

BACKBENCHERS' BRIEF:

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Stephen Sherborne N^o 10



An early copy of
our bankbenchers brief!

With the Compliments
of

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AR 13/3

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I BUDGET THEMES

1 To reduce inflation and improve the prospect for sustainable jobs

- MTF5 covers 5 years of full Parliament, lays foundation for long-run strategy of recovery. PSBR 1984-85 £7½ billion.
- Tax changes improve workings of the economy with accent on jobs.
- Substantial tax cuts for 1985-86 already announced. More to come if public spending is restricted and growth is sustained.
- Proposals reinforce "winning combination" of falling inflation, rising output, rising investment in 1984 and beyond.

2 To reform and simplify the tax system

- Major corporation tax reform; NIS abolished.
- Greater tax neutrality in treatment of savings and investment.
- Thresholds greatly increased to help low paid, partly financed by wider VAT base.
- Taxpayer left to take more decisions for himself.

3 To look ahead

- Green paper on Government spending and tax into the 1990s published.
- Shows we can reduce tax burden substantially and carry out some much needed reforms if we keep firm control of spending.

4 Three closely related sets of major changes in tax; (in a neutral 1984-85 budget), forming a major programme of reform.

a) Company taxes

- Corporation tax rates greatly reduced, allowances cut back and stock relief ended. Cash flow advantage to business in 1984-85 and big advantage in 1985-86.
- NIS abolished: big advantage to business.
- VAT on imports payable earlier: cash flow disadvantage to importing businesses this year. But

only one-year effect, and puts home producers on fairer basis vis-à-vis competition in EC.

b) Savings and Investment

- Investment income surcharge abolished.
- Life assurance premium relief abolished (new policies).
- Building societies and banks treated more equally: "composite rate" tax on bank interest.
- Stamp duty halved.

c) Personal Tax

- Efforts concentrated on tax thresholds - up 12½ per cent, worth over £2 per week to typical couple.
- Higher thresholds up by indexation - no more.
- VAT extended to hot take-away food and building alterations.
- Cigarettes up 10p; but beer only 2p.

5 Vital to Judge Budget Measures Taken Together.

The many changes proposed serve a variety of major objectives. Many of them achieve more than one purpose. It is important to look beyond narrow calculations of who gains or loses in the short run and by how much, from particular measures taken on their own. Their significance can only be appreciated and should only be judged as part of a coherent programme, which amounts to far more than the sum of its individual parts.

II SUMMARY OF MAIN PROPOSALS

1 Financial Framework

- a) Medium-term Financial Strategy now mapped out up to 1988-89. Declining path for monetary growth and also for PSBR as per cent GDP.
- b) Monetary targets for 1984-85 are 6-10 per cent growth at an annual rate for broad money (£M3) and 4-8 per cent for narrow money (M0). Targets to apply over period of 14 months beginning mid-February, 1984.
- c) PSBR for 1984-85 is about £7½ billion (2½ per cent of GDP).

2 Individual Measures

a) Income Tax

- Single person's allowance and married man's allowance raised by 12½ per cent, more than double indexation.
- Higher rate thresholds and age allowances indexed in line with inflation.
- Investment income surcharge abolished.
- Relief on life assurance premiums to be withdrawn on new policies taken out after Budget day.
- Reliefs on foreign earnings and foreign emoluments reduced or withdrawn.

b) i) Specific duties

- Duty on table wine reduced by 18p a bottle, and duty on beer increased by 2p a pint; complies with European Court of Justice ruling.
- Duties on other alcoholic drinks raised by varying amounts. Overall, duties on alcoholic drinks raised in line with inflation, but substantial differences in relative tax increases between drinks (only 10p on spirits).
- Duty on cigarettes raised by 10p a packet: no increase on pipe tobacco.
- Other specific duties raised broadly in line with inflation.

ii) VAT

- VAT base widened by withdrawing zero rating from alterations to building and hot take-away food. (No change in VAT rate). Effect on RPI about 0.1 per cent only.
- VAT on imports to be charged earlier. Deferred accounting abolished. Payment arrangements brought into line with Customs duty (and other EC countries) from 1 October 1984.

c) Stamp Duty

- On share transfers and transfers of land and buildings, rate reduced from 2 per cent to 1 per cent.

d) Composite Rate on Banks

- Extension of 'composite rate' tax treatment of building society deposits to bank deposits. Implementation in 1985-86.

e) Corporation Tax

i) Rates

- Main rate reduced from 52 per cent to 50 per cent. Applies to corporate income for FY 1983.
- Further reductions in main rate thereafter as follows - to 45 per cent for FY 1984 income; to 40 per cent for FY 1985 income; to 35 per cent for FY 1986 income: all in this year's Finance Bill.
- 'Small companies rate' of corporation tax to be reduced from 38 per cent to 30 per cent from April 1984.

ii) Allowances

- Stock relief abolished for account periods after March 13.
- Capital allowances changed for capital expenditure incurred after Budget day. First-year allowances for plant and machinery and industrial building each reduced by 25 per cent (to 75 per cent and 50 per cent respectively) from Budget day. Further reductions from March 1985 and March 1986. Then replaced by "writing down" allowances.

f) National Insurance Surcharge

- To be abolished from October 1984. (Currently 1 per cent).

g) North Sea taxation

- Repayment of ACT to oil companies with insufficient liability as offset against PRT to be discontinued.
- Tax treatment of "farn-outs" to be revised (in effect, closing tax loop-hole).

III ECONOMIC SITUATION AND OUTLOOK

(For full details, see FSBR. Section 3.)

1. Recent Developments

Since the Autumn Statement last November, indications of recovery at home and abroad have become firmer.

- a) Overseas: In 1983 OECD output grew by 2 per cent, world trade by 1 per cent, average price increases in major industrial countries fell below 5 per cent, and unemployment grew little or fell. Interest rates changed little. Confidence in recovery grew as policies for reducing public spending and borrowing and inflation strengthened foundations of sustainable recovery. Continuing major uncertainties about US economy and interest rates, however.
- b) UK:
- GDP 3 per cent up in first three quarters of 1983, manufacturing output growth picking up during the year.
 - Demand rising strongly, with estimated 1982-83 growth rates of $1\frac{1}{2}$ per cent for exports, 4 per cent for consumer spending, 5 per cent for investment.
 - Manufactured exports held their share of world trade in 1983, and grew strongly by 7 per cent (excluding erratics) in 3 months to January. The year's balance of payments surplus reached £2 billion.
 - Over the first 12 months of target period M_3 within 1983 Budget's 7-11 per cent per annum growth range, M_1 at the top.
 - Interest rates continued their decline, with Bank Base rates now at $8\frac{1}{2}$ -9 per cent (lowest for 6 years) as against $10\frac{1}{2}$ per cent a year ago.
 - Gross profits of non-North Sea industrial and commercial companies 25 per cent up in 1983 Q 1-3 over 1982 Q 1-3; and company liquidity maintaining in 1983 the substantial

improvement in liquidity begun in 1982.

- Employed labour force (including self-employed) up by an estimated 85,000 between March and September 1983; services employment up 200,000 1982 Q 4 to 1983 Q 3; hours worked up, overtime increased, short-time reduced since 1983 Q 2.
- Productivity in manufacturing continuing to rise at very fast 5-6 per cent per man hour per year, for third year running.

N.B. Also worth noticing that UK's net overseas assets rose from £10 billion in 1978 to £42 billion in 1982 (latest figure) - a very valuable counterpart to depletion of North Sea oil and prudent use of some of the foreign exchange it has saved. Earnings on UK's overseas portfolio investments rose from £400 million in 1978 to almost £2½ billion in 1983.

2. Outlook for 1984 and first half of 1985

(See Tables 3.8 and 3.9 of FSR for compact summary.)

- a) General. "Winning combination" of steady growth, rising investment and falling inflation set to continue through 1984 and beyond, with world economy recovering more strongly than in 1983. Autumn Statement forecasts confirmed.
- b) Overseas. Recovery in major six industrial countries, world trade in manufactures (UK weighted) expected to grow by 5 per cent, subject to no serious oil crisis, etc.
- c) Industry Act Forecast and Prospect for UK
 - Between 1983 and 1984, 3 per cent GDP and consumer spending growth, 2½ per cent increase in manufacturing, 5 per cent growth in exports 6 per cent increase in fixed investment, and some stock building. No increase in public spending planning total.
 - Current Account surplus of £2 billion in 1984.
 - Inflation at 4½ per cent by 1984 Q 4, 4 per cent by 1985 Q 2. N I prices are expected to rise more slowly than RPI in 1984-85 for

second year running.

- Effect of Budget including indexation of specific duties is only to add about $\frac{1}{2}$ per cent directly to prices. (In longer term inflation will be determined by monetary conditions.)
- Investment in non-North Sea industrial and commercial companies to rise by 9 per cent.

d) Other indicators and surveys

- Outside forecasters, who doubted Treasury's optimism on growth and inflation in 1983, have been revising their projections upward and downward respectively. More now project further falls in inflation; and most now concede 2-3 per cent GDP increase likely in 1984.
- February CBI trends inquiry suggests increased and broadening demand in manufacturing. CSO longer and shorter leading indicators have been rising, confirming prospect of no slackening of growth in 1984.

IV MTFS, PSBR AND MONETARY POLICY

(See also Section 2 of PSBR, which sets out the strategy in detail.)

1. With inflation already down to levels not experienced since the 1960s and a steady recovery under way, the 1984 MTFS sets out the policy framework for further reductions in inflation and interest rates, a continuation of the recovery; and for the monetary targets consistent with their achievement.
2. Changes since last MTFS
 - Period covered extended by three years, to cover full five year life of this Parliament to 1988-89.
 - Target aggregates redefined, with M0 the principal narrow aggregate instead of M₁, which is becoming misleading and difficult to interpret because of its large interest-bearing component.
 - Different target ranges set for broad and narrow money, as experience shows that thanks to technical innovation

(credit cards, cash dispensers etc) its trend growth will normally be slower than for wider aggregates such as M_3 .

3. Background assumptions

- Public spending up to 1986-87 broadly level in real (cost) terms as in latest White Paper. Assumed to continue constant in real terms to 1988-89.
- Annual real GDP growth averages $2\frac{1}{2}$ per cent to 1988-89; inflation (GDP deflator) falls to 3 per cent by 1988-89; no major change in exchange rate.
- North Sea revenues projected on basis of recently published Department of Energy production assumption. Dollar oil price assumed constant till end 1985, then to rise in line with world inflation.

4. Money Ranges

- Set consistent with inflation reduction, and falling by 1 per cent per annum as in previous versions of MTFS. 1984-85 ranges are targets, 1985-86 and later merely indicative.

<u>Fall from</u>	<u>1984-85</u>	<u>by</u>	<u>1988-89</u>
Narrow Money (M0)	4-8% p.a.	1% each year	0-4% p.a.
Broad Money (M_3)	6-10%	to	2-6

- Broad and narrow money will have equal status in assessing monetary conditions, and exchange rates and other available evidence will continue to be taken into account.
- National Savings contribution to funding policy set at £3 billion as in 1982-83 and 1983-84.

5. PSBR Profile

- Not targets, but illustration of levels which appear to be needed to ensure falling inflation and interest rates.
- Incorporate substantial reduction 1983-84 to 1984-85: from £10 billion (est) or $3\frac{1}{2}$ per cent of GDP to £7½ billion or $2\frac{1}{2}$ per cent. This major cut is needed and justified given that 1983-84 PSBR overshoot the

last year's Budget figure, despite July measures; asset sales and oil revenues in 1984-85 are expected to be higher than foreseen last year, the latter near their likely peak.

- Over later years PSBR to stay at £7 billion cash, which will involve a cut of GDP share from $2\frac{1}{2}$ per cent to $1\frac{1}{2}$ per cent given assumed growth of money GDP, a relatively gentle progression.
- Proposed path for PSBR reflects impact of Asset Sales and North Sea over the period, for both of which necessarily approximate year-by-year path is set out in Tables 2.4 and 2.5 of PSBR.

6. Fiscal Adjustment

- MTF5 shows clearly (Table 2) scope for further significant tax cuts in later years of period (provided spending is held to plans and recovery is sustained) which could exceed £4 billions by 1986-87 in comparison with post-Budget tax rates.

7. Interest rates

- Big reduction in PSBR in 1981-82 underpinned dramatic subsequent fall in both long and short interest rates. Further PSBR cut this year favours further reductions hereafter.
- Cannot ignore US influences however. Our policies have already brought UK interest rates below US ones by about $1-1\frac{1}{2}$ per cent for both short and long-term securities, for first time in decades. Further progress could be limited by US conditions.

V BUSINESS TAXATION - MAIN MEASURES (See Inland Revenue Press notice)

1. Corporation Tax

- a) Major reform proposed while preserving imputation system:
large company rate progressively reduced from 52%:

Profits earned	1983-84	50%
in	1984-85	45%
	1985-86	40%
	1986-87	35%

- small companies rate down immediately from 38% to 30% from April 1984. Profit limits unchanged.
 - 40% Building Society "special rate" and 37 $\frac{1}{2}$ % "pegged rate" for insurance companies, ^{life} business removed as rates fall.
- b) stock relief abolished for account periods beginning after Budget day.
- c) Allowances reduced in 84/5 and 85/6, and replaced by writing down allowances in 86/7

	<u>First year for plant and machinery and related assets</u>	<u>Initial; industrial buildings</u>
Present	100%	75%
1984-85	75%	50%
1985-86	50%	25%
1986-87 Replaced by:	25% writing down allowance	4% writing down allowance

- d) Allowances to be given from 85-6 when spending is incurred rather than when assets come into use

- will not apply to binding contracts entered into up to Budget day;
- special transitional arrangements for certain projects in the "regions";
- most other allowances to be aligned similarly over periods to March 86

2. Defects of present arrangements

- a) Rates of tax too high: penalise profit and success

- b) Allowances too many and very complicated. Original justifications for some of them overtaken by events eg stock relief as an emergency measure needed when inflation high. Allowances were meant to encourage profitable investment, but seem not to have done so. On any measure, returns on investment in UK lower than USA, Germany, France - sometimes dramatically lower;
- c) Allowances distort investment decisions: businesses putting money where tax system makes it look profitable, not where true underlying returns to economy on investment are high.
- d) Allowances discriminate against all but plant and machinery; all buildings except industrial;
- e) Allowances reinforce bias of tax and national insurance charges against labour, in favour of capital.

3. Purposes served by proposals

- a) To reduce tax rates
- b) To remove distortions, and the bias against jobs
- c) To stimulate higher quality investment, productive in its own right, not just because it saves tax
- d) To allow companies to make their own decisions, and higher profits
- e) To provide certainty for business: rates and allowances for years ahead will be in '84 Finance Bill

4. Benefit to Businesses of CT rate allowance and stock relief changes

Change structured to help business as a whole over next 2 years

Estimated cost to government £m

	1984-85	1985-86
Main rate changes	280	1100
Extra revenue from Capital allowance and stock relief	(nil)	650
Benefit to business	280	450

5. Major points to note

- When these changes have taken place, tax allowances for both plant and machinery and industrial buildings will still be rather more generous than would be provided by a strict system of commercial depreciation;

- The CT rates of 35%/30% will be significantly lower than in almost any of our major competitors (cf Japan 42%, USA 46%, France 50%, Germany 56%). This should attract inward investors.
- These changes will encourage higher investment for the next two or so transitional years, as firms exploit high allowances, knowing their ultimate profits will be taxed at the much lower CT rates.

6. Important further points of detail

As V (1) (b) above points out there are numerous other specific allowances, which will be adjusted over the next two years.

- Some will be abolished eg for Agricultural Buildings, Hotels, Dredging;
- Some will be retained eg for Films, Rented tv sets, buildings in Enterprise Zones, Small Industrial workshops. For new ships free depreciation will continue in respect of first year allowances
- The provisions for others still will be amended eg for "secondary allowances", patents or know how.
- Those for mining, mineral rights, oil wells and scientific research are already under review and proposals will be brought forward in due course.

7. National Insurance Surcharge

a) Proposal: to abolish from 1 October 1984 (except local authorities: 6 April 1985)

b) History: Labour's tax on jobs introduced 1977. Was 3½% in May 1979. Reduced in 1982 to 2½% then 1½% and to 1% last year.

c) Cost:

- If still 3½% would cost private sector £3 billion, which would buy a 3p reduction in basic income tax rate;
- Private sector gains £335m in 84/5, £865m in a full year.
- Benefit to public bodies clawed back through reductions in cash limits;
- Even though there have been increases in employer's NIC since 1978-79, overall effect of NIC and NIS changes together increasing the burden on business is worth £2.4 billion to private sector in full year.

NB Local authorities will pay the current 1% rate throughout 1984-85 because it is not

at this point practicable to recover the effects of cutting it through the rate support grant.

8. VAT on imports

See Section VIII for details. One-year effect of bringing forward payments which would in any case be made, compared to corporation tax rate reductions and abolition of NIS that will give lasting benefits.

9. Overall effects of changes in CT, NIS, VAT on imports

Taking '84 and '85 together, Budget will reduce tax payments of business by £900m. The NIS CT changes will mean substantial benefits continuing in later years.

10. Small companies

Benefit from:

- Corporation tax rate reduced from 38% to 30% from April 1984 (ie 30% applies to 1983-84 profits)
- VAT threshold increased to maximum permitted under EC 6th VAT directive from £18,000 up to £18,700
- Investment income surcharge abolished : benefit to retired small businessmen living on investments (in lieu of pension) made out of taxed income; and agricultural landlords
- Raising of tax thresholds means greater demand, greater incentives

NB Also changes in stock options, CTT rates and CTT retirement relief (VIII and IX below).

11. Other changes

a) Carry-back of ACT

- At present ACT which is "surplus" (ie which cannot be set against current year CT liability) may be carried back and set against CT paid on previous two years' profits.
- For accounting periods ending on or after 1 April 1984, this carry-back period is being extended from two to six years
- Cost : £1 million in 1984-85 and £30 million in 1985-86: declining thereafter

b) Corporate Finance Package - Eurobonds, Deep Discounts etc
(See Inland Revenue Press notice)

- CGT exemption - on lines of gilts exemption - for fixed interest corporate stock
- New tax regime for deep discount securities issued by companies
- Provisions to allow companies to pay Eurobond interest gross
- Relief for discounts on bills of exchange (acceptance credits)
- Relief for incidental costs of convertible loan stock issues
- Inland Revenue have confirmed that loan stock which carries a right of conversion into other loan stock is exempt from stamp duty

c) Offshore and overseas funds (roll-ups)

See announcements by Chancellor 15 September 1983, 17 November 1983 and 22 February 1984 which stopped this method of tax avoidance.

d) Consortium relief (See Inland Revenue Press Notice)

More generous treatment: available to larger permitted number companies in consortium: up from 5 to 20.

e) Taxation of International Business (See Inland Revenue Press Notice)

Case for tackling tax havens abuse widely accepted, including by British business. But no easy answers. Present "tax havens" legislation broadly the same as revised draft clauses issued October 1983, but being introduced now with significant modifications following extensive consultation with firms involved, to provide more safeguards for all "genuine" overseas operations of the companies. CT rate cuts will lessen impact of these provisions.

f) Business Expansion Scheme - Farming

- There has been widespread criticism about the use of the Scheme for investments in farmland: over £15 million known to have been invested in 1983-84

- Therefore proposed to exclude farming as qualifying trade under the scheme. Tax relief will not be available for shares in farming companies issued after 13 March 1984. Exclusions not so widely drawn as to eliminate related activities such as food processing, market gardening etc.

- This will help BES reliefs to go to the higher risk ventures for which they are interested.

VI NORTH SEA TAX REGIME

- 1 Positive changes in 1983 have led to substantial increase in development projects and exploration. Government already committed to a study of economics of incremental development in existing fields. Industry will be consulted, legislation in 1985 if required, which will be backdated to changes receiving consent after 13 March 1984. Meanwhile, two measures to limit unjustified loss of tax.
- 2 "Farmouts" (Sales of interests in oil fields)
(See IR press notice).
 - (a) PRT restriction on "farm-outs" announced by Chancellor on September 13 1983. Now right to follow this with analogous Corporation Tax restrictions on post-Budget Day farmouts.
 - (b) Several loopholes closed: capital gains on "farmouts" brought within North Sea corporation tax ring fence.
 - (c) Yield (ie loss of tax prevented) assuming continuing 1983 level of farmouts: £55 million in 1985-86.
- 3 Repayment of ACT to oil companies
 - (a) Present law. PRT is deductible in calculating corporation tax payable. But ACT already paid is repayable, to the extent that (by deducting PRT and so reducing the corporation tax payable) the possibility of ACT set-off is reduced. Oil Taxation Act 1975 S.17(3).
 - (b) High Court case in 1983, requiring repayment to be made as soon as facts clear, created two problems: substantial repayments could become due to be made before ACT could have been set off against CT liability under normal ACT/CT rules: administrative uncertainty about date when facts clear.
 - (c) Section 17(3) is therefore being repealed.
 - (d) Yield £100 million 1984-85; full year perhaps £150 million.
- 4 "Future field" concessions
Changes made last year to benefit future fields (e g no royalty payable) not extended to Southern Basin fields.

VII VAT ON IMPORTS

(See Customs and Excise Press Notice)

- (a) Since VAT was introduced our treatment of imports has given importers a cash flow advantage they do not get in other major EC countries. Average period of grace allowed to importers for payment of VAT to be shortened to one month instead of present average 2½ months, in line with those for customs dues. / Payment will normally be on 15th of following month.

This should minimise problems of delays at ports of entry.

- (b) Change will put relative positions of /home suppliers on same basis as on most EC countries. Follows representations by a number of firms and sectors of manufacturing against discrimination in favour of imported goods.
- (c) Present system has administrative advantages and is favoured by EC Commission as a standard for European harmonisation. But despite this no other EC country has properly adopted it. Taxpayer should not be giving importers free credit. ^{unfairly} If the other EC countries move to our system, we will return to it.
- (d) Selective exemption for raw materials importers would not be legal.
- (e) Bringing VAT payments on imports forward by average 1½ months gives once-for-all £1.2 billion yield, which will help this year to finance abolition of NIS, cut in CT rate and other measures. Some of this will be met by foreign firms. Overall, companies will enjoy large tax cuts over next two years. (See V above).
- (f) Implementation October 1, providing time for Customs to consult transport and importing interests and for those affected to prepare for new procedures. No change for non-VAT registered traders, who will continue to pay on importation.

VIII STOCK OPTIONS

(See IR Press Notice).

- 1 Several important changes which will encourage wider share ownership and help increase incentives.
- 2 Improved tax treatment of approved share option scheme. From April 6 gains on options granted under schemes approved by Inland Revenue will be charged not to income tax but to capital gains tax. There will be no charge on the exercise of the option as there is now; instead the whole gain between the cost of shares obtained under the option and the disposal proceeds will be charged only to capital gains tax and on disposal. Schemes will be subject to certain limits. A major improvement, which will be of great help in motivating, attracting and retaining key executives.
- 3 All-employee save-as-you-earn share option schemes. The £50 upper limit for monthly contributions under the SAYE share option schemes is to be doubled to £100. This will encourage growth of approved schemes for all employees have already increased from less than 30 in May 1979 to a total of 670 covering nearly $\frac{1}{2}$ million employees and £550 million of shares.
- 4 Easier terms for unapproved schemes
Income tax will continue to be paid on unapproved option schemes when options are exercised, but can now be paid in instalments over 5 years rather than 3, as from April 5 1983.

IX CAPITAL TAXES

(See IR Press Notice)

1 Capital Gains Tax

- (a) Threshold below which gains are exempt raised in line with prices from £5,300 or £5,600. Keeps about 6,000 potential taxpayers out of tax.
- (b) Exemption of gains - and disallowance of losses - on certain Corporate Bonds issued after Budget day and held for more than 12 months. Brings treatment of corporate stock broadly into line with that of Gilts, which have been exempt since 1969. Avoids complication of indexation provisions.
- (c) Limit for Retirement Relief exemption doubled to £100,000 which will help smaller businessmen particularly.
- (d) Several small concessions including amendment to market value rules, exemption for housing associations and self-build societies in N. Ireland, amendments to parallel pooling provisions, measures to allow Gilts relief to apply to heritage maintenance funds (as urged by Historic Houses Association), extension of concessions on traded options.
- (e) Chancellor recognised complexity of tax in Budget Speech - "a matter to which I hope to return in a later year".

2 Capital Transfer Tax

- (a) Three top rates of CTT on death abolished. Highest rate cut from 75 per cent to 60 per cent. Lifetime rates reduced to half the rate on death throughout the scale, reducing top rate from 50 per cent to 30 per cent. With this change, and IIS abolition no rate of personal tax will hereafter exceed 60 per cent. Cost to Exchequer about £50 million in a full year.
- (b) Lower and middle rate thresholds increased in line with inflation. Top rate now applied to transfers over £285,000. Thresholds 40 per cent higher than 1978-79 in real terms.
- (c) Previous top rates confiscatory and out of line with lower top rates of income tax. Now closer to top rates in other countries. Election manifesto of 1983 referred to "lowering taxes on capital and savings". Provides incentive and encourages ownership. Lower lifetime rates encourage transfer of family businesses and farms into younger hands.

3 Development Land Tax

- (a) Threshold for DLT raised from £50,000 to £75,000.
Increase broadly in line with prices since £50,000 rate set in 1979. Will cut number of DLT assessments by a third and save 20 staff.
- (b) Right to defer tax on development for the owner's use extended without time limit; and liability to deferred tax will now be extinguished after 12 years.
- (c) Housing Corporation and registered housing associations are being exempted from charge on deemed disposals.
- (d) These changes will give modest but useful help to the construction industry.

X STAMP DUTY

(See IR Press Notices)

- 1 a) Major and highly desirable reductions, which will help buyers of homes and securities alike.
 - b) Stamp Duty on shares to be halved from 2 per cent to 1 per cent
 - c) For land and buildings $\frac{1}{2}$ per cent reduced rate band abolished. $1\frac{1}{2}$ per cent and 2 per cent rates cut to 1 per cent. Threshold for house sales raised from £25,000 to £30,000.
 - d) Full year cost about £295 million for land and buildings, £165 million for share transactions.
- 2 a) Cut in SD on shares will encourage share ownership, reduce cost of raising new equity finance, help maintain international competitiveness of UK stock market.

As Sir N Goodison rightly observed in his Mansion House Speech in October 1983, ~~that~~ London would not have a flourishing central market or a wide spread of shareholders until there are cuts in stamp duty, which is

"responsible for the relatively high cost of buying shares in London."

On that occasion he also urged a more radical approach to tax reform.

"We must encourage people to hold shares in British industrial and commercial companies and units in unit trusts so they can understand how important industry is, and therefore support with their votes policies which encourage the development of industry".

- b) Cut in SD on land and buildings will save the average UK home buyer £142.50 (average price of a house is £28,500). Present four different rates and thresholds reduced to one which simplifies tax. Nine out of ten first-time home-buyers will now pay no stamp duty on their purchase.
- 3 Detailed review of SD in progress, and no action can yet be taken on the important further issues touched on in it, such as lease duty rates and thresholds, which call for further careful consideration in light of substantial public response.

XI INCOME TAX

(See Treasury and Inland Revenue Press Notices and Appendix to this Brief)

- 1 Raising basic thresholds substantially the overriding priority in income tax changes this year, together with abolition of the Investment Income Surcharge.

- 2 Main changes

- a) Basic rate thresholds up ^{nearly} $12\frac{1}{2}$ per cent: single up £220 to £2005: married man up £360 to £3155. Additional personal allowance and widow's bereavement allowance also up, by 14 per cent to £1150.
- b) All other allowances increased by statutory indexation formula only.
- c) Investment income surcharge (IIS) abolished for accounting periods starting after Budget day.
- d) Life assurance premium relief abolished for new policies, but retained on existing ones.
- e) 25 per cent foreign earnings relief for UK residents working abroad reduced to $12\frac{1}{2}$ per cent in 1983-84 and abolished from 1985-86.
- f) "Foreign enoluments" relief on UK earnings of "foreign" employees of foreign companies withdrawn (transitional arrangements for existing beneficiaries).
- g) Car benefit scales increased 10 per cent.
- h) "Composite rate" tax arrangements to apply to bank account interest from 1985-86.
- i) Stock options, employee share schemes - see Section IX.
- j) Costs of changes £billion:

	<u>1984/85</u>	<u>Full Year</u>
Total	1.32	2.61
Above indexation	0.94	1.47

3. Thresholds and allowances (see Appendix II for table)

- a) Increase in thresholds etc [2a) above] more than 7 per cent more than needed for indexation.
- b) Reflects great concentration of effort on basic income

tax thresholds and the lowest paid, who will in general get highest benefit from changes proportionate to their incomes. But income tax should take a lower proportion of income than in 1983-84 at all income levels.

- c) Worth £2.08 per week to married man, £1.27 to single (basic rate taxpayers). As a rule real take-home pay in 1984-85 is likely to be higher than in 1983-84 by 2 per cent or more if average earnings grow at $6\frac{1}{2}$ per annum as assumed by the Government Actuary. But as always there will be divergences from the average for particular individuals and groups.
- d) Higher rate bands increased in line with indexation.
- e) Over 350,000 fewer taxpayers than if thresholds had remained at 1983-84 levels (100,000 of them widows); 400,000 fewer than if thresholds had been indexed only.
- f) About 150,000 fewer higher-rate payers than if thresholds and allowances had remained at 1983-84 levels.
- g) Third successive budget to raise thresholds by more than indexation to highest-yet levels under present Government. Thresholds now 16 per cent or about $\frac{1}{6}$ th higher than 1978-79 in real terms; for single man highest since 1973-74; for married man under 65 highest since war.
- h) 10,000 families removed from poverty trap (paying tax and receiving family income supplement) - about 6 per cent of total. This relatively small number shows how important it is to go further. Putting enough "clear water" between tax threshold and income levels guaranteed by Social Security benefits to make dramatic inroads into poverty and unemployment traps will take years of determined effort. But that is no reason for not continuing on the road.
- i) Pensioners with basic state pension only will pay no income tax.

N.B Additional personal allowance and widows' bereavement allowance up by 14 per cent, $1\frac{1}{2}$ per cent more than basic rate threshold.

4. Investment Income Surcharge (IIS)

a) Abolition removes:

- injustice of "double taxation" of personal savings - both when money is earned and when it generates an income;

- a tax which bears particularly heavily and unfairly on the old and those who have built up their own businesses and sold them, or simply invested prudently.

- b) Abolished from 1984-85 (was 15 per cent on top of basic rate on investment incomes over £7,100).
- c) 280,000 people would have paid tax were it not abolished. Of that number, over 40 per cent otherwise only liable to income tax at basic rate, and over 50 per cent are over 65.
- d) Cost £25 million 1984-85; £200 million 1985-86; £360 million in full year.
- e) Top rate of tax on persons now 60 per cent (was 98 per cent under Labour).
- f) Saves 230 staff.
- g) One of three measures to reduce distortions in treatment of savings (abolition of life assurance premium relief and halving of stamp duty the others).
- h) Of our 12 major international partners and competitors (Japan, Canada, USA, EC 9) only Japan and Greece retain any discrimination against "unearned" income - in both cases less than 5 per cent [Hansard 8 Feb. 1984 W A col. 604]

5. Life Assurance Premium Relief

(See IR Press Notices)

- a) Withdrawn for new (or newly enhanced) qualifying contracts made after Budget Day. Existing policies unaffected (i.e. continue to receive relief equal to half basic rate of income tax).

N.B. Qualifying policies only accounted for one third of new premium income in 1982 of £2.7 billion.

- b) Very old relief, dating from days when life assurance proper was virtually only way of providing for future for ordinary families. Such a relief no longer justified
- with many forms of savings outlets, it is arbitrary to favour some at the expense of others, and the incentive is more likely to distort pattern of savings than raise overall level;
 - "life assurance" is now predominantly not life insurance in the technical sense, but one of a number of savings instruments;
 - policies are very often no more than a part of schemes for management and reduction of taxes - in which case argument for applying revenue cost to cutting general burden of tax thresholds becomes very strong;
 - relief favours institutional rather than direct personal savings;
- c) Together with cuts in stamp duty and IIS abolition reinforces move to more even-handedness in taxation of personal savings and investment.
- d) Yields £90 million in 1984-85, £240 million in 1985-86 (total cost of relief in 1983-84 some £700 million).
- e) Inland Revenue commitment not to change relief on existing policies without reasonable notice honoured.
- f) N.B. Such relief much more limited in most EC countries, some of which also have a stamp-duty-type insurance tax. Nonetheless Canada and USA give no premium relief at all; and policy gains are taxed in Belgium, Netherlands and Canada.

g. Registered Friendly Societies (See Inland Revenue & Treasury Press Notices)

Important changes proposed for both "tax exempt" and "mixed business" Friendly Societies. The "tax exempt" societies with their unique combination of tax-free build-up and exits have been exploiting present rules by marketing pure investment packages, rather than extending the self-help which was their original purpose. Their preferential regime will be withdrawn for new life or endowment contracts after Budget Day. Without this change they would have a particularly marked advantage over ordinary life assurance hereafter. However for the "mixed business" societies the limits on sums assured will be raised from £500 to £750; and for annuities from £109 to £156.

5. Foreign Earnings Relief

- a) This relief a desperate, arbitrary, complicated and highly discriminatory move by Denis Healey to offset damage of penal income tax rates under Labour in 1974-79. Clearly cannot be justified after cuts in income tax rates and allowances since 1979. Moreover, it is open to much abuse: employees extending visits, combining holiday with business trips etc.
- b) It provided a 25% deduction on earnings abroad where UK employees or self-employed overseas for more than 30 days. This will be reduced to 12½% in 1984-85 and abolished 1985-86. Saves £15 million 1984-85 and £60 million full year.
- c) But there will be no change in 100% allowance on 365 day absence or reliefs on foreign pensions. And Inland Revenue authorised to open consultations about possible relaxation in taxation of employees' expenses in overseas travel.

7. Foreign Emoluments Relief

- a) Case for removing this 1974 relief similar to that for Foreign Earnings Relief. It was 50% when foreigners had been resident for 9 out of last 10 years, in which case it fell to 25%.

- b) Relief on UK earnings of "foreign" employee of foreign company will be withdrawn from new applicants, and those here 9 out of last ten years: and phased out over 5 years for those resident here for shorter periods.
- c) Foreign executives often paying much less tax here than at home or elsewhere in Europe. Britain becoming tax-dodging haven.
- d) Encouraged "fiddles": eg UK bank employing foreign staff via Channel Islands company; or son of an immigrant to UK working for foreign firm could claim relief even if he had lived here all his life (by claiming father's foreign domicile).
- e) People doing same job in same company for same rate of pay could have very different take home pay: unfair and bad for morale.

8. Car and petrol benefits (See Inland Revenue Press Release)

- a) Scales for 1985-86 will be about 10% up on 1984-85 (announced a year ahead).
- b) Scales for cars still fall far short of true benefit: benefit of eg Rover in 1985-86 will be taxed as £825; and free petrol for it also as £825.
- c) Compares with 15% increase announced last year for 1984-85.

9. "Composite rate" tax on bank account interest

a) What is "composite rate"?

"Composite rate" has applied to building society account interest for 90 years. Tax is deducted at source as if basic income tax has been paid. But no tax repayable. Current

building society rate is 25%: approximate average of basic rate tax payable by investors allowing for non-taxpayers.

A very efficient and simple system for investors and Inland Revenue alike. 2,000 more Revenue staff would be required if building societies were not handled in this way.

And success of building societies in attracting non-taxpayer deposits shows societies offer offsetting benefits to compensate for implied income tax levied.

Basic rate taxpayer not required to pay any more tax (though his liability would otherwise be 30%). Though non-taxpayer cannot claim refund, building society rates have shown that non-taxpayers can be given better net-of-tax interest than banks offer gross.

- b) Banks however pay interest without deduction of tax. This creates complications for taxpayers who must account for it; and for Revenue who must process their returns, calling for 1,000 staff. Moreover banks are now moving to offer interest-bearing current accounts as financial markets become more competitive. This could call for massive further complications and up to 3,000 extra Revenue staff as such accounts become the norm.

- a) Extension of 25% Composite Rate to banks will give building societies the parity of treatment vis-a-vis banks which many have long sought; will simplify income tax returns for many taxpayers and save 1,000 Revenue staff now, potentially many more later; and it may promote better deals for savers (building societies currently offer a better return net (circa 8 $\frac{1}{2}$ %) than banks do gross (circa 5 $\frac{1}{2}$ %). Basic rate taxpayer will not pay any more income tax, though at present his liability would be 30%, not 25%.
- Interest of savings with local authorities also covered. But National Savings, Certificates of Deposit and Deposits over £50,000 and 28 days excluded.

XII NATIONAL INSURANCE CONTRIBUTIONS

Changes in NICs announced in Autumn Statement take effect in April. This year no change in employer and employee contribution rates, the first time these have not been increased since 1979-80.

2. Lower earnings limit, below which no contributions are paid, rises from £32.50 to £34.50 in line with single retirement pension. Upper earnings limit, beyond which contributions level off, increased from £235 to £250 in line with assumed $6\frac{1}{2}\%$ increase in earnings in 1984-85.

3. Treasury Supplement, which helps to top up National Insurance Fund, reduced from 13% of contributions to 11%. Reduction reflects fact that the general taxpayer is financing a rising proportion of total social security spending because of fast growth in non-contributory benefits which do not fall to National Insurance Fund. Lower Treasury Supplement helps to keep a reasonable balance between employee, employer and tax-payer in meeting total social security burden.

4. Total National Insurance and NIS burden on employers will fall from 13.5% of relevant pay in 1979-80 to 10.45% in 1984-85 for contracted-in, and from 9% to 6.35% for contracted out. Had 78/9 rates prevailed, private employers would have to find £2.4bn more.

XIII INDIRECT TAXES

1. General

a. The proposals this year involve a modest extension of the VAT base which helps finance the vital increases in income tax allowances; and changes in excise duties which maintain their real value overall to offset inflation since the last Budget. Their total impact on prices will be small; less than $\frac{3}{4}\%$ on the RPI, of which 0.4% represents indexation. This is reflected in the forecast of a total RPI increase of only $4\frac{1}{2}\%$ by 1984.

b. The effect of this on people's spending power will be more than offset on average by reductions in direct tax. The Tax and Price Index will actually fall slightly as a result of Budget. Social Security beneficiaries will be protected as price-linked benefits such as Pensions will be increased in line with impact of measures on May RPI.

2. VAT on Building Alterations and Takeaway Food

a. Budget continues the switch from direct taxation of income to indirect taxes on spending outlined in 1979 Conservative manifest by bringing into VAT base two areas of spending at present zero-rated: building alterations and hot takeaway food. This improves the incentive to work and increases freedom of choice for the individual. The effect on the RPI will be very small, circa 0.1%.

b. VAT on building alterations will be levied at standard rate of 15% from June 1. This gives time for most existing contracts to run off. New houses will continue to be zero-rated. But garages, greenhouses and garden sheds which are not part of a new house will be taxed, also certain fixtures and fittings.

The change affects spending which is clearly discretionary rather than essential. Does away with the most confused and nonsensical borderline in all VAT, that between repairs (taxed at 15%) and alterations (currently zero-rated). VAT remains a progressive, not regressive tax.

c. VAT levied on hot takeaway food from May 1. Most food remains zero-rated. But food served in restaurants has always been subject to VAT and, latterly, various snack items including ice-cream, confectionery, soft drinks and crisps brought into tax by Denis Healey. Takeaway food clearly competes with these forms of catering. All other EC countries tax both takeaway food and building alterations.

d. Taxing building alterations and takeaway food will raise £250m and £125m. respectively in 1984-85 and £450m. and £200m. in a full year.

e. Existing VAT relief for "Personal ambulances" extended to cover vehicles designed or adapted for carrying handicapped person in wheelchair or stretcher.

3. VAT Threshold

Registration threshold below which small traders not obliged to register raised from turnover of £18,000 to £18,700, the maximum possible under the EC's Sixth VAT Directive. Quarterly threshold up from £6,000 to £6,200. Helps to keep small business out of VAT net, reducing compliance costs and Customs and Excise manpower.

4. Drinks Duties

a. Changes have to take account of Judgement of European Court last year. Government has fought since 1978 Commission's view that our taxes discriminate in favour of home-produced beer. Now raising beer by minimum amount necessary to comply with judgement, equivalent to 2p on a pint. Complying with judgement could have raised price as much as 7p. Balance sought by Commission achieved instead by cutting duty on table wine by about 18p. a bottle.

b. Cider goes up by 3p a pint because it is substantially less heavily taxed than beer but increasingly competes with it. Spirits, fortified wine and sparkling wine all up 10p a bottle. In case of spirits that is well below increase indicated by inflation because existing burden of tax is so high. Duties on made-wine (e.g. British sherry) aligned with other wine. This represents a reduction in duty on 80% of British wine which is below 15% alcoholic strength.

c. Overall changes in drinks duties equivalent to indexation in line with prices. Revenue yield £140m. 1984-85, £145m. full year.

d. Government determined that other EC countries should end discrimination against British exports of drink. As result of that determination Italian Govt. has given undertaking to comply at last with earlier European Court ruling against the discriminatory duties it has levied on Scotch Whisky.

5. Tobacco Duties

a. (See Customs & Excise Press Notices). Cigarettes up 10p a packet. Additional revenue £330m in 1984/85, £340m. in a full year. Strong health arguments for raising duty. Royal College of Physicians' recent report "Health or Smoking?" recommended steady annual tax increases above the rate of inflation. Even so tax burden (expressed as proportion of retail price) will be about EC average only.

b. No increase in duty on pipe tobacco for second year running. Helps pensioners, more of whom smoke pipes.

6. Vehicle Excise Duty

a. Duty raised broadly in line with prices. VED on cars and light vans up £5 to £90. Duty reductions for 277,000 lighter lorries (second year running), offset by bigger increases for some 150,000 heavier lorries in line with road costs. Tax bands for heavier lorries simplified by increasing them from 1 tonne to 2 tonnes.

b. VED exemption extended retrospectively to recipients of War Pensioners Mobility Supplement;

Concessionary rate (£60) extended to all pre-1947 cars.

c. Revenue yield £110m. Duty still lower in real terms than set by Labour in 1975. Increased effort at enforcement; prosecutions up by half last year.

7. Petrol and Derv

a. Petrol up 4½p a gallon in line with prices. Similar inflation adjustment to Derv rounded down to 3½p. Will help to contain industrial costs. Total tax burden on petrol below 1975 in real terms. Derv well below June 1970. U.K. petrol

price still third lowest in EC after Luxembourg and Germany.

b. Duty on gas oil and aviation turbine fuel (AVTUR) and heavy fuel oil unchanged. The latter has not been increased since 1980, since when its real value has fallen by a quarter. This is a real help to industrial users.

8. Kerosene

Duty on kerosene abolished. Will help pensioners using paraffin stoves for heating: 1p. reduction in cost of a gallon.

9. Car Tax

To be removed from all vehicles for handicapped persons eligible for VAT relief (cf. XIII 2e)).

XIV A SELECT LIST OF SMALL BUT NOTEWORTHY PROPOSALS AND DECISIONS INCLUDED IN THE BUDGET

1. Additional resources for National Heritage Memorial Fund, among other things securing future of Calke Abbey. No change in overall public spending total involved.
2. Increase in Stamp Duty threshold means 90% of first time home buyers will pay no duty.
3. IR limit on tax-free extra-statutory concession for long-service awards to employees doubled, and gifts of shares in employee's company included within limit.
4. No change in duty on fuel oil, gas oil and aviation turbine fuel (avtur) for fourth successive year.
5. Duty on kerosene, including paraffin for stoves used by some pensioners, abolished.
6. No increase in duty on pipe tobacco for second year running (in 1982 increase was below that for other tobacco products).

Benefits large number of pipe smokers among elderly and less affluent and protects jobs in N. Ireland.

7. Recipients of War Pensioners' Mobility supplement exempted from Vehicle Excise Duty.

8. More vehicles designed or adapted for handicapped persons relieved of VAT; and all eligible for that VAT relief now to be free of car tax.

9. Reduced rate of VED extended to all pre-1947 cars.

10. Lifeboat carriage and launching equipment zero-rated for VAT where equipment supplied direct to RNLI (lifeboats are already zero-rated).

11. Some Livestock farmers will benefit from new "herd basis" relief provisions despite abolition of Stock Relief.

12. Limits within which Friendly Societies doing "mixed" business can write assurance on a tax exempt basis increased from £500 to £750.

13. Investment allowances to be given when expenditure is incurred rather than when the asset is brought into use. Important for assets like ships and oil rigs.

14. Limit for retirement relief from CGT doubled to £100,000 backdated to April 1983.

15. All reliefs dropped from 1983 Finance Bill because of election reinstated in 1984 bill. These include:-

a. Extension of "job-related" relief for mortgage interest and CGT to self-employed buying home of their own but under contractual obligation to live in accommodation provided.

b. Reliefs for share options, including doubling of limit on monthly contributions to SAYE-linked option schemes and increase in number of annual instalments under which income tax can be paid in non-approved schemes from 3 to 5.

c. Concessions on DLT including extinguishing deferred liability where development is for owner's own use after 12 years.

d. Furnished holiday lettings to qualify for same reliefs as where the activity amounts to a trade.

XV PUBLIC SPENDING AND TAXATION INTO THE 1990s.

1. General. The Green paper is a major contribution to the current debate on the longer term. It

- a. - describes growth of public spending and taxes over the past 20 years; and explains some of the problems which have arisen as the rising burden of public spending has driven up the tax burden in parallel;
- sets out some of the major likely pressures for higher spending over the next decade;
- examines what might happen to the tax burden on alternative assumptions about GDP and public spending growth;
- concludes that with 2 per cent GDP growth between 1988-89 and 1993-94, and public spending held at its present level for the next ten years, the tax burden could be reduced, but only to its early 1970s level; while with 1 per cent growth in public spending after 1988-89, the tax burden would scarcely be back to its 1978-79 level.

It does not

- b. - offer forecasts or set out policy options for individual programmes by 1993-94. Figures do not exist for the former; and it would be wrong in a discussion document to pre-empt debate about the latter;
- offer forecasts of inflation, pay or unemployment, which are not needed and would needlessly complicate such an exercise.

2. Key points in the Paper

- (a) PE in the past PE burden rose sharply as GDP% between 1963-64 and 1984-85, as real GDP grew at only 2 per cent per annum, or by 50 per cent in total; while real public spending (PE) grew at about 3 per cent per annum, by more than 90 per cent overall. PE burden rose in other OECD countries, too.
 - A variety of reasons for this, e.g. rising expectations, particularly in social policy; belief (disproved by experience) that higher public spending and borrowing would raise growth rates; the 1973 and 1979 oil crises, and recession.
- (b) Taxes in the past In the background, chronic over-optimism about growth, and in the foreground, latterly, need to cut public borrowing. Both together plus public spending trends meant that tax burden has had to rise sharply: from 29 per cent of GDP in 1963-64, to over 37 per cent by end '60s and to 39 per cent today.
 - Rising tax burden has been the upshot of spending decisions taken with little regard to total burden of the finance these programmes would call for.

Spending has been the driving force.

- Pattern of tax increases which has emerged has been very uneven, with particularly large increases in LA Rates, income tax and, most strikingly, national insurance contributions (See Table 3).
- One pernicious result: basic income tax threshold for e.g. married men without young children down from 45 per cent of 1963-64 average earnings to 31 per cent in 1983-84. Tax threshold has sunk closer and closer to income levels guaranteed by social security benefits for more and more taxpayers, threatening absurd position in which very poor pay for their own benefits, creating and deepening poverty trap and making it pay less to work rather than take social security benefits (the unemployment trap).

(c) Pressures for higher public spending in the future

Amongst the major pressures will be:

- the excess demand which is inevitable where sought - after public services are provided free;
- demographic trends, particularly the growing numbers of the very elderly during this century; and the rising proportion of retired people generally thereafter;
- the normal pressures for more numerous and more generous social security benefits;
- the substantial increases in earnings-related state pensions under the 1975 Pensions Act which 'matures' in 1998.
- rising demands for and costs of health care.

Many other countries - including many with high GDP growth rates have recognised they face similar problems, both in Europe, the US and Japan.

(d) Assumptions for projecting future prospects for the tax burden

- Real GDP growth of 2½ per cent per annum to 1988-89 as in MTFS; and alternative growth rates of 2 per cent (2½ per cent excluding the influence of a contracting North Sea sector) or 1½ per cent (1½ per cent excluding North Sea) from 1988-89 to 1993-94;
- PSBR set at 1 per cent by 1993-94, which would be consistent with zero inflation by that date;

and then explore what would happen to Non-North Sea tax burden which is what ordinary people and businesses have to pay if real public spending is flat until 1988/89 but grows by 1 per cent per annum in 1988-89 to 1993-94; or stays flat at today's levels throughout the decade to 1993-94.

(e) Implications of assumptions for Tax Burden (Non-North Sea) in 1993/94.

- The implications for the Non-North Sea Tax Burden as per cent of GDP are as follows:

Past	Projections in 1993/4, assuming growth rates pa 1988/9 to 1993/4 of:					
		GDP 1½%pa	2% pa			
'63/64	'73/4	'78/9	'83/4	FE 0%pa	32½	31½
29%	33	34.7	38.5	1%pa	34	33½

On these assumptions, non-North Sea Tax Burden

- would fall below 1973-74 level with zero FE growth and 2 per cent GDP growth. This would make it possible

to reduce the proportion of income taken by income tax to fall to nearly the 1963/64 level for those on average earnings; but at the other extreme,

- with 1 per cent PE growth and $1\frac{1}{2}$ per cent PE growth the burden would scarcely fall below 1973/74 level; while
- with 2 per cent PE growth - 1 per cent per annum below the average rate of the last 20 years - the burden would still be 36-37 per cent, well above 1978-79 level. This would only allow the income tax burden for the man on average earnings to fall from about 20 per cent now to 18 per cent in 1993-94.

(f) Issues posed by Green Paper

- processes and trends at work in the past have shown how tax burden is driven up by what is in effect an "in-built" tendency for public spending to rise;
- this process clearly has to be checked, both to recreate tolerable personal taxation, and in order to avoid the vicious circle of a higher spending burden leading to higher taxes and lower growth, pushing the spending burden still higher.
- the balance of risks and rewards is not at all symmetrical. To plan public spending on over-optimistic growth assumptions which are disappointed is a recipe for major problems as PE is restrained or cut subsequently. To plan on modest growth assumptions which are surpassed in the event opens up the agreeable prospect of higher spending or lower taxes than foreseen.
- There will be continuing pressures for higher spending in the future. But if these are kept under firm control, substantial reductions in the tax burden are possible;

- Firm control to achieve that goal demands a change in philosophy and practice, in effect "finance must determine expenditure" in the future, rather than vice versa, as in the past;

- successful reestablishment of the virtuous circle of a lower tax and PE burden and faster growth is the crucial goal. If that can be established, it is then possible to achieve an absolute level of PE in the long run which, though a smaller share of a "large and healthily growing cake", before long exceeds the absolute level which is possible if PE forms a larger share of a smaller and sluggishly growing cake. Equally it is always possible to devote some of the extra resources generated by a virtuous circle of growth to improved public services, rather than concentrating it all on further tax cuts.

XVI APPENDIX : MAIN INCOME TAX CHANGES

(See also Treasury and Inland Revenue Press Notices)

(a) Allowances

	84-85	83-84	Increase over 83-84		Increase over indexation
	£	£	£	%	£
Married man's	3155	2795	360	12.9	210
Single(& wife's earned income)	2005	1785	220	12.3	120
Additional personal and widow's bereavement	1150	1010	140	13.9	90
Age married man's	3955	3755	200	5.3	-
Age single	2490	2360	130	5.5	-
Age income limit	8100	7600	500	6.6	-

(b) Higher rate thresholds and bands

Band	84-85		83-84		Increase in threshold	
	£	%	£	%	£	%
40	15401-18200		14601-17200		800	5.5
45	18201-23100		17201-21800		1000	5.8
50	23101-30600		21801-28900		1300	6.0
55	30601-38100		28901-36000		1700	5.9
60	over 38100		over 36000		2100	5.8

(c) Tax reductions (including any tax overpaid after 6 April) will be in pay packets first pay day after 10 May.

(ii) Weekly tax reductions in cash terms for a basic rate taxpayer of working age will be £2.08 married (new threshold £60.67 a week) and £1.27 a week single (new threshold £38.56 a week).

(iii) No change in basic rate of tax (30 per cent) or higher rates (40, 45, 50, 55 and 60). But Investment Income Surcharge (IIS) abolished: 1983-84 charge was 15 per cent on investment income over £7,100 (see also Brief H6).

(b) Costs (£ million):

	<u>Total costs</u>		<u>Cost above indexation</u>	
	1984-85	Full year	1984-85	Full year
Allowances	1715	2110	915	1130
Basic rate limit	45	75	0	0
Further higher rate thresholds	35	65	0	0
Investment income surcharge	25	360	25	340
<hr/>				
TOTALS	1820	2610	940	1470
<hr/>				

80 per cent of the total full year cost of the income tax changes is due to the increase in allowances.