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Prime Minister

I suggest you discuss the ideas for further work at the end of this minute with the Chancellor after the holiday.
(Peter Bottomley's idea - para 17 - looks interesting).

cc Mr Hoskyns
Mr Wolfson

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

TAX RELIEFS FOR HOUSING

Since the Budget, I have pressed ahead with preparations to involve a few experienced people outside Whitehall in the work on taxation and savings which you endorsed earlier in the year (your Private Secretary's letter of 31 March to mine). The involvement of the outsiders was made public in a Written Answer on 14 July. I am also asking officials (but not the outsiders) to consider the tax treatment of gilts and chattels as you suggested.

TL 7/8

Background

2. You also mentioned the present bias towards housing. I have been thinking carefully about the scope for doing more work on this. This is a difficult area, and I thought it might be useful to set out some of the considerations which we would need to take into account in deciding what work to put in hand. There are a number of conflicting issues.

3. I have not concerned myself with rented housing - either in the public or private sectors - but have concentrated on owner-occupation, where the tax reliefs are given. What we decide on owner-occupation, however, will need to be viewed alongside our policy in the public rented sector, where our aim is to increase rents and reduce subsidies, and in the private rented sector where one of our aims is to improve the working of the market by reducing the extent of rent controls.

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<u>The Reliefs Available</u>

4. The main tax provisions from which owner-occupiers can be said to benefit (apart from general help for housing) are:-

(a) <u>mortgage interest relief</u> on loans up to £25,000 for the purchase or improvement of one's main or only residence;

(b) exemption from <u>capital gains tax</u> on disposal of one's main or only residence;

(c) exemption from <u>stamp duty</u> on the transfer of residential property not exceeding £20,000, and reduced rates up to £35,000; and

(d) (included for the sake of theoretical completeness) the absence since 1963 of tax on the "imputed" income from owner-occupation - <u>the old Schedule A tax</u>.

5. The cost of these provisions cannot be calculated with any degree of certainty. It would be misleading simply to aggregate the various costs in calculating the total tax subsidy to owner-occupation. But the cost in 1979-80 of mortgage interest relief was around £1.4 billion (and is estimated this year to be around £2 billion), and the cost of the stamp duty relief some £230million. The tax "forgone" in giving CGT relief and from the absence of Schedule A is likely to be more than £1 billion in each case.

6. The value of these reliefs has continued to increase rapidly in recent years with the growth in the size of mortgages (due to inflation) and the increase in mortgage rates. In 1973-74, for example, the cost of mortgage interest relief was only £500 million - equivalent to about £1.2 billion at 1979-80 prices.

7. On the other hand, domestic rates, which yielded last year nearly £3 billion, work in the opposite direction to these reliefs. They are a tax on the occupation of property, and assessed on its annual value. As such they are paid by those who rent their house as well as by owner-occupiers; but even so they represent something of an offset to the fiscal concessions outlined above (though domestic ratepayers are still better treated than industrial and commercial ratepayers because of domestic rate relief).

The issues

8. The reliefs for owner-occupation are now very generous - No arguably too generous, at least in the extent to which they are particularly concentrated on those who already own, in contrast with those wishing to buy for the first time. Indeed, from an economic, social and fiscal point of view, a case can certainly be made for re-examining them. They are not a very cost-effective way of increasing owner-occupation; the fiscal incentives push up house prices so that much of the benefit goes to existing owners, rather than first-time buyers. By diverting savings flows away from the capital market, they raise the cost of money to industry and commerce and may crowd out productive investment. Some reduction in the tax concessions would go some way to widen the income tax base. And it should reduce the overall level of interest rates at which the monetary target can be met. (Tax relief damps the price sensitivity of demand for housing credit and so raises total credit for any given level of interest rates generally, except insofar as housing finance is directly rationed.)

9. On the other hand, as a Government, we are committed to a property-owning democracy and it is right that we should retain a range of generous incentives in this area. I would not, therefore, want to make a ~~substantial~~ any reduction in the total scale or scope of reliefs - at least while mortgage rates remain relatively high. If at any stage the pattern of reliefs was changed, that would need to happen gradually to avoid hardship.

I am not prepared to make any changes which diminish mortgage relief. On the contrary. The £25,000 limit - needs increasing. MT.

10. Certainly this does not mean that we should rule out making changes at all. But in considering what might be done, the points I would wish to stress are these:-

(i) the need for tax simplification. We must try to reduce the administrative complications of the present arrangements. Mortgage interest relief is costly in manpower - requiring some 1400 Inland Revenue staff, and even more when PAYE codes have to be changed mid-year to take account of alterations in the mortgage rate;

(ii) the effect of labour mobility. As part of our policy of improving the supply side of the economy, we should aim to make changes that will encourage labour mobility. I have little doubt, for example, that the present burden of stamp duty on house transfers is harmful in this respect;

(iii) the possible need for greater competition among the building societies. We have up to now acquiesced in exempting the building society cartel from restrictive trade practices legislation because it helps to ration mortgage finance and so keeps down mortgage rates. But there can be little doubt that the building society cartel creates inefficiency. It restricts price competition between the societies, ensuring that the least efficient can survive. One conspicuous consequence of the cartel has been the recent increase in the number of high street building society branch offices.

Possible developments

11. If we were thinking of making changes, I would suggest the following broad approach:

12. Schedule A. I cannot believe that we could or would wish to turn back the clock and re-introduce Schedule A. It would be costly to administer, and cause enormous trouble with our supporters.

13. Capital gains tax. Nor could we contemplate taking away the exemption from capital gains tax for owner-occupied houses. It would be absurd to impose a heavy CGT charge on owner-occupiers, with the most damaging effects on labour mobility, at a time when we are still giving thought to reducing the burden of this tax generally.

14. Stamp duty. Clearly there is a good case for reducing or even abolishing stamp duty on house sales. A change here would encourage labour mobility, and abolition would represent a useful simplification of the tax system. But stamp duty is now a big revenue-raiser and changes would be expensive.

15. Mortgage interest relief. There are a number of possibilities here. We could reconsider the £25,000 - raise it ceiling, and the rate of tax at which relief is given. The ceiling has remained unchanged since 1974 and there are strong pressures within the party to increase it. One possibility which has been suggested would be to increase (or even abolish) the ceiling whilst restricting the value of the tax relief to the No. basic rate. (We should need to examine the distributional consequences of this and other possibilities.)

16. A second possibility would be introduction of a universal option mortgage scheme - replacing the present tax relief with a direct

No subsidy paid by the Government to the building societies, who would then pass it on to the mortgagee in the form of a lower mortgage rate. The Government could then choose to set the subsidy at whatever rate it wished. Such a scheme would produce staff savings in the Inland Revenue, though these would be partly offset by the extra staff needed by the DOE for a wider option mortgage scheme.

17. A more radical approach, of which Peter Bottomley is a persistent advocate, might be to do away with mortgage interest relief as such, replacing it with a general relief covering life assurance premiums, mortgage interest and possibly other forms of contractual or medium-term savings. Supporters of this scheme see it as a way of limiting relief for owner-occupiers, whilst removing some of the existing distortions in the tax field. Though it would raise difficult problems, it is certainly an interesting longer-term idea.

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18. Lastly, there is a rather separate point on the building societies. The Wilson Committee recommended a number of changes in the tax treatment of the societies which are not far removed from this general area and I am arranging for these to be looked at in the Tax and Savings Group.

Conclusions

19. There can be little doubt that the tax treatment of those already established in owner-occupation is generous. This reflects the priority we give to encouraging home ownership. Whether we want to make any changes is as much a matter of politics as of economics, and is something which you will no doubt want to consider very carefully. I would rule out any thought of re-introducing Schedule A or removing the CGT exemption. But it might be worth commissioning some work on the various suggestions for mortgage

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interest relief, along with reducing or even abolishing stamp duty on house sales. There could be a useful package here which would make better use of the revenue involved and save staff, whilst simultaneously reinforcing the forces of competition and encouraging and assisting labour mobility.

20. If you wanted to proceed, I would ask officials in the Tax and Savings Group (without outsiders for this purpose) to embark on a study. But perhaps we should first discuss.

It will be waste of time to commission any work that will have the effect of reducing mortgage relief.

I am not prepared to agree to any such reduction.

MT.

(G.H.)

7 August 1980

Extract from Hansard, Vol 987, Col 711,

Dated 4 July, 1980,

Housing Market

Mr. Durant asked the Secretary of State for the Environment what consideration has been given to the workings of the owner-occupied housing market and in particular to the factors which may determine the rate of house price changes.

Mr. Stanley: A review has been undertaken jointly by officials and representatives of the Building Societies Association. A copy of the report subsequently prepared for the Joint Advisory Committee on Building Society Mortgage Finance, and broadly endorsed by that committee, has been placed in the library.

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cc Mr. Hoskyns
Mr. Wolfson

Econ Pol

copied to HMT
Tolkien

10 DOWNING STREET

From the Private Secretary

8 August 1980

The Prime Minister has read the Chancellor's minute of 7 August about tax reliefs for housing. She would be prepared to discuss with the Chancellor some of the ideas in this minute after the holidays; but you should know that she is not prepared to countenance any reduction in mortgage relief, and that therefore it would be a waste of time commissioning further work on proposals which would have this effect. You should also be aware that the Prime Minister is not disposed to the idea of increasing the ceiling on mortgage relief while restricting the value of the relief to the basic rate, nor to the possibility of a universal option mortgage scheme, nor to the approach favoured by Peter Bottomley.

T. P. LANKESTER

Martin Hall, Esq., M.V.O.,
HM Treasury.

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