



10 DOWNING STREET

(4)

PRIME MINISTER

Mr. Bruce Sutherland, whom I think you may know, has sent you an interesting letter about reforming taxation on earned income. He has also written to the Chancellor, who has asked the Tax Consultative Committee (a group of outside experts chaired by John Moore) to look into his ideas.

I attach advice from the Policy Unit. Would you like a report from John Moore in due course?

Yes please

DMB

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19 January, 1984.

18 January 1984

MR BARCLAY

TAXATION REFORM

Mr Sutherland is correct in saying:

- (a) There are many anomalies in an income tax system which is meant to be progressive, when it is combined with a National Insurance contribution system which is only partly progressive.
- (b) He is right that gross pay is not as important to the individual as take-home pay, and is not a cost that can be found in the books of any employer.
- (c) He is right that there is additional administration in having a separate PAYE income tax system and a National Insurance system.

There is need for a little more caution about his aims (page 3). Yes, the burden of taxes should be progressive in an even-handed way. Yes, the system should be as simple as possible. Yes, it would be desirable that all earned income is treated in the same manner. However, it would be unwise to enter major reform with the proposition that there must be no losers, as this could well result in an expensive escalation of the total costs of tax relief.

Mr Sutherland's Scheme

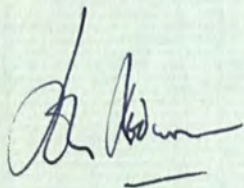
1. The expression of all incomes in terms of take-home pay would be a major change. Whilst people are mainly interested in their take-home pay, the labour market uses gross pay - as do employers when planning salary structures.
2. A basic rate tax credit system is not difficult to envisage. The complication of the higher paid requires a separate system for them. One of Mr Sutherland's methods involves employer deduction using tax tables in exactly the same way as is currently used in the system he is trying to simplify, but of course the higher paid are a relatively small group.
3. Tax allowances paid in cash has the desirable feature of making such tax expenditures much more visible, but may not simplify the present system greatly.

Mr Sutherland states the advantages and the disadvantages fairly and well, with the exception of the advertised huge savings in administration. Most companies have their income tax calculation computerised, and the computations based on pay weeks are therefore carried out at modest cost to the employer. New systems would be cheaper and simpler to install under his proposals.

Mr Sutherland draws attention to the need to introduce tax allowances for non-employed people. Care would be needed to prevent a costly auction of promises.

Conclusion

Mr Sutherland is right to remind the Treasury of the enormous complications and difficulties inherent in the present mixture of National Insurance and income tax measures in this country. His revolutionary concept of looking at net pay is a good one. It is a good idea to take the paper at the Tax Consultative Committee, where John Moore and his colleagues will examine it. There is, of course, no substitute for actually cutting taxes, and my main reservations about this proposal concern the danger of ensuring that there were no losers, which could be a costly exercise, and in the ability to deliver the administrative savings by preserving the basic simplicity of his scheme.



JOHN REDWOOD