



Treasury Chambers, Parliament Street, SW1P 3AG  
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*Dear Andrew*

OFFSHORE AND OVERSEAS FUNDS: OFFSHORE LIFE ASSURANCE

You told us yesterday evening that the Prime Minister had asked some further questions on the announcement of which I told you in my letter of 14 November.

We would not in fact create a new precedent by announcing this measure before the Finance Bill: exactly the same approach was followed when the Government acted against "second-hand bonds" in 1982 and "Capital and Income Bonds" earlier this year. These were also tax avoidance devices in the life assurance field.

In both these earlier cases, existing policy holders were not penalised. We propose to take the same approach here. Where no penalty is involved, the life assurance industry generally accepts such measures without much complaint.

In principle, the Chancellor, like his predecessor, dislikes retrospective legislation, but we have always accepted that it can be justified in some circumstances, provided it is done in the right way. Our stipulations as to what constitutes the right way were spelled out by the present Chief Secretary when in opposition, and have subsequently been known as the "Rees rules". These state that the Government must give a clear and precise warning of its intentions, with the legislation applying only from the date of the announcement, and that wherever possible, draft clauses should be published before the Finance Bill. We aim to publish draft clauses in this case as soon as possible. However, if, through consultation, we were to provide the industry with any warning before the legislation came into effect, we fear we would simply provoke a major marketing campaign, leading to a stampede to invest in such devices before it was too late.

/The Prime



The Prime Minister might like to note that there is an important difference between what we are proposing on offshore funds and on life assurance. In the case of life assurance, the new measures would have no impact on existing policies, unless their terms were altered. In the case of offshore funds, the different tax treatment would apply to disposals on all investments after 1 January. The reason for this difference in approach is that the investor in offshore life assurance will in practice be committed for a number of years and early withdrawals are penalised, whereas the investor in offshore funds can withdraw his investment at any time without penalty. This is why we gave an early warning to investors in offshore funds, so that they could change their investments if they wished and this is why it is essential to protect the existing policy-holder.

Unfortunately, the proposed measures on offshore life assurance cannot safely await next year's Finance Bill. The money at present invested in offshore funds will be coming out before the end of this year. If it were subsequently channelled into offshore life assurance, the tax leakage could amount to as much as £100 million and the legislation on offshore funds would thus be criticised as ineffective. It is in order to avoid this that the Chancellor believes we must make an immediate announcement on offshore life assurance.

Since no change is to be made to existing policies, to allow offshore funds to go into life assurance before acting would be bolting the stable door

Yours sincerely,  
Margaret O'Mara

MISS M O'MARA  
Private Secretary

Econ Rd : Budget Pt 11.



116 NOV 1983

