



✓ Mr. Walters  
Mr. Wilson.

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

Prin. Am. Int. St. L.

PRIME MINISTER

MS

Contact with these  
proposals? They  
seem to me to strike  
a reasonable balance,  
and one of the CBI's  
two main  
points.

COMPANY TAXATION: STOCK RELIEF

I have been considering the response to the Consultative Document on Stock Relief which we published last November.

(ie about the  
credit  
restrictions)  
has been  
met.  
(CBI's  
infringe  
document  
is at  
Flag A)

Background

- As you know, we saw 3 main defects in the old stock relief scheme.
- First, it extended relief not only in respect of higher prices of stocks, but also in respect of higher physical volumes of stocks held.\* This led in some instances to artificial stock building to secure a tax advantage.
- Second, it gave relief where stock was being financed out of credit or other borrowings so that businesses were receiving relief for inflationary costs that they themselves had not had to bear.
- Third, the old scheme withdrew relief - imposed a charge to tax ("clawback") - when the value of stocks held fell. This clawback charge became a major threat to the solvency of businesses which had been reducing stock in the current recession.

R  
2072

/The main

\*subject to a rule that relief was given only to the extent that the stock increase exceeded 15 per cent of profits - the "profit restriction".



6. The main differences between the old scheme and the new proposals in the Consultative Document were:

- a. relief to be given, by reference to the effects on profit of price rises on stock-holdings, irrespective of whether they are increasing or decreasing in total value
- b. the relief to be given by reference to a general measure of inflation as it affects stocks (the "all stocks" index)
- c. there is to be no profit restriction
- d. clawback to disappear save in exceptional circumstances
- e. relief to be restricted to the extent that stock is financed by borrowing, where stocks exceed £m1.

7. The new scheme would thus tackle the well-known abuses of the old stock relief scheme and at the same time virtually ending clawback and providing much needed relief to companies in present circumstances (up to £m300 in 1981/82, rising to perhaps £m500 in the following years), mainly to the benefit of manufacturing industry. (The figures are being up-dated in the light of the latest economic forecasts.)

#### Response to the Consultative Document

8. The initial response to the Consultative Document was largely favourable. But, there have been criticisms from representative bodies and others of certain specific aspects of the new proposals.

/Thus there has



Thus there has been some - though by no means universal - disappointment that it has not been possible to come closer to adopting the Accountants' new "Current Cost Accounting" rules for tax purposes, as they stand. And there has been much anxiety about the effects of the credit restriction - the rule restricting relief to the extent that stock is financed by borrowing.

#### Conclusions

9. I have discussed these representations with Arthur Cockfield, who has been deeply engaged at all stages in preparing the new scheme, and with my other Ministerial advisers. In the light of these discussions I remain persuaded that the new proposals represent a rational and constructive answer to the problems posed by the effects of inflation on business stocks. In particular the removal of the threat of clawback is of great benefit to industry. Subject to a few points of detail - and to the one major point which I discuss below - I intend therefore to legislate in the Finance Bill for the new stock relief in the form proposed in the Consultative Document.

10. The major question concerns the proposed new credit restriction. I have thought long and hard about this:

- a. On the one hand, the representations have raised no new points which were not foreseen in drawing up the new proposals, or which call seriously in question the intellectual case for the credit restriction argued in the Consultative Document. In principle, we should not give tax relief for stocks financed by trade credit or other borrowings. The retail sector finances much

/of its stocks



of its stocks in this way (one aspect of the so-called "Tesco abuse"), and so do many other businesses.

b. On the other hand, I have to recognise that it is this aspect of the new proposals which has aroused most anxiety. Much of this can be attributed to industry's natural desire to extract the maximum value from any relief, and to reduce to a minimum the effect of any restriction on it. However, the credit restriction would be complex to legislate and administer, particularly as it affected company groups. It would also have a sharp - and it would be argued, arbitrary - impact on the tax relief available in some individual cases. The other elements in the new stock relief proposals - by excluding relief for increases in the volume of stocks - would in themselves cut out something like one-third or more of the stock relief which people like Tesco have enjoyed on average over the past 5 years or so.

11. The additional cost of withdrawing the credit restriction in present circumstances would be moderate: negligible in 1981/82, rising to perhaps £m100 a year in 2 years' time.

12. In all the circumstances, I have come to the conclusion that it would be wrong to risk jeopardising the favourable political impact of the new stock relief scheme on industry generally, or indeed to add to businesses' anxieties at this time. It would be a great pity if the whole effect of our most substantial relief to industry was marred by insistence on one arguable set-off. I propose therefore to legislate

/in this year's





in this year's Finance Bill for the new stock relief without a credit restriction at this stage. I would not, of course, concede the case which is well established in principle for the credit restriction and this would be for consideration again in the wider-ranging Green Paper on the future of corporation tax in due course.

14. The stock relief proposals will be an important part of my Budget Statement and I would not therefore propose to announce this decision, or the other minor detailed concessions which I have in mind, in advance of my Budget Statement.

---

15. I am sending copies of this minute to Keith Joseph and John Biffen.

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

(G.H.)

18 February 1981



18 FEB 1981



*[Handwritten signature]*

18 FEB 1981

CONFIDENTIAL

je 13



10 DOWNING STREET

*From the Principal Private Secretary*

23 February 1981

Company Tax: Stock Relief

The Prime Minister has seen the Chancellor of the Exchequer's minute of 18 February 1981 about stock relief.

She agrees that he should legislate in the forthcoming Finance Bill for the new stock relief scheme in the form proposed in the Consultative Document but without a credit restriction at this stage and that he should announce his proposals in his Budget Statement.

I am sending copies of this letter to Ian Ellison (Department of Industry) and Stuart Hampson (Department of Trade).

C A WHITMORE

CS

John Wiggins, Esq.,  
H.M. Treasury.

CONFIDENTIAL