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To: MR WOLFSON
From: SIR KENNETH BERRILL

Short-term Benefits, Supplementary Benefit, Strikers'
Benefits and Taxation

1. At last Tuesday's meeting of E you asked me if the CPRS kept an eye on the taxation of benefits and I said we could let you have a short note. This is attached.
2. As always in this field, it is a complicated situation. But briefly the position is this: full-scale taxation of short-term contributory benefits is unlikely to be practicable until the Revenue's PAYE is fully computerised (in the later 1980s). A limited scheme to tax unemployment benefit (possibly linked with transfer to employers of responsibility for paying most sickness benefit) might be practicable by 1982 - see (a) of the note. This would be helpful in improving in-work/out-of-work incentives, and would bring in a substantial revenue yield. But there are problems still to be worked out (in particular the treatment of supplementary benefit) and the Revenue staff cost would still be considerable.
3. This would, however, have very limited effect on the position of strikers. If the objective is to reduce the financial resources available to strikers, it would be necessary to consider one of the two approaches set out at (b) of the note. These could in principle be introduced with little delay. But they would be much more controversial.
4. So far as we know, a good deal of work has been done already on the limited option described at (a) for taxing short-term contributory benefits, but detailed work on the options under (b) for dealing with strikers' financial

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position has not yet advanced far. But we shall find out when we see the paper on benefits for strikers which, following the meeting of E on 19 June, the Secretaries of State for Social Services and Employment have been asked to prepare. I was not clear how widely the paper was expected to range. Presumably it will cover tax refunds to strikers and so involve Treasury Ministers as well. But if it were thought desirable that both of the problems set out under (a) and (b) should be covered, I think that the Ministers concerned would need to be told.

5. I am sending a copy of this to Clive Whitmore and John Hunt.

RR

25 June 1979

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SHORT-TERM BENEFITS, SUPPLEMENTARY BENEFITS, STRIKERS' BENEFITS
AND TAXATION

There are two distinct issues

- (a) the taxation of short-term benefits, with implications for incentives; and
- (b) the treatment of strikers' benefits and tax refunds, with implications for industrial relations.

(a) Taxation of short-term benefits

It has long been accepted by both parties that the short-term contributory benefits (in particular sickness benefit and unemployment benefit) ought to be taxed, in the same way as the long-term contributory benefits (in particular retirement pensions and widows' pensions) are already taxed. The original intention in 1946 was that both short and long-term benefits should be taxed, and it is administrative problems only which have hitherto prevented the taxation of short-term benefits. If they were subject to tax, this would bring in substantial additional revenue (around £400 million from unemployment benefit and sickness benefit combined), and would reduce some of the incentive problems that arise in the comparative positions of those in work and those out of work.

The full taxation of short-term contributory benefits, if introduced by the Revenue on a manual basis before computerisation, would cost some 10,000 additional Revenue staff. On manpower grounds this option seems to be out of the question until PAYE has been computerised (this will not be completed on present plans until 1987).

Some work has been done on a more limited scheme for taxing unemployment benefit only on a manual basis by 1982 (this date links with relevant computerisation plans in DE and DHSS). This would reduce the staff cost to around 3,000. It is possible that this option could be linked with the option which is currently under study in DHSS for transferring payment of sickness benefit for the first six weeks to employers.

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(Apart from securing a substantial DHSS staff saving, this would allow most payments of sickness benefit to be brought within PAYE operated by the employer, without adding to Revenue staff costs.)

This option is being further considered at official level, but we understand that Ministers have not yet taken any firm view.

A particular problem which arises if short-term contributory benefits are brought into tax is the tax treatment of supplementary benefit. Supplementary benefit, whether payed at the "ordinary" rates or long-term rates, is not taxable at all at present. The case for taxing it is less clear cut and more controversial than for the contributory short-term benefits. A traditional argument has been that, since supplementary benefit is a means-tested benefit designed to secure minimum subsistence, it would be wrong to tax it. But, if supplementary benefit were not taxed at all, while contributory short-term benefits were taxed, there would be serious anomalies between people qualifying for full contributory unemployment or sickness benefit and those whose contributions are deficient and whose contributory benefit is topped up by supplementary benefit. One possible approach to this difficulty would be to "take account" of supplementary benefit payed in respect of the claimant and his wife (or other adult dependent) but not to take account of supplementary benefit paid for children or other dependents. This would ensure that the taxable supplementary benefit did not exceed the weekly tax threshold, while at the same time reducing tax refunds due later in the year but would avoid a situation in which tax had to be actually deducted from supplementary benefit when paid. But this idea has not yet been fully worked out, and it is not yet clear whether it would provide a fully practicable solution to the difficulty.

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(b) Treatment of strikers' benefits and tax refunds

Strikers cannot claim either unemployment benefit or supplementary benefit for themselves. They can however claim supplementary benefit in respect of their dependants (wife and children), and they can, while on strike, get PAYE tax refunds, normally direct from their employer (exceptionally direct from the Revenue, if the employer is unwilling). The evidence is that only a minority of those on strike actually claim any supplementary benefit for dependants, and, if the aim were to reduce financial resources available for strikers, action to limit or stop PAYE refunds would probably be more important than action to tax any supplementary benefit which they claim.

The effect on strikers' resources of taxing short-term contributory benefits on the lines of the limited scheme discussed at (a) would be very small. If supplementary benefit claimed in respect of a wife were to be taxable, this would reduce the tax refunds which could be claimed, but only by about one third. There would be no effect for the majority of strikers who do not claim any supplementary benefit.

A more direct method would be to legislate to defer the tax refunds for strikers until they return to work. This could in principle be done without delay, and without significant staff costs. The main problem, apart from political difficulties in withholding from strikers money which it could be claimed is by right theirs, is that for strikers who at present both claim supplementary benefit and also get tax refunds, their benefit entitlement is reduced by any tax refund received. If tax refunds were deferred, the entitlement to supplementary benefit would go up pro tanto, so that the benefit of the tax refund could in effect be received twice, once in the form of higher supplementary benefit than is at present due and again when the actual refund was made on return to work.

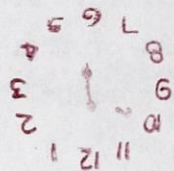
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An alternative approach which was canvassed before the election would be to deem strikers to be in receipt of a notional level of strike pay from their union. (One would have to deem this, whether a strike was official or unofficial, or there would be an incentive towards unofficial strikes.) A notional level of strike pay would presumably be taken into account both by DHSS in calculating any supplementary benefit claimed (so reducing entitlement), and by employers in operating PAYE (so that tax refunds would be reduced). But, assuming that a notional level of strike pay could probably not exceed around £10 - £12 a week, the effect on tax refunds, if employers were required to take account of additional pay, would again be limited. They might be reduced by about one third but not eliminated.

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