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The Rt. Hon. Norman Tebbit MP  
Secretary of State for Trade and Industry

*Norman Tebbit*

In my letter of 28 February I promised to write to you after the Budget about the taxation aspects of competition policy. (You have already received our paper covering other aspects of the subject).

I enclose a short note covering both the 1984 Budget itself and some possibilities for future changes in the tax system. Needless to say, many desirable reforms of the tax system are concerned not so much with promoting competition as with reducing the tax burden (particularly for direct taxation), broadening the tax base, removing discrimination between different types of activity, and simplification. Nevertheless, tax changes can clearly have a role to play in improving the operation of markets generally and facilitating greater competition.

I am copying this letter to the Prime Minister, other members of the Cabinet and to Sir Robert Armstrong.

*John* *Erh*  
*Nigel*

NIGEL LAWSON

## COMPETITION POLICY: TAXATION ASPECTS

### Tax policy

Tax policy has an important role to play in promoting competition, in particular by:

- Reducing the level of taxation, so as to improve incentives
- Reducing the distortions in the tax system which discriminate between different types of activity and impede the working of the market
- Simplifying the tax system to make it more intelligible to the taxpayer and reduce the costs of compliance.

### The 1984 Budget

2. The 1984 Budget was designed to reform the tax system so as to help achieve these objectives. In particular it:

- Made big real increases in tax thresholds so as to take substantial numbers of people out of tax and improve incentives especially for the lower paid.
- Continued the process of reducing the punitive higher rates of tax which we inherited by cutting the top CTT rate to 60 per cent and abolishing the IIS.
- Increased the incentives and motivation of key executives by the more favourable tax treatment of share options.
- Set out a medium-term programme for reforming company tax mainly by abolishing first year allowances on capital equipment, reducing the rates of Corporation Tax, and abolishing NIS. These changes will reduce the distortions which now exist between investment in different types of equipment, between different methods of financing, and between capital and labour.
- Introduced various measures for improving the flow of savings and investment and reducing discrimination between different forms of saving, notably by

withdrawing life assurance premium relief for new policies, halving the main rates of stamp duty, bringing in composite rate scheme for payments of bank interest and making various changes to encourage corporate bond issues.

- Broadened the VAT base, both to provide more revenue to finance the desirable change in direct taxation and to reduce distortions between those goods and services which are zero-rated for VAT and those which are not.

### Future action

3. We must aim to move further in these directions. In particular we must aim:

- To continue to reduce the level of taxation so as to leave taxpayers more freedom to decide how to spend their money and to improve work incentives. Further real increases in tax thresholds, to take the lowest paid out of tax altogether, will continue to be a priority.
- To continue the movement which began in 1979 from direct to indirect taxation. We must proceed carefully, taking account of the effects of any changes on those affected. But we have been clear for a long time that, to promote individual freedom of choice, there should be more taxation of spending and less taxation of income.

4. On more specific measures, we can probably regard the main structure of company taxation as now settled for the lifetime of this Parliament. Other important areas are:

VAT Only about half of the total consumer spending is liable to VAT. This distorts consumer choice to some extent, and may direct investment towards non-taxable areas. Extension of the VAT base could reduce or eliminate these distortions, but the political difficulties need no underlining.

Housing I made suggestions in my earlier note for reducing the heavy distortions in the housing market. Mortgage interest relief also has a major influence on the market but we are firmly committed to the principle of this relief.

Pensions Tax treatment of pensions is especially favourable. But decisions in the pensions area should await progress on the enquiry now under way under the Chairmanship of the Secretary of State for Social Services.

Capital markets We must continue to consider the possibilities for improving the workings of the capital markets.

Tax simplification It will also continue to be important to make progress towards tax simplification. I mentioned in the Budget speech that I hoped to return to Capital Gains Tax next year and there may be other possibilities in the personal tax field, for example taxation of the self-employed. I intend to keep this area under especially careful review.

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