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

PRIME MINISTER

*(Many continue  
 but figures in  
 para 12 and 14 are correct) RL 13/7*

INCOME TAX AND CAPITAL TAX PACKAGES FOR THE BUDGET

Mr. Lankester's letter of 10th March refers to your concern about the implications of my proposed income tax and capital tax packages. You also said you would find it helpful to have some clear figures on the distributional effects of my income tax proposals, and possible alternatives.

Income Tax

2. First, however, a word about the income tax package as a whole. There is a limit to what we can or should do to help individuals in this Budget. Over the last year, individuals have increased their after-tax incomes by 20 per cent in nominal terms, and by 3 per cent in real terms. As the minutes which I sent you by Mr. Burns and Mr. Middleton showed, they have benefited overwhelmingly both from the policies which we have pursued and the high pay settlements which they have extracted.

3. In order to retain the broad balance of the Budget and offer the prospect of declining interest rates over the coming year, I must aim for a PSBR of about £8½ bn or slightly lower. Even then, there can be no guarantee that interest rates will fall in the early months, given the present background of rising international interest rates and a continuing high level of bank lending.

/4. The



4. The money is simply not available fully to index the tax system. The Budget arithmetic allows me to spend only £1½ billion on income tax next year. A 17.8 per cent change in the income tax system - the basic personal allowances (i.e. those covered by the Rooker/Wise provision) plus the lower rate band, and the basic and higher rate bands and thresholds - would cost £2 billion next year. This is what would be required to prevent any increase in the real burden of income tax between the two years. To find enough to do this full indexation would mean either putting up the basic rate of income tax or adding to indirect taxes and the RPI. This is clearly unthinkable.

5. So whatever shape the package takes, it cannot compensate fully for inflation. This is what lies at the heart of the distributional effects which you noted.

6. Perhaps I can try to illustrate this. Prices have risen by about 18 per cent over the past year. For a married couple whose earnings just keep pace with that, the effect of unchanged tax rates and allowances produces the following reductions in real take-home pay:

Gross Pay (£ per week)	50	80	100	120	180	360	600
Percentage reduction	<u>-4.1</u>	-3.3	-2.7	-2.4	-2.0	-4.7	-5.4

7. Those who suffer most from the interaction of inflation and tax are at the bottom and top ends of the income scale. This reflects the fact that, under our income tax system, these are the points at which people face the sharpest increase in tax on extra income.

/8. Only



8. Only if the tax system is fully indexed can these inflationary effects be completely offset for everyone in a particular year. To the extent that the personal allowance increases fall short of full indexation, we can mitigate, but never completely eliminate, the awkward distributional features of the effects of inflation shown in paragraph 6 above.

9. This is the problem this year. There are effectively only two ways of constructing a package costing no more than £1½ billion:

(i) by increasing all the allowances and rate bands by a lower percentage than 17.8 per cent, while retaining the lower rate band; or

(ii) by increasing them by the full 17.8 per cent, but saving money through doing away with the lower rate band altogether and, at the top end, by providing something rather less for higher rate taxpayers.

10. The first option would forego the savings from removing the lower rate band. It would mean I could afford only a 10 per cent increase in the personal allowances. But this would also bear more heavily on the lower-paid, so we should not be giving any more to those with incomes between £2,500 and £5,000.

11. So my proposal is for the second option. This has the advantages that it would enable me:

(i) to meet the Rooker/Wise increase in allowances;

(ii) to stop inflation eroding the tax threshold, dragging people on low incomes into tax and

/creating



creating difficulties in the overlap between tax and social security;

(iii) to give rather more to married couples than to single people; and

(iv) to make major staff savings of over 1,200 in the Inland Revenue.

12. In distributional terms the package will go a fair way to restore the position of a year ago and so offset the effects of inflation shown in paragraph 6 above. But it cannot do so fully. Consequently, the reductions in real take-home pay will be as follows:

Gross Pay (£ per week)	50	80	100	120	180	360	600
Percentage reduction in real take-home pay	-1.8	-1.5	-1.2	-1.2	-1.2	-1.6	-1.9

13. I have been considering how to present this package in the light of these figures and your comments on them. The first point to make is that the newspapers are unlikely to make sophisticated calculations of the sort I have just described - though we may have to face some of these in the House. The Press will show the changes in simple money terms, comparing the tax paid before the Budget with that paid immediately after. This represents a true picture of the impact of the Budget on family living standards on the day after the Budget, even if it becomes increasingly unrealistic as prices and incomes continue to rise during the following twelve months.

/14. On



14. On this simple basis, our press notice issued on Budget Day will show the following cuts in income tax as a result of the Budget:

Gross Pay (£ per week)	50	80	100	120	180	360	600
Reduction in tax (per year)	64	61	61	61	61	380	686

15. The cash gains to those on the highest incomes look large, even though they represent only an 11 per cent increase in the higher rate threshold and bands, and not the full 17.8 per cent. But we can nevertheless say that, when account is taken of inflation, this group is being asked to shoulder the largest real increase in their tax burden - as the figures in paragraph 12 show.

16. My conclusion is that, since we cannot fully compensate this year for inflation, I have identified the best possible package, and one which, in the circumstances, we can defend.



Capital Taxation

17. So far as capital taxation is concerned, I also believe that we ought to stick to the main changes I proposed in my minute of 7th March. They fall well short of those provisionally agreed at the beginning of the year, which were in turn less than I should have wished to have put forward and less than we have led our supporters to expect. If we now make no major changes in the tax at all - not even to take account of inflation - it will be severely damaging to the enterprise theme in the Budget and undo much of the good which my enterprise package should otherwise achieve.

18. The CGT proposals I put to you provide the only way we can see of dealing with the serious distortions and inequities caused by taxing paper gains: while the overlap between that tax and CTT is seen as an unreasonable double charge. The CTT proposals are also designed to take account of inflation and check the rapid increase in the weight of the tax which it has brought about. If we make no changes at all, the number of taxpayers will rise from less than 30,000 at the time of the last change to nearly 60,000 next year. Simply to allow for inflation and get the number back to the previous level would require an increase in the threshold to £35,000 and increases in the rate bands all the way up the scale. By proposing, at considerably lesser cost, a rather larger increase in the threshold and no changes further up, I am concentrating the benefit on the smallest estates and doing little for the really wealthy.

19. There are also considerable staff savings which can be achieved here. The CGT package would realise a saving ultimately of 550 staff. In the case of CTT, no increase  
/in the



in the staff complement has yet been allowed to cover the increase in cases brought about by inflation. That in itself would call for an increase of some 200. By contrast, with a threshold of £50,000 we could cut the present complement by 220. Hence the gross staff saving which my capital taxation proposals would secure as a whole would fall only a little short of 1,000.

20. In short, while this is not the time to help the rich, we must do something now to ease the oppressive burden of these taxes, if only a first step to compensate for the effects of inflation. I am deliberately foregoing major structural changes for this year. In this respect, the proposal for 10 year cumulation, although it can have no cost until at least 1984, could be construed as structural and therefore dropped from my proposals with less damage than the other, main items. This apart I should much prefer not to water down yet further the proposals I put to you.

*G.H.*

R 12 (G.H.)  
March, 1980

DISTRIBUTIONAL EFFECTS  
"STATIC" COMPARISON

<u>Examples of Average Earnings (£ p. week)</u>	<u>50</u>	<u>2/3x 80</u>	<u>100</u>	<u>1x 120</u>	<u>1 1/2x 180</u>	<u>3x 360</u>	<u>5x 600</u>
<u>"Preferred" Income Tax</u>							
<u>SINGLE PERSON</u>							
Change in Take Home Pay (£ p. week)	0.50	0.50	0.50	0.50	0.50	6.60	11.80
Change in Take Home Pay (%)	+1.1	+0.8	+0.7	+0.6	+0.4	+2.8	+3.4
<u>MARRIED COUPLE</u>							
Change in Take Home Pay (£ p. week)	1.20	1.20	1.20	1.20	1.20	7.75	13.20
Change in Take Home Pay (%)	2.5	+1.8	+1.5	+1.3	+0.9	+3.2	+3.7
<u>MARRIED PLUS TWO CHILDREN</u>							
Change in Disposable Income* (£ p. week) - CB at £1.50	2.70	2.70	2.70	2.70	2.70	9.25	14.70
Change in Disposable Income (%)	+4.8	+3.7	+3.1	+2.7	+1.9	+3.7	+4.2
Change in Disposable Income (£ p. week) - CB @52p **	1.70	1.70	1.70	1.70	1.70	8.25	13.70
Change in Disposable Income (%)	+3.0	+2.3	+2.0	+1.7	+1.2	+3.3	+3.8
<u>"Alternative" Income Tax Package</u>							
<u>SINGLE PERSON</u>							
Change in Take Home Pay (£ p. week)	0.77	0.77	0.77	0.77	0.77	5.75	10.30
Change in Take Home Pay (%)	+1.7	+1.3	+1.0	+0.9	+0.6	+2.4	+3.0
<u>MARRIED COUPLE</u>							
Change in Take Home Pay (£ p. week)	1.15	1.15	1.15	1.15	1.15	6.35	11.00
Change in Take Home Pay (%)	+2.4	+1.7	+1.5	+1.2	+0.8	+2.6	+3.1
<u>MARRIED PLUS TWO CHILDREN</u>							
Change in Disposable Income (£ p. week) - CB at £1.50	2.65	2.65	2.65	2.65	2.65	7.90	12.55
Change (%)	+4.7	+3.6	+3.1	+2.6	+1.9	+3.1	+3.4
Change in Disposable Income (£ p. week) - CB @ 52p	1.65	1.65	1.65	1.65	1.65	6.90	11.55
Change (%)	+2.9	+2.3	+1.9	+1.7	+1.2	+1.2	+3.2

\* Although Child Benefit will not be paid until 24 November, the full figure of 2x75p = £1.50 is shown as benefitting families as from April.

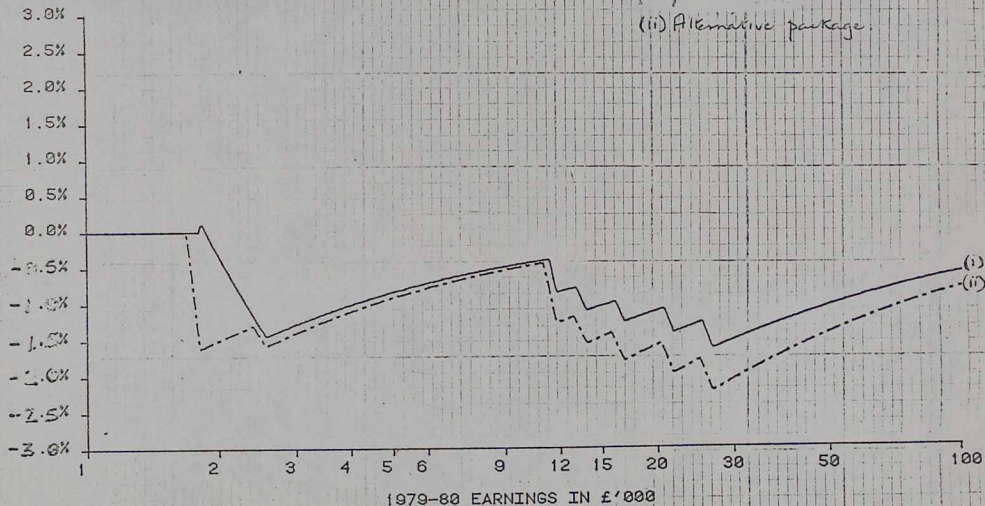
\*\* Here the value of the £1.50 increase in CB is averaged over the year i.e. (18/52) x £1.50 = 52 pence.





BUDGET - SECRET.

PERCENTAGE CHANGE IN INCOME AFTER TAX  
 IN REAL TERMS  
 RESULTING FROM A 17.5% INCREASE IN PRE-TAX INCOME  
 BETWEEN 1979-80 AND 1980-81  
 MARRIED

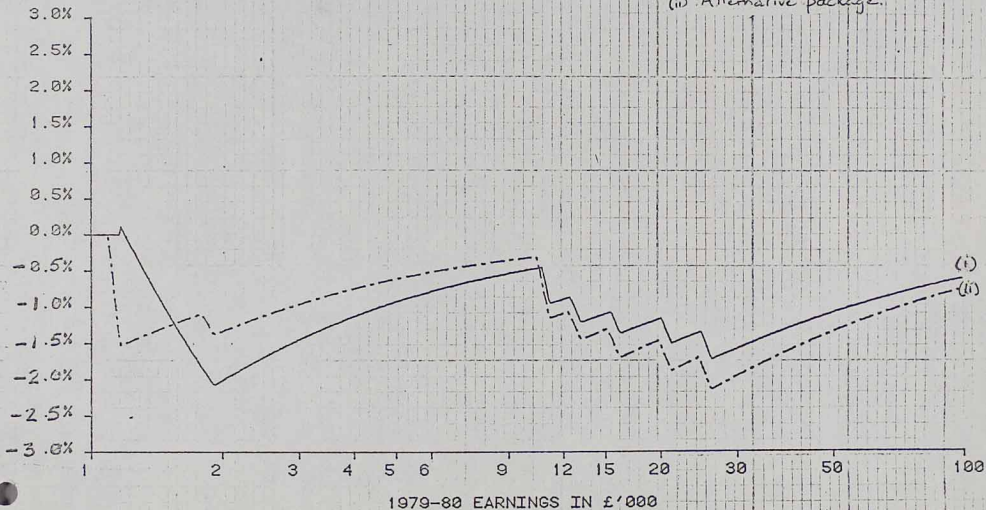


12 MAR 1980

BUDGET - SECRET.

PERCENTAGE CHANGE IN INCOME AFTER TAX  
IN REAL TERMS  
RESULTING FROM A 17.5% INCREASE IN PRE-TAX INCOME  
BETWEEN 1979-80 AND 1980-81  
SINGLE

(i) Preferred package  
(ii) Alternative package.



12 MAR 1980

TABLE 1

## SINGLE PERSONS - INCOME ALL EARNED - ANNUAL FIGURES

Income	Charge for 1979/80		Proposed charge for 1980/81		Reduction in tax after proposed changes
	Income tax	Percentage of total income taken in tax	Income tax	Percentage of total income taken in tax	
£	£	per cent	£	per cent	£
1,500	84	5.6	37	2.5	46
2,000	213	10.7	187	9.4	25
2,500	363	14.5	337	13.5	25
3,000	513	17.1	487	16.3	25
3,500	663	18.9	637	18.2	25
4,000	813	20.3	787	19.7	25
4,500	963	21.4	937	20.8	25
5,000	1,113	22.3	1,087	21.8	25
6,000	1,413	23.6	1,387	23.1	25
7,000	1,713	24.5	1,687	24.1	25
8,000	2,013	25.2	1,987	24.8	25
9,000	2,313	25.7	2,287	25.4	25
10,000	2,613	26.1	2,587	25.9	25
12,000	3,296	27.5	3,187	26.6	109
15,000	4,588	30.6	4,344	29.0	244
20,000	7,030	35.2	6,687	33.4	342
25,000	9,722	38.9	9,256	37.0	466
30,000	12,663	42.2	12,050	40.2	614
40,000	18,663	46.7	18,050	45.1	614

10/10/81  
 10/10/81

## MARRIED COUPLES - INCOME ALL EARNED - ANNUAL FIGURES

TABLE 2

Income	Charge for 1979/80		Proposed charge for 1980/81		Reduction in tax after proposed changes
	Income tax	Percentage of total income taken in tax	Income tax	Percentage of total income taken in tax	
£	£	per cent	£	per cent	£
2,000	46	2.3	0	0	46
2,500	171	6.9	106	4.3	64
3,000	318	10.6	256	8.5	61
3,500	468	13.4	406	11.6	61
4,000	618	15.5	556	13.9	61
4,500	768	17.1	706	15.7	61
5,000	918	18.4	856	17.1	61
6,000	1,218	20.3	1,156	19.3	61
7,000	1,518	21.7	1,456	20.8	61
8,000	1,818	22.7	1,756	22.0	61
9,000	2,118	23.5	2,056	22.8	61
10,000	2,418	24.2	2,356	23.6	61
12,000	3,036	25.3	2,956	24.6	80
15,000	4,296	28.6	4,017	26.8	279
20,000	6,705	33.5	6,302	31.5	402
25,000	9,364	37.5	8,833	35.3	531
30,000	12,273	40.9	11,588	38.6	686
40,000	18,273	45.7	17,588	44.0	686

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