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NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, HM TREASURY AT 2.30 PM ON MONDAY, 2ND FEBRUARY, 1981

Present:

- Chancellor of the Exchequer
 - Chief Secretary
 - Financial Secretary
 - Minister of State (Commons)
 - Minister of State (Lords)
 - Mr. Ryrie
 - Mr. Burns
 - Mr. Middleton
 - Mr. Byatt
 - Mr. Battishill
 - Mr. Unwin
 - Mr. Dixon
 - Mr. Griffiths
 - Mr. Cropper
 - Mr. Ridley
 - Mr. Wiggins
 - Mr. Pickering
-
- Sir Douglas Lovelock)
 - Mr. Phelps)
 - Mr. Howard)
- Customs
and
Excise

The meeting was held to discuss indirect tax options and took as its agenda Mr. Griffiths' minute of 30 January.

More frequent upratings of specific duties

2. The Chancellor asked for views on the suggestion that legislation should be proposed to allow more frequent upratings of specific duties between Budgets. Sir Douglas Lovelock said that the Customs and Excise would have to advise against, as they had when similar proposals had been put in the past. It was unlikely, when it came to the point, that Ministers would be content to allow the duty relativities to remain fixed without any provision for override, regardless of all other circumstances; so in effect deliberate decisions would have to be taken every three months on the level of each duty. Moreover, Parliamentary Counsel had thought that any



provision for automatic increases in duties might raise Parliamentary problems. He would have to be consulted urgently if Ministers wanted to consider this proposal further. The Minister of State (Lords) noted that the idea had been greeted rather sceptically by officials when it had been suggested before, even though it might be easier, in political and economic terms, to raise the specific duties step by step, by small amounts every three months, than in large amounts once a year; it would certainly be an advantage to avoid the large once-a-year impact on the price level, for which the Government were inevitably, though unreasonably, blamed. The Chief Secretary said there were clearly dangers in automatic indexation of all specific duties, but frequent price increases in the goods concerned ought to be reflected in the tax take. The "constitutional" argument seemed dubious. The Financial Secretary said that if Ministers wanted to alleviate the present, highly unsatisfactory, situation where the real tax burden of specific duties diminished throughout the year, it was for the Customs and Excise to recommend appropriate methods. The Minister of State (Commons) was sceptical of the proposal: if more revenue was needed later in the year, the regulator was already available. Moreover such a system for the specific duties would constitute a very awkward precedent for movement in social security benefits. The Chancellor concluded that the automatic nature of the proposal had some political attraction, and he asked Customs and Excise to prepare a note, taking account of work that had been done previously.

Heavy fuel oil duty

3. The Chancellor said that, because of the effect of the Frigg contract, the case against cutting heavy fuel oil duty seemed overwhelming, notwithstanding the Secretary of State for Energy's support for some reduction in the present rate of duty. The main difficulty would be how to justify publicly taking no action. The Financial Secretary agreed; the logic of the link with the Frigg contract pointed to an increase in the duty. The Minister of State (Lords) suggested that the best way to justify the retention was to publicise the Frigg contract point. Mr. Battishill said that the Department of Energy would be concerned about drawing



attention to the contract on grounds of commercial confidentiality. On balance, the contract seemed to favour the UK and it might be tactically unwise to draw attention to it. Mr. Ryrie agreed but added that a further study of the contract would be useful.

4. After further discussion, the Chancellor concluded that, in present circumstances, he was not disposed to make any change in the rate of heavy fuel oil duty this year; but the presentational problem arising from the confidentiality of the Frigg contract would need further careful consideration.

Illustrative packages

5. The packages attached to Sir Douglas Lovelock's minute of 20 January were discussed. The Minister of State (Lords) said that he thought the packages were presented in a misleading way: it was not possible to compare directly the packages with and without VAT blocking as the composition of the duty changes was different. Mr. Phelps said that simply to add blocking to package B1 would imply an increase of 32p per gallon in petrol for business users: it had been assumed that increases of this amount would be unacceptable. After some discussion, the Chancellor concluded that the next set of packages should show the possible effects of $1\frac{3}{4}$ and 2 per cent increases in the RPI respectively. The effect of VAT blocking should be shown separately in each case.

6. The Minister of State (Commons) said that VAT blocking of petrol was the one significant proposal in the area of perks. It would help towards energy conservation. The omission of derv would limit the burden on business. The Financial Secretary pointed out that, to the extent that company petrol was used as a perk, companies were free to reduce costs in response to VAT blocking. In the indirect tax package there was a trade-off here between the effects on companies and the desire to minimise the RPI effect of the Budget. The Chief Secretary said that with VAT blocking those companies which did not abuse the VAT rules would be penalised because the Government had been unable to devise another method of tackling the free petrol problem. Sir Douglas Lovelock said that



the evidence available to Customs suggested that the extent of the abuse had continued to increase in the last year. Mr. Dixon said that VAT blocking was defensible in the terms that had been discussed, but it had to be judged against the overall measures which could be included in the Budget to help the business sector. The Chancellor noted that the proposal raised a number of difficult issues, including its effect on non-metropolitan taxis. These would need to be taken into account in further consideration of the proposal.

7. In discussion of the details of the packages, the points raised included the following:-

- (i) The Chancellor said that the balance of the packages was about right, though larger increases could be considered for tobacco products, fortified wine and spirits. In considering spirits, the Customs' and Treasury's different views on their elasticity of demand should be taken into account.
- (ii) The Chancellor agreed that the ratio of the duties on wine and beer should be changed so as to minimise the risk of EC infraction proceedings.
- (iii) Once the main decisions had been taken on the duties on cigarettes the Minister of State (Commons) should settle the detailed implications for other tobacco products and for the balance of the specific and ad valorem elements.
- (iv) The Chief Secretary suggested that increasing car tax might be a useful source of revenue. Following a short discussion, the Chancellor concluded that, in view of recent decisions to provide assistance to the UK car industry, there should be no change in the rate of car tax, though he agreed that the tax should be extended to motor cycles.



- (v) The Minister of State (Commons) agreed that there should be no change in the rates of gaming duties.
- (vi) The Chancellor asked the Customs and Excise to prepare a submission, jointly with the Inland Revenue, on possible tax changes affecting charities, for the Minister of State (Commons).
- (viii) The Minister of State (Lords) suggested a special premium on lager. The Customs and Excise would consider urgently.
- (ix) The Financial Secretary asked whether a final decision had been made on VAT on imports. The Chancellor confirmed that it should remain on the back burner.
- (x) The Chancellor decided that there should be no change in the VAT treatment of the construction industry.

C.R. PICKERING
5 February 1981

Distribution:-

Those present
Sir Douglas Wass
Mr. Folger
Mr. Cardona

PS/Inland Revenue
Mr. Gracey, Inland Revenue