurance contributions but also on the knock-on effects for spouses' income and building society interest etc. This seems a formidable proposition. It would certainly compound the bureaucratic nonsense which we acknowledge: all the more need therefore to arrive at a workable arrangement for bulk payments of tax as quickly as possible.

5. I am copying this minute to the Prime Minister, George Younger and the Chief Whip.

A handwritten signature in black ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

Foreign & Commonwealth Office

20 May 1986



CCBS



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

NBPN.

D Norgrove Esq
Private Secretary
10 Downing Street

10 December 1985

Dear David

TAXATION OF BOARDING SCHOOL ALLOWANCES AND DETACHED DUTY PAYMENTS

Thank you for your letter of 20 November, recording the Prime Minister's agreement, subject to the views of colleagues, to the proposal set out in the Chancellor's minute to her of 19 November. As you will have seen, the Foreign Secretary, the Secretary of State for Defence, and the Chancellor of the Duchy of Lancaster have now all written to say that they too are content, and the Chancellor therefore proposes to proceed accordingly.

I am copying this letter to Len Appleyard (Foreign and Commonwealth Office), Richard Mottram (Ministry of Defence), Andrew Lansley (Office of the Chancellor of the Duchy of Lancaster) and Murdo Maclean (Chief Whip's Office).

Yours ever,

Tony

A W KUCZYS

Civil Service Feb. 83

Reimbursement of Travel Costs





clg

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111

MO 4/4/4

29th November 1985

Deputy

NBPT

TAXATION OF BOARDING SCHOOL ALLOWANCES AND DETACHED DUTY
PAYMENTS

You kindly sent me a copy of your minute of 19th November 1985 to the Prime Minister about the proposed statutory exemption of boarding school allowances and Civil Service detached duty payments from tax. The Prime Minister's Private Secretary's letter of 20th November recorded the Prime Minister's agreement, subject to the views of colleagues, that an amendment to this effect should be introduced by a Government backbencher during the Committee stage of the 1986 Finance Bill.

As you know, my main concern was over the adverse effects of the present arrangements for the large number of Service personnel - nearly 11,000 - currently in receipt of boarding school allowance while serving in this country. I too therefore welcomed your acceptance of the case which Geoffrey Howe and I put to you earlier this year, that clear-cut corrective action should be taken by means of an appropriate provision in the next Finance Bill. I agree with Geoffrey Howe that there are good and valid arguments for this course which can be advanced in Parliament.

The Rt Hon Nigel Lawson MP



My preference would have been to see the provision included at the outset in the published bill and to deal with objections if they should arise. I am not sure that any such objections would be avoided or minimised by having an amendment tabled by one of our backbenchers which we would then accept. But, like Geoffrey Howe, I am content to leave it to you and John Wakeham to judge how best to achieve the desired result. My Department will naturally be pleased to provide whatever assistance it can in the preparation of the amendment and advice as required during the Parliamentary processes.

I am sending copies of this letter to the Prime Minister, Geoffrey Howe, Norman Tebbit and John Wakeham.

Michael Heseltine

Civil service

Feb 83

TRAVEL COSTS



CONFIDENTIAL



Chancellor of the Duchy of Lancaster

CABINET OFFICE,
WHITEHALL, LONDON SW1A 2AS

Tel No: 233 3299
7471

28th November 1985

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

N.B.P.M.

D. Nigel

TAXATION OF BOARDING SCHOOL ALLOWANCES AND DETACHED DUTY PAYMENTS

Thank you for sending me a copy of your minute of 19 November to the Prime Minister. I have also seen the Private Secretary to the Prime Minister's reply of 20 November, recording the Prime Minister's view, and Geoffrey Howe's minute of 22 November.

I am quite sure that you are right to propose that we should exempt Detached Duty Payments and Boarding School Allowances from taxation. To embark on grossing up these payments, in order then to claw back the tax would be an absurdity. But our problem will be to ensure that these objections on grounds of the bureaucracy involved are appreciated, rather than the implication that there is one standard for the private sector and another for the public. If we fail in this there will certainly be a row, and it will be an echo of the Top Salaries Review Board row.

I am copying this letter to the Prime Minister, Geoffrey Howe, Michael Heseltine and John Wakeham.

NORMAN TEBBIT



Civil Service
Reimbursement of
Travel. Feb '83

ccBG

PM/85/96

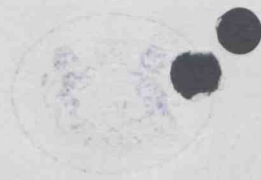
NBPT.

PRIME MINISTERTaxation of Detached Duty Payments
and Boarding School Allowances

1. The Chancellor of the Exchequer has sent me a copy of his minute to you of 19 November. I have also now seen your Private Secretary's letter of 20 November to Tony Kuczys at the Treasury and was pleased to see you endorsed the Chancellor's proposal to exempt these payments and allowances from tax.
2. The grossing-up of Detached Duty Payments and Boarding School Allowances (BSA) is an unsatisfactory means of compensating for the effect of income tax on a Civil Servant's reckonable income. In your words it is "a rather bureaucratic way of achieving the result that is desired".
3. I have therefore welcomed the Chancellor's decision to exempt both allowances from taxation in the 1986 Finance Bill. The case is a strong one and a convincing line can be prepared for use in Parliament. My main concern has been the injustice to those on lower salaries whose taxation and national insurance burdens have been increased by grossing up BSA and especially those whose children's university grants are reduced as a result. There are other anomalies which suggest that the law should be clarified.
4. I believe our objective should be to get this measure through quickly and without unnecessary controversy. I had earlier thought that there was an argument for including the new clause in the main body of the Bill, rather than risk drawing attention to it by arranging for it to be introduced at the Committee stage. However, I am prepared to be guided by the Chancellor and the Chief Whip on the best tactics to adopt.
5. I am copying this minute to Nigel Lawson, Michael Heseltine, Norman Tebbit and John Wakeham.

(GEOFFREY HOWE)

CIVIL SERVICE
TAXATION OF CIVIL
SERVICE ALLOWANCES
FEB 83



CONFIDENTIAL



10 DOWNING STREET

From the Private Secretary

20 November 1985

*file 16
LO3APO
a copy of this*

TAXATION OF BOARDING SCHOOL ALLOWANCES AND DETACHED
DUTY PAYMENTS

The Prime Minister has seen the Chancellor's minute of 19 November proposing that a statutory exemption from tax should be granted in respect of both boarding school allowances and Civil Service detached duty payments. The Prime Minister is content, subject to the views of colleagues, that a clause along these lines should be added in Committee to the 1986 Finance Bill and that it should be introduced by a Government Backbencher.

I am copying this letter to Len Appleyard (Foreign and Commonwealth Office), Richard Mottram (Ministry of Defence), Andrew Lansley (Office of the Chancellor of the Duchy of Lancaster) and Murdo Maclean (Chief Whip's Office).

DAVID NORGROVE

Tony Kuczys, Esq.,
H.M. Treasury.

So



LO34PO. cyBG

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

Prime Minister

PRIME MINISTER

Yes

Agree to proceed as
in the Chancellor's final
paragraph?

**TAXATION OF BOARDING SCHOOL ALLOWANCES AND DETACHED
DUTY PAYMENTS**

DR
19/11

As you will recall, Geoffrey Howe as Chancellor wrote to you on 6 May 1983 (copy of his minute attached) about the tax treatment of certain Civil Service allowances. His concern was that some civil servants working away from base receive certain (Detached Duty) payments tax free in circumstances where they would normally be taxed in the private sector. His conclusion was that the least unsatisfactory way of dealing with this problem would be to bring them into tax, but for the Government as employer to gross them up so as to seek to leave the recipients in the same net position as before. This is how the private sector would handle the problem. You commented (your Private Secretary's minute of 9 May 1983 - attached) that the monies were needed for the duties in question, and that a flat tax free allowance would be much better. This reflected your earlier comments in the House that grossing up seemed to be a rather bureaucratic way of achieving the desired result.

The arrangements Geoffrey Howe contemplated were not in fact introduced. It was realised that a more elaborate mechanism would be needed to deal with the further effects of taxing and grossing up these allowances. Principally these are the extra National Insurance contributions and the greater parental contributions in respect of further education grants. They arise because the allowances and the grossing up payments are taxable and therefore increase reckonable income for these purposes as well. In addition, Geoffrey Howe (as Foreign



Secretary) and Michael Heseltine later made the point that similar effects are associated with the existing grossing up of boarding school allowances, which are taxable when paid to members of the Diplomatic Service and Servicemen on duty in the United Kingdom (they are paid free of tax when the recipient is overseas).

This whole question raises some very difficult issues. I have discussed it with Geoffrey Howe who feels very strongly that the best way forward would be a statutory exemption in respect of both boarding school allowances and Civil Service detached duty payments. The grossing up process involved becomes even more cumbersome and expensive if we try to correct the NIC and education grant, as well as the tax, consequential: indeed, it all adds up to something of a bureaucratic nonsense. Against that, it is clear that legislation to exempt these two classes of payment from tax would be controversial, since - particularly following the TSRB row - it would be seen by some as further special treatment for the Government's own employees, and as such resented.

I have therefore discussed the matter with John Wakeham, who feels that, if we do want to go ahead and legislate in the 1986 Finance Bill, it should not appear in the original Bill but should be added in Committee by way of a new clause introduced by one of our own backbenchers. Subject to your views, and given Geoffrey's forceful representations, I would therefore propose to proceed in that way.

I am copying this to Geoffrey Howe, Michael Heseltine, Norman Tebbit and John Wakeham.

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

N.L.

19 November 1985



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

PS/FST
SP/EST
PS/MST(R)
Mr Middleton
Mr Bailey
Mr Le Cheminant
Mr Robson
Mr Williams
Mr Porteous
Mr Corcoran

PRIME MINISTER

PS/IR
Mr Driscoll - II

TAXATION OF CIVIL SERVICE ALLOWANCES

You were much concerned about this problem which attracted some press coverage last month. John Townend raised it with you at Question Time on 1 March.

2. The amount involved is some £10 million (not £250 million as misreported in the Times which is the total of the travel and subsistence allowances paid to civil servants).

The Problem

3. Its origins go back to 1979 when the Inland Revenue became aware that Civil Service departments were paying tax-free to civil servants some expense allowances which in the private sector were being taxed in accordance with the law. The recent splash of publicity arose because the Civil Service unions - or some of them - were unhappy about the inconvenience involved in grossing up. Since private sector employees have to put up with this inconvenience, this attitude was sharply, and understandably, criticised in a leading article in "The Accountant".

4. The dilemma for the Treasury - as paymaster for the Civil Service - and now for Ministers is whether simply to allow the value of those allowances to be reduced by taxation (as they undoubtedly should be under the law as it stands) or to pay allowances, which after tax, meet the reasonable extra expenses incurred.

/Our Objectives and



Our Objectives and the Current Proposal

5. We have two objectives. We want civil servants to be treated neither more nor less favourably than private sector employees. And we want any solution to make administrative sense.

6. The current proposal - to tax civil servants who get taxable payments and to compensate them by in effect bearing the tax for them - meets the first of those objectives and follows private sector practice. But as we are both paymaster and tax collector in relation to civil servants it produces what looks like an administrative nonsense.

7. More fundamentally, it is something of an anomaly that a necessary expense which a bona fide employer imposes on his employee and then reimburses cannot be brought within the terms of the very strict "wholly, exclusively and necessarily" test which the law applies to employees' expenses. I have tried to see whether the effects of this paradox can be reduced - by changing either the law or the nature of the allowances.

The Tax Rules

8. If Government were operating in a vacuum, we could declare all payments in the categories with which we are concerned to be tax-free. This could be done either administratively or by statute. Of course the Government would not be tempted to pay bogus allowances in order to reduce civil servants' tax liability. But that would mean either giving an unacceptable privilege to public sector employees or, if extended to the private sector, opening up a massive and easy way for employers and employees to get together so as to reduce tax paid.

/9. We are looking



9. We are looking into the possibility of re-formulating the tax rules to exempt the majority of the payments now in dispute for both the public and the private sector. That would mean legislation. But such a solution would be some way off and an alternative rule would produce its own crop of anomalies and hard cases. It cannot be an immediate answer to our problem.

The Allowances

10. Telephones and clothing allowances are undoubtedly taxable under the law as it stands. We will replace the existing ones by new taxable allowances negotiated at levels which reflect their taxability. There will be neither individual nor precise grossing-up. We shall also try to reduce the number of payments. There may be some overall saving.

11. I have considered whether the payments made to those seconded to Northern Ireland and elsewhere could also be rationalised in this way. But flat-rate taxable allowances could be more expensive than the present system and would undoubtedly be criticised as being both too broad-brush and too generous for application to public servants. If most were to be fairly treated, some would get too much by way of allowances.

12. The present system is cheaper and, because it is based more closely on individual behaviour, more easily defensible. But there may be scope for some reduction in the incidence of detached duty payments and a closer examination of the facts by the Inland Revenue (coupled possibly with a small change in procedures) may take a few of the staff concerned out of the tax net.

/Conclusion



Conclusion

13. Having rejected any proposal for preferential treatment for civil servants (eg "bulk accounting" or "compositing" as proposed by the unions, which would involve the Treasury accounting to the Revenue for a global sum), I conclude therefore that grossing-up and taxing is the least unsatisfactory way of dealing with these allowances in the short term. Private employers do it. Relatively little administrative cost (perhaps 10 staff) is involved. The numbers of individuals and the amounts of money are very small - less than 1 per cent of civil servants and less than 4 per cent of total annual expenditure on travel and subsistence. It is, of course, unfortunate that figures like £250 million have been used when the true total is more like £10 million.

14. This is obviously not an ideal outcome. But in this area anything we do is liable to be misunderstood and misrepresented. We should ourselves keep the matter in perspective. It is very much a problem of the margins. Moreover, if we had not moved to apply tax, "Civil Servants Tax-Free Bonanza" might have been an equally unwelcome headline. It would have been indefensible to have allowed tax-free payments to civil servants to continue once liability was established.

15. Treasury officials have virtually agreed with the departments a set of comparatively simple arrangements and are ready to go ahead, if you agree.

A handwritten signature in dark ink, appearing to be 'G.H.'.

G.H.
6 May 1983



1100
10 DOWNING STREET

From the Private Secretary

Dear Margaret.

TAXATION OF CIVIL SERVICE ALLOWANCES

The Prime Minister was grateful for the Chancellor's minute of 6 May.

The Prime Minister has commented that she personally thinks that a flat tax-free allowance would be much better than what is proposed. The Prime Minister has further commented that these monies are needed for these duties, and that a flat tax-free allowance would be a simpler system.

Yours sincerely,

Michael Scholar

←

Miss Margaret O'Mara,
HM Treasury.

MANAGEMENT IN CONFIDENCE

- H. Duncall
- cc Chairman
- T. Lucas
- H. Rogers
- T. Glavin
- H. Slythe
- H. Lawrence
- H. Campbell
- Mrs. Roberts
- Mrs. Keating
- H. Paine

ACTION: PS/IR, S
CMT, FTI, CIT, MST

cc MJE, Mr. Middleton

Mr. Barley, Mr.

9 May 1983

Le Cheminant, Mr.

Korea, Mr. Williams,

Mr. Potteous, ~~Mr.~~

Mr. Dawson (IR)

10 MAY 1983

Mr Rodgers
Borrower from a Tax-ke!
Reference
Mick L
6/4

Extract From Hansard.

1.3.83. Column ~~125~~.

OA. 128

X Mr. John Townend: Will my right hon. Friend confirm that civil servants' pay is to be increased at a cost of some £250 million to compensate them for the tax they are to be charged on their perks? Does she accept that drivers of company cars, who are to be taxed on their petrol for the first time with little opportunity to get this tax reimbursed, will consider this another example of where the public servant is feather-bedded as compared with his counterpart in private industry?

The Prime Minister: No, I would not necessarily accept that. There have been some comments on the changes in taxation of the Civil Service allowances. I understand that the allowances are taxable in law, and taxing them when paid to civil servants merely ensures that private sector employees and civil servants are treated equally. It is proposed that the value of the allowance should be grossed up by Departments so that those receiving them are not worse off as a result of taxation. That also happens in the outside world. I am, nevertheless, having further inquiries made into the matter, because it does seem to me to be a rather bureaucratic way of achieving the result that is desired.

~~Mc~~

Margaret O'Mara ²phoned to
ask whether her letter d:
13/5 (at Herp) had ~~been~~
now been agreed:

Presumably I can tell
her it has.

Mark

Mal

Have told Miss O'Mara
that the PM saw her

16/6/83.

letter of 13 May without comment

- neither agreed nor disagreed - so, presumably,
the Treasury may go ahead as they propose.

MCS 16/5



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MCS 16/5



Prime Minister

MUS 13/5

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

Michael Scholar Esq
Private Secretary
No 10 Downing Street
LONDON SW1

13 May 1983

MS

Dear Michael,

TAXATION OF CIVIL SERVICE ALLOWANCES

Thank you for your letter of 9/ May recording the Prime Minister's further comments on the issue of taxing certain Civil Service allowances.

The Chancellor agrees with the Prime Minister's view that, were there no extraneous considerations, tax free allowances, in appropriate cases, would be the simplest course. But to follow it would mean either:-

- a. Being prepared to reject accusations that civil servants were receiving preferential treatment as compared with the private sector or
- b. allowing all similar allowances in the private sector to be paid free of tax. The Revenue are considering whether suitable legislation to this effect can be drafted but, even if it can, there would be a risk of loss of revenue.

It was for these reasons that the Chancellor came to the view that the proposal to gross the allowances up for tax, and then tax them, was the best of a not very satisfactory series of options. It involves some bureaucratic "nonsense" but puts the public and private sectors on a par and avoids the need for legislation and the risk of loss of revenue.

Yours ever,
John Kerr

MS

M MISS M O'MARA

CIVIL SERVICE: Home to Office Travel
Taxation of CS Allowances
Dec 83

3 MAY 1985





10 DOWNING STREET

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9 May 1983

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M. C. SCHOLAR

Miss Margaret O'Mara,
HM Treasury.



Prime Minister !

Agree with this approach?

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

Mrs G/S

PRIME MINISTER

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A handwritten signature in blue ink, appearing to be 'G.H.' with a flourish.

G.H.
6 May 1983

10
SC Dinky Clerk

SWITCHBOARD

Car Hire and Taxis

When cars have to be provided to take No.10 staff home late at night, it is your normal practice to go through the Government Car Service. If they cannot send a car, they provide a taxi or hire car which is paid for from that account so that the member of our staff does not have to pay for it and claim reimbursement.

That is the right procedure and it should continue.

If by any chance you cannot contact the Government Car Service or get a car through them you may like to know the names and telephone numbers of the following two car services from which cars can be hired and the fee charged to the Government:-

- | | |
|------------------------------------|------------------------|
| London Wide Radio Taxis - 286 6070 | Account No: 1853/9 |
| Victoria Car Hire - 834 7293 | Cabinet Office Account |

These should however only be used on the exceptional occasion when for some reason you cannot use the Government Car Service: if you have to order a car from these companies and the charge is to be paid by the Government you should say this and quote the account number when ordering the car.

E. E. R. BUTLER



10 DOWNING STREET

From the Principal Private Secretary

25 March 1983

Thank you for your letter of 23 March about tax on funds reimbursed for taxi or hire car fares. I am very grateful to you for trying to find a way round this.

I think that we all recognise that the discrepancy is anomalous, but fortunately there is an easy way round it in practice. Thank you for telling me of the additional firms with which you have accounts. I gather that in general we can achieve the necessary result by arranging that the Government Car Service provide a taxi or hire car on one of their accounts; but I have given to our switchboard the two accounts which you have mentioned in your letter for use if by any chance they cannot operate through the Government Car Service. Such occasions should be very rare indeed.

E. E. R. BUTLER

J.W. Stevens, Esq.
Management and Personnel Office.



FIV

SW

10 DOWNING STREET

From the Principal Private Secretary

25 March, 1983

PERSONAL

I enclose a copy of a letter I have had from John Stevens - unconvincing, anomalous but unexpected!

B. E. R. BUTLER

J. M. M. Vereker, Esq.,
Overseas Development Administration

6



CABINET OFFICE

MANAGEMENT AND PERSONNEL OFFICE

WHITEHALL LONDON SW1A 2AZ

Telephone Direct line 01-273 3233

GTN 273 Switchboard 01-273 3000

Principal Establishment Officer

F E R Butler Esq
10 Downing Street
LONDON SW1

23 March 1983

Dear Robin

I am sorry it has taken a little while to reply to your letter of 24 February about staff at No 10 being required to pay income tax on the sum reimbursed to them for taxi or hire car fares for the journey home after they have worked late at the office. The case you mentioned seemed invidious to me so we took time and tried hard to do something about it. I regret to say that we have failed.

I am sure you do not wish to have it confirmed that the reimbursement of the cost of office to home travel is liable to tax under Schedule E as an emolument of office! I have argued that there are compelling reasons for exceptional treatment in that the time of departure cannot be fixed, it is frequently in the small hours of the morning when the public transport facilities have ceased to run and that any personal costs incurred are therefore very high in relation to those which would be incurred if public transport was available. However, the official position is that grossing up the tax is not a practice which is encouraged in the Civil Service. The reason being that as the Government is responsible for the tax laws it is very vulnerable to criticism if it makes provision for its own employees to be sheltered from the effect of these laws in certain circumstances. I am very sorry that I have been unable to obtain any movement from that view. It follows that much as I would like to help I am unable to do so by grossing up the amounts paid for fares to cover the amount of tax.

The only thing I can do - if you think it would help - is to increase the number of firms with whom we have an account which hopefully should avoid the need for No 10 staff to make payments from their own pocket. At the moment we have accounts with:-

| | | |
|-------------------------|------------|------------------------|
| London Wide Radio Taxis | - 286 6070 | Account No: 1853/9 |
| Victoria Car Hire | - 834 7293 | Cabinet Office Account |

*Yours ever
John Stevens*

J W STEVENS

2

MANAGEMENT AND PERSONNEL OFFICE

London Office

27 March 1957

London Office

I am sorry it has taken a little while to reply to your letter of 24 February about staff at No 10 being required to pay income tax or the sum reimbursed to them for taxi or hire car fares for the journey home after they have worked late at the office. The case you mentioned seemed irrelevant to me so we took time and tried hard to do something about it. I regret to say that we have failed

I am sure you do not wish to have it confirmed that the reimbursement of the cost of office to home travel is liable to tax under Schedule A as an emolument of his office. I have argued that there are compelling reasons for exceptional treatment in that the time of departure cannot be fixed, it is frequently in the small hours of the morning when the public transport facilities have ceased to run and that any personal costs incurred are therefore very high in relation to those which would be incurred if public transport was available. However, the official position is that provision in the tax is not a practice which is encouraged in the Civil Service. The reasoning that as the Government is responsible for the law it is very vulnerable to criticism if it is a provision for the over-employees to be sheltered from the effect of these laws in certain circumstances. I am very sorry that I have been unable to obtain any agreement from that view. I have been unable to like to help I am unable to do so by increasing the amount paid for fares to cover the amount of tax.

4 MAR 1957

The only thing I can do - if you think it would help - is to discuss the matter of firms with whom we have an account which hopefully would avoid the need for No 10 staff to make payments from their own pocket. At the moment we have accounts with:-

- London Wide Radio Taxicabs - 285 5070 Account No: 1575
- Victoria Car Hire - 354 7213 - Garnet Office Account



Civil Service
Zic AH

10 DOWNING STREET

From the Principal Private Secretary

24 February 1983

Dear John,

There have been reports in the newspapers that, because some allowances are taxable, they are to be rounded up so that civil servants will continue to obtain full net benefit. It is under discussion whether it is sensible to treat these civil service allowances as taxable at all and that is being discussed between Ministers and the Inland Revenue: this letter is not about that argument.

I am writing about a particular anomaly which has been felt by staff at No 10, when they are kept here working with the Prime Minister into the small hours of the morning. If their transport home is provided by the Government in a Government pool car or in a car from a firm with which the MPO have an account, no money changes hands and there is no problem. If they go home in a taxi or hired car from a firm with which the MPO has no account and they have to pay and reclaim, the reimbursement is regarded as taxable and so up to 50% of the cost falls on the claimant.

There have been some cases when members of the No 10 staff have effectively had to pay sums of several pounds in such circumstances. May I ask whether the MPO would be prepared to gross up the amounts they have paid to cover the amount of tax? If so, I will arrange for some claims arising from recent cases to be sent to you.

Most No 10 staff now know that the way to avoid such a thing happening is to insist that No 10 call up a car from either the Pool or a firm with which the MPO has an account. In cases when I have had to do it, it has resulted in an ordinary taxi appearing and that is satisfactory. But when it is very late the Pool is not available, and the firms with whom we have an account cannot always provide a taxi when we want them; I should tell you that there was a case about a year ago in which a larger Daimler normally used for weddings

AH

appeared, complete with white fur upholstery, and the member of our staff concerned was told by the driver that the call-out fee alone (met by MPO) was £25. That does not seem satisfactory; and nobody here would want such a charge to fall on public funds.

Yours ever,

Ratna Butler

J W Stevens Esq.,
Cabinet Office.

Ar Bettle.
Arge Pl type letter, below to M. Stevens for my signature. FRRS
Many thanks - I hope I am not the only potential beneficiary!
Just one or two small additions, as indicated.

MR VEREKER

cc Mr Scholar

2 1/2

REIMBURSEMENT OF HOME TO OFFICE TRAVEL

Thank you for your minute of 18 February.

I should prefer to tackle this head-on with the MPO rather than through an expenses claim, by writing to Mr Stevens as follows:-

"There have been reports in the newspapers that, because some allowances are taxable, they are to be rounded up so that civil servants will continue to obtain full net benefit. It is under discussion whether it is sensible to treat these civil service allowances as taxable at all and that is being discussed between Ministers and the Inland Revenue: this letter is not about that argument.

"I am writing about a particular anomaly which has been felt by staff at No 10, when they are kept here working with the Prime Minister into the small hours of the morning. If their transport home is provided by the Government in a Government pool car or in a car from a firm with which the MPO have an account, no money changes hands and there is no problem. If they go home in a taxi or hired car from a firm with which the MPO has no account and they have to pay and reclaim, the reimbursement is regarded as taxable and so up to 50% of the cost falls on the claimant.

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"Most No 10 staff now know that the way to avoid such a thing happening is to insist that No 10 call up a car from either the Pool or a firm with which the MPO has an account. In cases

But when it is very late the Pool is not available, and the firm with whom we have an account cannot always provide a taxi when we want them;
and

Take in at (X) overleaf

when I have had to do it, it has resulted in an ordinary taxi appearing and that is satisfactory. ~~But~~ I should tell you that there was a ~~recent~~ ^{about a year ago} case in which a larger Daimler normally used for weddings appeared, complete with white fur upholstery, and the member of our staff concerned was told ^{by the driver} that the call-out fee alone (met by MPO) was £25. That does not seem satisfactory; and nobody here would want such a charge to fall on public funds".

Do you agree ?

F.E.R.B.

21 February 1983

MR BUTLER

cc Mr Scholar

REIMBURSEMENT OF HOME TO OFFICE TRAVEL

You - and, I believe, the Prime Minister - have taken some interest in the absurdity of the rules governing taxation of reimbursed home to office travel expenses. You may like to have a recent example; and I have a suggestion.

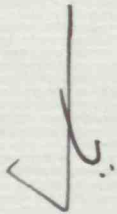
In connection with the Prime Minister's visit to Glasgow at the end of the month, I claimed on a single form for three items: a taxi home after speech writing the night before, leaving No 10 at about 2.00 am; a taxi from my home to Heathrow Airport; and (unrelated to Glasgow, but at much the same period) mileage allowance for driving from home to the office and back late one Sunday night to do a brief for the Prime Minister on the water strike, at a time when there was inadequate public transport. I have been reimbursed in cash for the journey to Heathrow; and the MPO have explained to my Secretary that the other two items are taxable and will ^{appear}/gross on my next pay slip. I shall therefore lose about 50% of the value of the reimbursement.

This has happened to me many times before. When I realised that it was a rule, rather than an inadvertence, I took to asking the switchboard to arrange transport home after speech writing with a taxi or hire car firm who charged No 10 direct. But this was not always possible, and indeed was not possible after the Glasgow speech writing. I have already mentioned to Michael Scholar the extraordinary waste of public money involved in this, when a car appeared to take me home at 4.00 am in the shape of a massive Daimler normally used for weddings, complete with white fur upholstery.

The amount I have lost over the past three years or so adds up to quite a significant sum, and naturally I am a bit aggrieved about it - particularly since the occasion for these claims has invariably been when the call of duty has kept me in the office

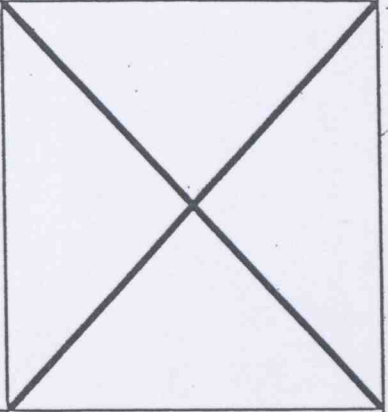
during what for most people are not working hours. And, looking beyond my own example, the absurdity of the rule is bound to tempt individuals to put in exaggerated claims, or even to make them less enthusiastic about working late. I should add that doubling the allowances would not solve the problem of non-reimbursement of taxi fares.

My suggestion is that we try a test case on the MPO in the shape of the attached claim for miscellaneous taxi fares not fully reimbursed over the period 1980-1983. Given that as I understand it Ministers accept that this arises because of an anomaly in the law, rather than a policy decision that we should have to pay for half the cost of taxi fares home in the small hours of the morning, it seems to me that this claim could properly be met by the MPO. Would you be prepared to countersign it on that basis, and forward it to the MPO with a suitable covering note? I have deliberately kept the amount small, in order to make it easier to establish the principle.

A handwritten signature in black ink, consisting of a vertical line that curves to the left at the bottom and has a small flourish at the end.

18 February 1983

The National Archives

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10 DOWNING STREET

3/17
PA

From the Private Secretary

14 February, 1983.

Dear Margaret,

Taxation of Civil Service Allowances

The Prime Minister has seen some briefing which was prepared for Questions last week on the Press stories on 9 and 10 February about the taxation of civil service allowances (in particular, Mr. Porteous' minute to the Parliamentary Clerk, HM Treasury, of 10 February).

The Prime Minister has minuted that she does not understand the decision which has been taken: there will, it appears, now be two lots of administration where previously there was none. The Prime Minister has enquired whether it would not be better to correct the law to what everyone thought it was before, in the Finance Bill. The Prime Minister wishes to discuss this with the Chancellor urgently.

Yours sincerely,

Michael Scholar

Miss Margaret O'Mara,
HM Treasury.

Prime Minister 2
Briefing we did not reach.

WJ
1/2

PARLIAMENTARY CLERK

FROM B J Porteous
DATE 10 February 1983

Chancellor

This seems to me
a ridiculous
There will now be 2 bits
of administration where
previously there was
one - Bill to
amend the law to
make it total
in Finance
Bill. Please discuss
urgently

- cc PS/Chancellor of Exchequer
- PS/Chief Secretary
- PS/Financial Secretary
- PS/Economic Secretary
- PS/Minister of State (C)
- PS/Minister of State (R)
- Sir Douglas Wass
- Sir Anthony Rawlinson
- Mr Le Cheminant
- Mr Middleton
- Mr Moore
- Mr Hall
- Mr Williams
- Mr Robson
- Mr Blythe IR
- Mr Driscoll IR

TAXATION OF CIVIL SERVICE ALLOWANCES

You have asked for briefing on the current press stories about taxation of Civil Service allowances. These appeared in the Daily Mail on 9 February and the Daily Telegraph and Times on 10 February.

The Inland Revenue have been discussing with Treasury, and formerly the CSD, the extent to which the non-taxation of reimbursement allowances in the Civil Service is comparable with the taxation treatment of similar allowances paid by other employers. These discussions started in 1979 when the Inland Revenue proposed that a long list of allowances which were currently tax-free should be considered for tax.

The list has now been reduced to:

1. Travelling and subsistence allowances paid for certain types of detached duty;
2. The return cost of sea travel for officer, family and motor car from Northern Ireland to Great Britain once a year;
3. Reimbursement of telephone rental and connection charges for on call staff;
4. Clothing allowances paid to the TV weather forecasters and certain other officers.

It has been accepted that taxation should be introduced in the financial year 1983/4 probably starting on 1 July.

Although these allowances are considered to be taxable, from the employer's point of view they represent reimbursement of expenditure necessarily incurred as a result of the employment so it is unreasonable for the employee not to receive full net reimbursement. Consequently it is necessary to gross up the payment to allow for the amount that will be taxable. The Inland Revenue have advised us that it is common practice for employers to gross up these kinds of allowances where they are taxable.



The administrative arrangements are under discussion with the Council of Civil Service Unions who are concerned that the staff should not be financially worse off as a result of taxation. In particular they want grossing up for ERNIC and for the tax levels above 30%. Our current stance is to resist grossing up for ERNIC but concede grossing up for the higher levels of tax where that higher level arises from remuneration from Civil Service employment (not where it arises through non-Civil Service income).

Current expenditure on travel and subsistence is about £250m a year. It is estimated that the cost of grossing up where the allowances will in future be taxable will be about £6m a year. Departments will not receive any increase in their cash allocation on this account. There will be some additional administrative costs but these are not expected to exceed a total of about 10 clerical officers, say £100,000 a year.

The Council of Civil Service Unions took a deputation to the Financial Secretary on 2 February to appeal against the taxation and to appeal against the collection of tax on these allowances through the PAYE system. The reasons for taxation and why the tax cannot be paid by an annual payment by the Departments to the Inland Revenue are covered in Mrs Driscoll's note of today's date.

A typical example of what is involved is given in the annex.

B J PORTEOUS
HOA DIVISION

EXAMPLE OF TAXATION

Married civil servant sent on detached duty to another part of the country for a job which will last about 18 months at the end of which time he will return to his permanent station. During this time he will be paid lodging allowance and reimbursed for his fares home every weekend. These would typically cost about £3,500 a year for lodging allowance and £500 a year for fares home - a total of £4,000 a year.

From the employer's point of view this is a temporary absence from the normal place of work, but where the absence exceeds one year the Inland Revenue consider there has been a change in the normal place of work and so these allowances become taxable as assistance with the costs of working at the normal place of work.

The £4,000 will thus be taxable and if grossed up for the rate of 30% would result in a payment of £5714. If however the civil servant was liable for tax at 40% this payment would leave him with £3428 after tax so that he would have to meet nearly £600 of his expenses out of other taxed income. It is considered appropriate therefore for the employer to gross up such cases for the higher rate of tax giving a gross payment of £6667. The employee would then receive £4000 net. These calculations ignore the impact of ERNIC.

The alternative of allowing the civil servant to move house at public expense for the 18 months and then back again would be even more expensive and constitute an unreasonable disruption of the officer's family arrangements - children's schooling, etc.

- Q. Why are these allowances considered to be taxable?
- A. In general, expense allowances paid to employees are taxable unless they are designed to meet expenses incurred in the performance of the duties of the employment. Some work-related expenses are not incurred in the performance of the duties of the employment. The most obvious example is the cost of getting to or from work but there are many other payments made by employers to their employees which in law are taxable as emoluments. PAYE should be applied to all emoluments when they are paid.
- Q. Why is the Inland Revenue only now applying the law to Civil Servants?
- A. A number of allowances paid to Civil Servants are already taxed under PAYE. However, the law in this area is not always clear beyond doubt. Whether a particular payment is taxable depends on the circumstances in which it is made. Indeed the Council of Civil Service Unions dispute the Inland Revenue's interpretation of the law in relation to certain of these allowances and are considering taking test cases to the Commissioners. The present proposal to bring these particular payments into tax follows an extensive review of allowances by the Inland Revenue in collaboration with the Treasury (previously the CSD).
- Q. Why does the Treasury not simply account for the tax to the Inland Revenue in a lump sum?
- A. Income tax is a personal tax. The amount payable by an individual depends on the level of his income from all sources and on his personal circumstances. In this respect, Civil Servants are no different from other taxpayers and the Civil Service is no different from other employers. After all Civil Servants pay income tax on all their other

emoluments. It would in theory be possible to calculate a single composite payment from the Treasury to the Inland Revenue but

- the principle of individual liability would be lost
- it would be contrary to the requirements of the PAYE regulations, which are strictly enforced in relation to other employers
- it is doubtful whether much work would be saved - it would still be necessary to record and report all payments of taxable allowances and individual calculations would still be needed to establish representative marginal rates of tax.

Inland Revenue did suggest that a simple formula short of grossing-up by reference to individual circumstances would give the right result for most Civil Servants. For example taxable allowances could have been enhanced by a factor of $\frac{100}{70}$. The CCSU rejected this proposal on the grounds that a small number of their members would suffer an overall loss compared with the present position.



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