



FROM: A J G ISAAC

THE BOARD ROOM  
INLAND REVENUE  
SOMERSET HOUSE

10 October 1985

MRS LOMAX

**COST OF INTRODUCING TRANSFERABLE ALLOWANCES**

1. I promised to send you a note illustrating how the "realistic" cost of introducing transferable allowances on a no cash losers basis is far less than the "theoretical" cost.

The theoretical cost

2. The "theoretical" cost is £5.3 billion. This is the cost if we made the change this current financial year, retrospectively to April 1985, on a no-losers basis. The single person's allowance goes up from £2,205 to £2,830 - an increase of over 28%.

The realistic cost

3. In practice, it is inconceivable that transferable allowances would be introduced in this way. The change would be phased over two Budgets. The total allowances for a two-earner couple could be "frozen" in those Budgets.

4. In this note, therefore, I compare

- a. the "theoretical" £5.3 billion cost of introducing transferable allowances retrospectively, with effect from April 1985; and

cc Ms Life  
Sir Peter Middleton  
Mr Cassell

MR SCHOLAR

Mr Isaac  
Mr Blythe  
Mr Mace  
Mr Eason  
Mr Hudson  
PS/IR

*U*  
*See also my*  
*memo to the Board*  
*dated 10/10/85*  
*re: See C. Eason's comments below, & also*  
*letter note on your LTPE Report.*

*A paper for the Committee - same*  
*with State*  
*John*  
*John*

- b. the "realistic" cost of phasing in transferable allowances over a two-year period at the earliest practicable opportunity - that is in the 1986 and 1987 Budgets - taking the same assumptions for prices and earnings as in the latest NIF forecasts.

Both estimates of course are strictly illustrative. The actual cost of introducing transferable allowances in the 1990s will depend on movements in prices and earnings which none of us can forecast confidently. As you yourself have emphasised, the lower the then rate of inflation, the less there is to be "gained" from money illusion. The current forecasts assume, of course, a sharp fall in the rate.

5. The approach at 4b. implies a total cost - over and above statutory revalorisation in line with prices - of about £3 billion (instead of £5.3 billion) or (say) some £1½ billion per annum for 2 years.

6. The cost is smaller, if expressed in relation to the cost of maintaining tax thresholds generally constant, as a percentage of earnings - which is surely the Government's minimum policy objective. On this basis, the total additional cost of introducing transferable allowances on a no-cash-losers basis would be a total of £1.9 billion - under £1 billion per annum for 2 years.

(Note: this point does not in principle depend entirely on assuming a continuation of inflation. Even if there were no inflation - perhaps particularly if there were no inflation - one would hope to see at least some modest increase in real earnings.)

7. A cost of £1 billion or £1½ billion a year is still a lot of money. However, to set these figures in context, the annual cost of threshold increases in the last 3 Budgets - over and above statutory revalorisation - has ranged from £0.9 billion to £1.3 billion per annum. The total cost of increases in tax thresholds in these 3 Budgets has been £6.2 billion - or £3.4 billion more than the cost of statutory revalorisation.

CLG.1.  
A J G ISAAC

Cost of introducing Transferable Allowances on no cash losers basis

	£ bn	Cost per year (over 2 years)
Compared with no change in allowances	5.3	
<u>less</u> statutory indexation in 1985 and 1986	2.3	
Cost over and above statutory indexation	3.0	1½
<u>less</u> additional cost of keeping thresholds in line with earnings	1.1	
Cost over and above earnings indexation	1.9	0.95
<u>Memo</u> Cost of threshold increases <u>1982, 83 and 84 Budgets</u>		
Total	6.2	(over 3 years)
Over and above statutory indexation	3.4	↓ 1.1 average range 0.9-1.3