

FILE ~~SECRET~~ *Smith RH*

14

1. Mr Wolfson ✓
2. Mr Hoskyns ✓ *Also seen by A. Dwyer ✓*
3. Return to Mr Lankester

17 March 1980

Budget

This is to confirm that the Prime Minister has agreed the Chancellor's proposals on Capital Gains Tax and interest on Beneficial Loans as set out in his minute of 14 March.

J. P. LANKESTER

R I Tolkien Esq
HM Treasury

~~SECRET~~

PRIME MINISTER

BUDGET

There are just two outstanding decisions on the Budget. These are covered in the Chancellor's note at Flag A.

On Capital Gains Tax, you said that you would have no objection if he raised the threshold from £1,000 to £2,000. He has come back by proposing an increase to £3,000. His argument rests on a point which he did not explain to you before - namely, that he is intending to get rid of the existing marginal relief. In other words, in future all gains above the threshold will be subject to 30% - rather than the present complicated system of first 15%, then 50%, and finally 30%.

Paragraph 4 of his minute explains that if he increases the threshold to only £2,000, and gets rid of the marginal relief, many people will be worse off than at present; and that £3,000 is the lowest he can go for without having this perverse effect.

The argument for abolishing the marginal relief is to simplify the tax, to save staff and to provide a decent reduction in tax on large capital gains. The table which I have prepared at Flag B shows that the alternative of retaining the marginal relief and increasing the threshold to only £2,000 will have only a very small proportionate impact on large gains (see last column). On the other hand, it might be easier to present and defend.

Are you content for the Chancellor to go ahead on the basis of £3,000 as he proposes?

*Yes
No.*

On interest on beneficial loans you were worried about increasing the rate of interest for calculating the taxable benefit from interest-free loans to as much as 15%. The Chancellor argues - fairly convincingly in my view - that this is reasonable. It does not affect loans for mortgages up to £25,000; there is a £200 maximum limit; and the cost of a bank overdraft is currently about 20%. Moreover, a 15% rate can be reduced by Order.

/ Are you

Are you content with this?

in said yes
B. 7/3

Final decisions on both of these items are required by Monday morning in order to meet the Red Book printing schedule. The Chancellor is leaving for Brussels at 1030 a.m. on Monday; if you do not agree with his proposals, perhaps you could speak to him on Sunday night.

There are two other points which I should mention:

- I The Chancellor has finally decided not to reduce the National Insurance Surcharge. He thinks industry will prefer a lower PSBR than the marginal help which a lower NIS would produce. (This was your own initial reaction when you discussed the matter with the Chancellor.)

- II Bank Profits - The Chancellor has decided to do nothing in the Budget itself. But he will refer to the problem of windfall profits in his speech in a way which will not rule out some kind of levy at Report Stage. The Governor has agreed that further contingency work should be done. The Chancellor will minute you on this early next week.

B.

14 March 1980

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PRIME MINISTER

CAPITAL GAINS TAX AND THE RATE OF INTEREST ON BENEFICIAL LOANS

There were two points that you were concerned about when we discussed my Budget proposals this morning. The first was the increase in the capital gains tax threshold; the other was the increase in the notional rate of interest on beneficial loans.

Capital Gains Tax

2. You wondered whether it would not be better to move to a rather lower capital gains tax threshold than my proposed £5,000, and you suggested £2,000.

3. The difficulty about £2,000 is that we are proposing to change the form of the exemption. At present, no tax is charged where total gains do not exceed £1,000. Where total gains lie between £1,000 and £5,000, the tax is charged at half the rate on the amount by which the gains exceed £1,000. Thereafter, the full rate applies to the whole of the gain, except that there is a special marginal relief, which runs out at £9,500 of gains, to ease the transition.

i.e.
 i) 15% on £1,000-5,000
 ii) 50% on £5,000-9,500
 iii) 30% on £9,500+

4. Under my proposals, the new exemption will apply to everyone, whatever the total amount of their gains. There would be no need for any marginal relief. But with an exemption of only £2,000, the effect would be that for gains between £3,000 and £6,500 the tax under the new system would exceed that payable with

/the present



the present exemption limit and the marginal relief. Clearly, we could not defend that.

5. An increase in the exemption to £3,000 is the absolute minimum necessary to avoid that problem, and to ensure that no-one is worse off. And we should still be saving 300 staff, while reducing the full year cost of the capital gains tax package from £110 million to £65 million.

6. There is also the fact that we shall want to present the new exemption as our considered response to the sustained pressure for introducing either indexation or tapering. Whilst I think we should be hard put to carry the argument with a figure as low as £2,000, we could probably do so if I could announce an exemption of £3,000.

7. I hope you will agree that £3,000 would be a reasonable compromise.

Interest on Beneficial Loans

8. You were worried that increasing to 15 per cent the rate of interest for calculating the taxable benefit from interest-free loans would be seen, and represented, as confirming the Government's expectations of continuing high interest rates. I think we can quite easily deflect this charge. After all, this rate is intended to measure the benefit to an employee from not having to pay normal commercial rates on a loan from his employer. When the 9 per cent figure was fixed in April 1978, that was broadly the minimum rate a personal borrower would have had to pay on a bank overdraft. Now he would have to pay in the region of 20 per cent. So 15 per cent still provides a margin below the commercial rate, and we can say so. When interest rates come down again, we can always reduce the rate at any time by a fresh Order.



9. To keep the rate at only 9 per cent would be substantially to under-value this particular benefit, and, since we have already in recent months made comparable increases in two other interest rates in the tax field, I think there would be general surprise if this rate were not now increased.

10. There are three other points to bear in mind. First, cheap or interest-free mortgages of up to £25,000 do not count as taxable benefits, because the interest would be tax deductible anyway. Second, I am proposing to increase to £200 the limit up to which the benefit is not taxed at all, and this will exclude entirely small loans for such things as season tickets. Third, the main people affected will be those who borrow substantial sums of money from their employers for their personal requirements and I see no good reason, by leaving the rate unchanged, for enabling them to continue to enjoy an increased benefit.

11. In short, an increase to 15 per cent will do no more than maintain the real value of the benefit for tax purposes. On that basis, I think it fits neatly within the general stance we are taking on fringe benefits this year.

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

(G.H.)

14 March, 1980

CAPITAL GAINTAX LIABILITY

	<u>At present</u>	<u>Chancellor's proposal:</u> ie £3,000 threshold, no <u>marginal relief</u>	<u>Alternatives</u> £2,000 no marginal <u>relief</u>	<u>Alternatives</u> £2,000 marginal relief retained in <u>present form</u>
£2,000	150	-	-	-
<u>£4,000</u>	450	300	600	300
£11,000	<u>3,300</u>	<u>2,400</u>	2,700	3,150