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CHANCELLOR OF THE EXCHEQUER
HONI SOIT QUI MAL Y PENSE

NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, H.M. TREASURY AT 10.00 A.M. ON TUESDAY, 3 FEBRUARY, 1981

Present:

Chancellor of the Exchequer
Minister of State (C)
Minister of State (L)
Mr. Middleton
Mr. Battishill
Mr. Cropper

Mr. Dalton - Inland Revenue
Mr. Isaac - Inland Revenue

The meeting considered on the basis of the agenda note attached to Mr. Isaac's minute of 26 January the outstanding points for decision on the stock relief scheme. It was agreed that the scheme, as a whole, should be enacted in the 1981 Finance Bill.

2. The Minister of State (L) agreed to receive a deputation from the CCAB, who had written on 28 January enclosing a paper responding to Revenue's consultative document.

Single index

3. It was generally accepted that it would not be acceptable to align fiscal with commercial practice in this area. It could be argued in defence of a single index that SSAP 16 left a lot of scopr for judgement, whilst the tax system required objectivity and certainty. Furthermore, the coverage of the accounting standard was limited, whilst tax law had, of course, to cover all cases. Mr. Isaac thought that provided the Government avoided talking about a single index in the context of the standard it should be sustainable. Ministers concluded that the scheme should be based on a single index.

£2,000 "De Minimis"

4. It was recognised that allowing relief on the first £2,000 of the increase in stock values would not provide a particularly

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efficient way of assisting small businesses, whilst it would provide a strong incentive to incorporate, though this was not an argument which could be deployed in public. Furthermore, such a provision would extend relief to many who would not have received it under the old scheme. Ministers concluded that the first £2,000 of stock should be disqualified and that, in order to avoid complexity, full relief should be available on increases in stock values above £2,000, i.e. there should be no taper.

Cancellation of unused relief after six years

5. Ministers were concerned at the size of the overhang of unused tax reliefs, which were now valued at £30 billion and growing at a rate of £5 billion per year. Hitherto, no way had been found of limiting this growth, though relief unused after six years might have been cancelled when the provision to limit liability to clawback to six years was introduced. The present changes provided an opportunity to rectify this omission. There was a danger that the banking system would find ways of converting these unused reliefs into cash, with all that that would imply for monetary control. Cancelling unused relief after six years would not offend fiscal principle and was something which had been done in other countries. Ministers decided that unused relief should be cancelled after this period. The decision could be defended by explicit reference to the £30 billion overhang, which had been mentioned in the consultative document, and which outsiders when aware of the issues generally recognised as a problem.

Transition

6. It was recognised that wherever the timing line was drawn it would be criticised by some. Ministers concluded that the starting date should remain as 14 November, 1980. They also agreed that the 25 per cent restriction on the option to claim old scheme relief in the transitional period should be retained. Finally, under this head, they decided that action should be taken to ease payment of clawback deferred under the 1980 "dips" scheme.

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Credit restriction

7. It was noted that the Financial Secretary, who could not attend the meeting, continued to believe that the new scheme should retain a credit restriction.

8. The Minister of State (L), arguing the case for credit restriction, said that there was a strong intelluctual case for a restriction and one would be in line with the provisions of SSAP 16. Dropping the restriction would increase the revenue cost, in terms of tax foregone, by £30 million in 1982-83 and by £100 million in later years, according to the most recent forecast. If a simpler form of restriction could be found, he would favour it. As it was, the system was more favourable than might be justified and would recoup less revenue than a restriction fully in accordance with the provisions of the accounting standard. In reality, short term borrowing was related more to stocks than to fixed assets, whilst the proposed credit restriction was based on the relationship of borrowing to total assets. Ministers attention had been focused on the case for a credit restriction following the Prime Minister's concern at the "Tesco" abuse, part of which consisted of companies like Tesco obtaining relief on stocks which had been financed by creditors and which was not therefore required to enable the capital of the business to remain intact. Finally, if the new scheme were to be introduced without a restriction, and it were later to be judged that a restriction was needed, it would be difficult to introduce the restriction at that stage since the natural counter - the abolition of clawback - would already have been granted.

9. Mr. Isaac said that frequent criticism of the credit restriction had been that, if there had to be a credit restriction, there should also be relief for debtors. On the "Tesco" abuse, he said that this had comprised two elements, namely relief on increases in stock volumes and relief on increases in stock values financed by creditors. The proposals would eliminate relief being given on increases on stock volumes, whilst the absolute value of the remaining stock relief would be substantially reduced as inflation fell

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10. The Minister of State (C) said that whilst he recognised the intelluctual case for the restriction, politically it was the least attractive part of a package of reforms which was designed to asist industry, which could well be, in the event, the only measures of assistance which it would be possible to introduce in the Budget. He would drop the restriction. Presentationally, the Chancellor could say that the Government would be considering in the context of the promised Green Paper how far the stock relief scheme might be developed in the light of SSAP 16. The Revenue agreed with this. It would be unfortunate if, because of the credit restriction, a measure which was designed to assist industry should become highly contentious in Finance Bill debates.

11. The Minister of State (L) said that if the Government were now to abandon the credit restriction - and it would, in his view, be very difficult to re-introduce it at a later stage - it would mean, in effect, that the Government was declining to align the tax system with inflation accounting, since it would in any case be very difficult indeed to admit for tax purposes the adjustment in SSAP 16 for monetary working capital. This was generally accepted, though it was pointed out that a credit restriction and an MWCA went together and that if the tax system could not admit an MWCA the case for a credit restriction alone was weakened. More generally, Mr. Middleton thought that it would not necessarily be a bad thing to move further away from SSAP 16, whose importance would diminish as inflation declined.

12. Mr. Middleton noted that the credit restriction had been partly designed to discourage borrowing to build up stocks, with the implications that had for monetary growth. However, a credit restriction would not begin to bite until 1982-83, by which time monetary growth would, hopefully, be under control.

13. The meeting considered whether there might not be some alternative to the proposed credit restriction which would enable the scheme to reflect the fact that stocks were financed in part by creditors.

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One possibility, mentioned by Lord Weinstock among others, would be to abate relief by say 25 per cent. Another might be to exclude long term borrowing from the credit restriction. There would almost certainly however be pressures for the exemption to be extended to short term borrowing for specific purchases of fixed assets, e.g. ships and aircraft. It was recognised that any intermediate scheme would be complex and would give rise to pressures to extend the exemption which Ministers would find hard to resist.

14. The Chancellor said, concluding discussion on this point, that the argument seemed to be moving away from a credit restriction, though no final view had been reached and that discussion should be resumed on another occasion.

R.I.T.

(R.I. TOLKIEN)
6 February 1981

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Financial Secretary
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