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DIRECT PERSONAL TAXATION
RECORD OF A MEETING HELD IN THE TREASURY
AT 11.00AM ON MONDAY 2 FEBRUARY

Present: Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Mr Burns
Mr Ryrie
Mr Byatt
Mr Middleton
Mr Battishill
Mr Kemp
Mr Unwin
Mr Corlett
Mr Gordon
Mr Wiggins
Mr Kelly
Mr Ridley
Mr Cropper

Sir Lawrence Airey)
Mr Green) Inland Revenue
Mr Taylor Thomson)

The meeting took as its agenda Mr Corlett's minute of 30 January and the papers listed in the first paragraph of that.

Broad contribution to be sought from income tax

2 The Chancellor said that they were not yet clear what kind of target they were working towards. It was almost certainly the case that it would only be possible to increase the personal allowances by less than revalorisation. But how much less would depend on how much he decided to do for companies and on how much he decided to increase the indirect taxes. The latter were to be discussed that afternoon, but his present inclination was to go for a package which had the effect of adding perhaps 1½ percentage

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points to the RPI, together with VAT blocking. One important point he would want to take into acccount, however, was the extent to which this was likely to jeopardise the possibility of an Industry Act RPI forecast of 10 per cent. 116

3 In discussion the following points were made:

(i) A $1\frac{1}{2}$ per cent package for the indirect taxes would leave little room for an industrial support package.

(ii) If the personal allowances were to be less than revalorised, the indirect taxes would have to be more than revalorised if a shift away from indirect towards direct taxation was to be avoided.

(iii) A large increase in the indirect taxes would add to the extent to which it might appear, in an accounting sense, that the inflation rate was being held up by the Government's own actions when added to the effects of, for example, increases in nationalised industry prices and housing costs.

(iv) Last year's experience suggested that the actual increase in the RPI resulting from the Budget was smaller than might have been anticipated. But this in turn implied that the burden on companies through not passing on fully the increase in their costs had been greater.

4 Mr Burns doubted whether increasing the indirect taxes was a particularly helpful way of making room for an industrial support package given the way in which it would be reflected in wage and other industrial costs, though he accepted that it might be justified for other reasons. The Chancellor said that increases in both direct and indirect

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taxation would always be used to justify higher wage claims. His instinct was that increases in indirect taxes had a slightly greater effect (though he accepted that the linkage was unlikely to be particularly strong at the present time). But he pointed out that those who wished to argue in favour of substantial industrial support had to will the means as well as the ends. Mr Burns said that, if the package was to be financed by increases in indirect taxation, he was less enthusiastic about it.

5 The Chancellor asked for views on the possibility which had recently been canvassed of financing a reduction in NIS by a further increase in the employee's national insurance contribution. In discussion little enthusiasum was expressed for this. It was felt that it would be regarded as a palpable subterfuge to avoid increasing the basic rate of income tax, that it would be administratively complicated and that employers would not necessarily be able to pass the increased contribution through to their employees. With hindsight, it might have been possible to have gone for a larger increase in contributions last November, but it was too late to reopen that question now. The Chancellor said that he agreed that the proposal should be abandoned.

The Basic Rate

6 The Chancellor confirmed that an increase in the basic rate of tax was effectively ruled out, subject to unforeseen events.

Increase in the personal allowances

7 The Chancellor said that if the personal allowances were not to be fully revalorised, there were a number of other yardsticks which could be taken. The minimum increase would appear to be 6½ per cent, which was what was required to maintain clear water between the single allowance and the single woman's pension. It was pointed out that this had been calculated on the assumption of an 11 per cent RPI increase and a corresponding 10 per cent pensions uprating. If the RPI forecast, and hence the pensions uprating, were less than this, the increase needed in the personal allowances in order to maintain clear water would also be reduced.

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6½ per cent was also about what was needed, if the abolition of the lower rate band was ignored, in order to keep the real value of the personal allowances above what it had been when the present Government came into office. The Minister of State (Lords) argued that an increase of this order would be derisory in cash terms, and that no increase at all might be easier to defend, though this would, of course, increase the ground to be made up in subsequent years.

8 The Chancellor suggested that the most obvious alternative yardstick which people would recognise would be to increase the personal allowances by the same amount as the pensions uprating, that is by 1 per cent less than the RPI forecast. It was not possible to say exactly at this stage what this would imply, but it seemed likely to be 9 or 10 per cent. Another possibility was to increase the allowance by the same amount as the RPI forecast, without the 1 per cent reduction, which was being made for reasons which had nothing to do with the personal allowances.

9 In discussion it was argued that there was no logical connection between the increase in the personal allowances and the pension uprating, which were statutorily related to different periods. To link them this year could create an awkward precedent for the future. An increase in line with the forecast would preserve freedom of action in later years and could be supported on the grounds that, although full revalorisation could not be afforded, it was sensible to compensate for future inflation over the year ahead. On the other hand, this could lead to charges that the Government was choosing whichever period suited them best and might suggest a spurious precision. It might be preferable to take a round number, such as 10 per cent, whatever happened to the RPI forecast and to justify this on general grounds of what could be afforded.

10 It was recognised that there would be great pressure to increase Child Benefit by the same percentage as the personal allowances. Last year's Budget had showed CB rising at the same annual

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rate as the personal allowances; and correspondence between the Chancellor and the Secretary of State for Social Services and Cabinet had tended to link them more closely. It seemed probable that Ministers had not fully realised last year that the implication of what they had decided was that Child Benefit should be increased by 4 percentage points less than the increase in personal allowances. In practice it was doubtful that this could be sustained, and it would probably be necessary to increase both by the same percentage. This might help to make it easier to handle some of the distributional aspects of the Budget.

11 Summing up this part of the discussion, the Chancellor said that he thought they should assume an RPI forecast of 10 per cent, which implied a pension uprating of 9 per cent. On this basis he would like two packages to be prepared, with the personal allowances increasing by 9 per cent and 10 per cent respectively and Child Benefit increasing by the same amount. He saw no reason for any differential increases in the different allowances or in the higher rate thresholds. If possible, he would like to avoid having to round down any increases which had also been rounded down last year. He would reserve a decision on the investment income surcharge (to which Mr Middleton said that the report of the Working Group on Tax and Savings which he expected to submit to the Chancellor shortly was relevant) until he could look at the enterprise package as a whole.

Blind Allowance

12 The Chancellor said that he was not particularly attracted by an increase in the blind allowance. The Financial Secretary pointed out that they had only with difficulty avoided an increase in the allowance the previous year. They could get into some difficulty if they did not do it this year. It would be very cheap and would be seen as an appropiate gesture in the Year of the Disabled. It would be better to get credit for it than to have to concede it

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under pressure. Mr Green suggested that conceding the blind allowance would give rise to great pressure for comparable allowances for other disabilities. He would personally prefer to do something for the mobility allowance.

13 The Chancellor said he would like a note drawing together all the various items in this area, including not only the blind and mobility allowances but also incapacity benefit and, for example, VAT on equipment related to hospitals. It might be possible to produce a 'beneficence' package.

NIS

14 The Chancellor said that he would like to keep open the option of a July increase in the NIS, at least to the extent of talking to DHSS and to the Leader of the House.

Representation at meetings

15 Sir Lawrence Airey said that there had been a meeting the previous week on Budget strategy to which the Revenue had not been invited, though their interests had been closely involved. He hoped that this would be avoided in future. The Chancellor said that his office should obviously always try to ensure proper representation at meetings, subject to his preference for keeping numbers down if possible. He would also find it helpful if officials could, as far as possible, try to ensure that major submissions reached him 48 hours before any meeting to discuss them.

C W KELLY

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