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U. B.
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Ref. A01199

PRIME MINISTER

Bringing Short Term Benefits into Tax

(E(80) 2 and 3)

Arranged
for 10.30
P.

This brief is intended to serve both for your preliminary talk with the Chancellor and for the E Committee meeting on 23rd January.

BACKGROUND

2. Originally, three papers on this subject were circulated: a note by the Chancellor (with a lengthy paper by the Inland Revenue attached); a dissenting paper by the Secretary of State for Social Services; and another one by the Secretary of State for Employment. You refused to take this hotch-potch on the Agenda before Christmas, and asked the Chancellor to try to agree a line with the two Secretaries of State. He has now done so, and his paper contains an agreed recommendation. This has, however, attracted a further paper, from the Minister of State, CSD, pointing to the high staff costs and asking that these should be fully absorbed by the Departments concerned.

3. The single main paper makes the issue easier to understand, though it is still complicated. The area of disagreement has narrowed down, and there are now four issues for Ministers to consider:

- (i) Do they accept the proposed coverage of the scheme (agreed between the Ministers concerned and described in paragraph 4 of the Chancellor's paper as supplemented by paragraph 3 of Annex A to the Revenue paper circulated with it)?
- (ii) Do they agree that the "rough and ready" solution, involving a flat rate deduction from benefit, is not politically acceptable (paragraphs 11-13 of the Chancellor's paper)?
- (iii) If the benefits are to be taxed in a formal fashion, do they agree that the "subsequent taxation" method (Method B) is to be preferred to "current taxation" (Method A)? The recommendation is for Method B because it does not involve cutting some families' current income below Supplementary Benefit level - a procedure which, under the law, would generate further claims for Supplementary Benefit.

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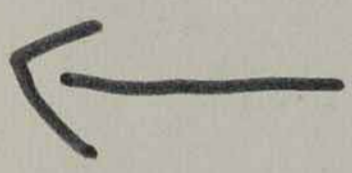
- (iv) Whatever solution is adopted, do they agree with Mr. Channon that no allowance should be made for additional staff costs in implementing the claim - or do they regard this as impracticable and the additional staff costs to be seen, therefore, as a necessary price to obtain the revenue and other benefits sought?
4. In considering these matters you will want to remember:-
- (i) That the present proposals relate only to benefits paid to the unemployed. Sickness benefit is being tackled separately.
 - (ii) The timing point. Decisions are needed by the end of this month to meet the April 1982 deadline. Even then, action in Northern Ireland will have to follow later. Legislation will be needed in the 1980-81 Session and is likely to be complicated and controversial.
 - (iii) The Chancellor refers in paragraph 19 of his paper to a cross-link with the question of Supplementary Benefit for strikers now being considered by officials and points out that there would be an appearance of discriminatory treatment if Supplementary Benefit were taxable in the hands of the unemployed but not in the hands of strikers. In fact, however, it is to be doubted whether the report on strikers and Supplementary Benefit will help very much - because it is directed at the separate problem of entitlement to Supplementary Benefit and not to tax on that benefit. The work of the Treasury group on "work incentives for the lower paid" is likely to be more relevant, but is unlikely, on present plans, to be available before February. The way out may be to ask the Chancellor to produce a separate note specifically directed to the question of how Supplementary Benefits to strikers could be brought within the tax system. It may be that the examination of this problem will reinforce the case for Method B rather than Method A (it would presumably be much easier to cope with the taxation of Supplementary Benefits to strikers in a single round-up operation at the end of the tax year than through the PAYE system as such).

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HANDLING

5. Before the meeting. You have asked to see the Chancellor privately before this paper is taken by E. In view of the consensus he has now reached with the two Secretaries of State you may feel able to endorse his, and their, preferences on the coverage of the scheme and on taxing the benefits by Method B. As in subsequent discussion in E, however, you will want to be sure that you both accept his conclusion that a reduction of benefit "in lieu of tax" is not politically acceptable, because this bears directly on Mr. Channon's manpower point (it is the one method of handling this issue which requires no extra staff). Given agreement on this the staffing implications of the proposals can be handled on their merits. The question is really whether Mr. Channon's proposal, for a nil increase in staff, is realistic; and, if not, how staff costs can be kept to a minimum. You will also want to put the Chancellor on notice that he must come up urgently with a proposal on how the Supplementary Benefits received by strikers could be taxed - to meet the inevitable questions - and to get his view on whether this consideration also reinforces the case for Method B (as it almost certainly does).

But the Chancellor is proposing to cut benefits - by 10% less than needed for full indemnity.



6. At E Committee. I suggest you begin with set-piece statements from the Chancellor, the Secretary of State for Social Services, the Secretary of State for Employment, and the Minister of State, Civil Service Department. Other Ministers will then want to join in: in particular, the Secretary of State for Northern Ireland will wish to argue the case for postponement for two years in Northern Ireland. (This is messy, but apparently unavoidable).

7. The discussion will be difficult to structure: I suggest you concentrate at the start on getting agreement on the need to tax rather than reduce short-term benefits while noting that sick pay will be dealt with separately. You should then be able to line up the majority of the Committee behind the agreed position of the Chancellor and the two Secretaries of State. That leaves the difficult manpower problem. Taxing benefits is bound to produce extra work for somebody. In the case of sickness benefits, that work will be done by the employer (at relatively little extra cost: because he has to operate PAYE already). But both Method A and Method B impose broadly similar additional

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loads on the two benefit-paying Departments and the Inland Revenue, and this is unavoidable. How far are the two Secretaries of State and the Chancellor willing to make off-setting savings elsewhere? Is a compromise possible? In any case does the Committee accept the need for some net increase in manpower (at a smaller figure than the 2,800 set out in the paper) as the price of this improvement in the work-incentive structure and the revenue gains.

CONCLUSIONS

8. You will need to frame these in the light of discussion: but you will need to cover:

- (i) the benefits to be brought into tax - unemployment benefit up to the standard rate (for single or married people, excluding child additions and other additions listed in Annex A), supplementary benefit and earnings-related supplement;
- (ii) the acceptability or otherwise of the 'reduction in lieu' solution;
- (iii) the choice of taxing method - A or B;
- (iv) the temporary omission of Northern Ireland;
- (v) timing of any announcement - before the end of January and consultations with those concerned to be done immediately;
- (vi) timing of legislation - during the 1980-81 Session of Parliament;
- (vii) a remit to the Chancellor to produce a quick note on the taxing of Supplementary Benefit to strikers - so as to be ready to answer questions on the point when the main announcement is made.

RA

(Robert Armstrong)

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22nd January, 1980