

PRIME MINISTER

BILATERAL WITH THE CHANCELLOR

Subjects for discussion include the following:

(i) Markets. Sterling has this week been moving against the Mark in line with the dollar, falling with it and rising with it. The first guess for M0 in calendar November is now in, and shows growth of 5.2% over November last year. The Treasury see this as getting uncomfortably close to the top end of the 2-6% range, and they also see signs of looseness elsewhere. The general view seems to be that another increase in interest rates will be needed before too long, perhaps before the first guess money numbers are announced on 18 December.

I fear that if the Treasury holds to this view, you will, in a couple of weeks time, suddenly be presented by the Chancellor and the Governor with a proposal for an increase. It would, I suggest, be helpful before too long to hold a meeting with the Chancellor, Peter Middleton and Terry Burns to discuss in a more general way their views on where the economy is heading, even though the Treasury have not prepared a new forecast since the early autumn. You should have an opportunity to talk this through in a meeting at which no decision is required. I have mentioned this as a possibility to the Chancellor's Private Secretary (as my idea, not yours), but if you felt it would be useful, you might like to say so to the Chancellor.

(ii) Managing Director of the IMF. The Treasury have heard that Craxi has decided against supporting Jeremy Morse, so his candidature is now effectively at an end. They also understand that Lubbers wishes to raise the Managing Directorship informally at the European Council, and will wish to have a word with you before the Council starts about how best to do this. The Chancellor will offer advice.

cc of sup 3
Director
What matches
to him to be a Governor
of the Bank. I
see none in
his CV.

(iii) Sizewell. The Chancellor is concerned that Peter Walker may try to squeeze the Treasury out of the Sizewell decision. You can reassure him that there will be full discussion with colleagues, though the planning decision is for Peter Walker alone.

(iv) Bank of England Directors. The terms of Hector Laing, John Bairing, Martin Jacomb and Lord Nelson all come to an end in February next year. The first three all wish to stay on, and the Governor and Chancellor are content that they should do so. Lord Nelson wishes to retire from the Board, and the Governor is content to let him go. The front runner to succeed him is Sir Colin Corness, Chairman of Redland, of whom the Governor and Chancellor think highly. I attach his entry in Who's Who.

(v) IMF Article IV. The IMF have recently finished their annual consultations about the UK economy. The Chancellor will report. I understand from Nigel that they have their doubts about the stance of fiscal policy.

(iv) Dual Resident Companies. The Chancellor proposes to restrict the group relief arrangements for companies which are resident in two countries. At present these companies can be used by multi-nationals to secure tax relief in two countries on the same interest payments. Lord Hanson is, I understand, likely to have strong views on this. The relevant papers are below in case you wish to look at the problem in greater detail.

S. Davis

PR DN

2 December, 1986.

Council for Calibration and Measurement, Dol, 1975-84; BSI Quality Assurance Council, 1979-84; BSI Bd, 1980-84. *Recreations*: gardening, listening to music, building and flying radio controlled model aircraft. *Address*: 97 Dartnell Park Road, West Byfleet, Weybridge, Surrey KT14 6QE.

CORNESS, Colin Ross; Chairman, Redland PLC, since 1977 (Managing Director, 1967-82); *b* 9 Oct. 1931; *s* of Thomas Corness and Mary Evlyne Corness. *Educ*: Uppingham Sch.; Magdalene Coll., Cambridge (BA 1954, MA 1958); Graduate Sch. of Business Admin, Harvard, USA (Advanced Management Program Dip. 1970). Called to the Bar, Inner Temple, 1956. Dir, Taylor Woodrow Construction Ltd, 1961-64; Man. Dir, Redland Tiles Ltd, 1965-70. Director: Chubb & Son Ltd, 1974-84 (Dep. Chm., 1984); W. H. Smith and Son Ltd, 1980-; Giroflex Ltd, 1985-. Chm., Building Centre, 1974-77; Member: EDC for Building, 1980-84; Industrial Develt Adv. Bd, 1982-84. *Recreations*: squash rackets, travel, music. *Address*: Redland House, Reigate, Surrey RH2 0SJ. *T*: Reigate 42488. *Club*: White's.

CORNFORD, Sir (Edward) Clifford, KCB 1977 (CB 1966); FEng 1980; Member, Post Office Board, since 1981; Chairman: Raytheon Europe International, since 1985; A. C. Cossor Ltd, since 1985; *b* 6 Feb. 1918; *s* of John Herbert Cornford; *m* 1945, Catherine Muir; three *s* three *d*. *Educ*: Kimbolton Sch.; Jesus Coll., Cambridge (BA). Joined RAE, 1938. Operational Research with RAF, 1939-45. Guided Weapons Res. at RAE, 1945-60; jssc 1951; Head of Guided Weapons Dept, RAE, 1956-61; Min. of Defence: Chm., Def. Res. Policy Staff, 1961-63; Asst Chief Scientific Adviser, 1963-64; Chief Scientist (Army), Mem. Army Board, Ministry of Defence, 1965-67; Chm. Programme Evaluation Group, MoD, 1967-Jan. 1968 Dep. Chief Adviser (Research and Studies), MoD, 1968-69; Controller of Guided Weapons and Electronics, Min. of Technology, later Min. of Aviation Supply and MoD (Procurement Executive), 1969-72; Ministry of Defence (PE): Controller (Policy), 1972-74; Dep. Chief Exec., 1974-75; Chief Exec. and Permanent Under Sec. of State, 1975-77; Chief of Defence Procurement, MoD, 1977-80. FRAeS. *Publications*: on aeronautical subjects in jls of learned socs and technical publications. *Recreation*: travelling. *Address*: Beechurst, Shaftesbury Road, Woking, Surrey. *T*: 68919. *Club*: Athenzium.

CORNFORD, James Peters; Director, Nuffield Foundation, since 1980; *b* 1935; *s* of John Cornford and Rachel Peters; *m* 1960, Avery Amanda Goodfellow; one *s* three *d*. *Educ*: Winchester Coll.; Trinity Coll., Cambridge (MA). Fellow, Trinity Coll., Cambridge, 1960-64; Harkness Fellow, 1961-62; Univ. of Edinburgh: Lectr in Politics, 1964-68; Prof. of Politics, 1968-76; Dir, Outer Circle Policy Unit, 1976-80. Vis. Fellow, All Souls Coll., Oxford, 1975-76; Vis. Prof., Birkbeck Coll., Univ. of London, 1977-80. Mem., Cttee of Inquiry into Educn of Children from Ethnic Minority Gps (DES), 1981-85. Dir, Job Ownership Ltd, 1979-. Chairman of Council: RIPA, 1982-; Campaign for Freedom of Information, 1984-. Literary Editor, The Political Quarterly, 1976-. *Publications*: contrib.: Cleavages. Ideologies and Party Systems, ed Allardt and Littunen, 1965; Ideas

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**INLAND
REVENUE**

Press Release

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Dec
November 1986

TAXATION OF INTERNATIONAL BUSINESS: DUAL RESIDENT COMPANIES

The Government propose to restrict the group relief currently available in respect of losses made by dual resident companies. After 1 April 1987 dual resident companies other than genuine trading companies will be unable to surrender losses to other members of their UK group.

In reply to a Parliamentary Question the Financial Secretary to the Treasury, Mr Norman Lamont MP, said:

"I have authorised the Inland Revenue to publish today a Consultative Document introducing draft clauses on the tax treatment of Dual Resident Companies. Comments on the draft clauses should be sent to the Board of Inland Revenue to arrive by 31 January 1987.

Recent legislation in the United States and evidence of substantially increased use of dual resident companies at the expense of the United Kingdom Exchequer now make UK legislation necessary. The Government intend to introduce provisions dealing with dual resident companies in the Finance Bill 1987."

Copies of the Consultative Document and draft clauses (price 60p post free) may be obtained on application to the Reference Room of the Inland Revenue Library, Room 8, New Wing, Somerset House, Strand, London WC2R 1LB. Remittances should be made by cheque or postal order (payable to "Inland Revenue") or in cash. Postage stamps cannot be accepted as payment.

NOTES FOR EDITORS

1. Dual resident companies are companies which simultaneously satisfy the residence rules of two countries. A company may be resident in the UK because it is managed and controlled here yet at the same time be resident in an overseas country because, for example, it is incorporated there.

2. These dual resident companies are often set up as part of a multinational group to arrange finance for group members. They are normally members of two sub-groups (a UK group and an overseas group) and typically have no taxable income against which to set the interest payments in respect of their borrowing. The interest payments therefore create tax losses and because the companies are resident in two countries they get deductions for the losses in both countries. The deductions are achieved through set-off by group relief (or the overseas equivalent) against profits of other members of the groups.

3. The Government propose that, with effect from 1 April 1987, such companies should be denied the ability to surrender their losses to other members of the UK group under the UK group relief provisions. The new rules will not apply to dual resident companies which are genuinely trading, only to those whose main function is to borrow to purchase or hold shares in a member of the multinational group.

4. Provisions in the US Tax Reform Act 1986 will prohibit a dual resident company from setting-off a loss against the profits of another company in its US group. Legislation in the UK will complement legislation in the US and the intention of both Governments is to ensure that the relief for borrowings at present given in both countries will in future be given in one country only. To obtain such relief a multinational will normally have to rearrange its affairs so that the relevant interest is paid by a singly resident company.

5. The Government issued a consultative document on dual resident companies in 1984. The Chancellor decided in March 1985 that it would not be appropriate to legislate in 1985 but said that the matter would be kept under close review. If there was evidence of growing exploitation at the UK Exchequer's expense he would reconsider the possibility of remedial legislation.

3361 /58

cc. N. Lawcell (o.v.)
Mrs. Smyth



CL ITJ
CST
EST
AST
Sir P. Middleton
MR Cassel
MR Hanger
MR Cropper
MR Ross Babbey
Miss Sinclair
MR LINFORD IR
MR TAYLOR-THOMPSON
MR GREEN (BANK)
MRS T. ALLEN (FCO)
MR R.I.G. ALLEN (FISH)
PS/IR

Treasury Chambers, Parliament Street, SW1P 3AG

Lord Hanson
Chairman
Hanson Trust PLC
180 Brompton Road
London SW3 1HF

14 August 1986

Dear James

You wrote to Nigel Lawson on 1 August enclosing a copy of your letter of 31 July to Sir Geoffrey Howe concerning the tax treatment of dual resident companies. I am replying in his absence.

As you will know, the Government has been concerned for some time about the use of non-trading, loss-making, dual resident companies which have been set up chiefly to secure the tax advantage of a double deduction for interest payments. A consultative document was issued by the Inland Revenue in November 1984 and although it was decided that no action should be taken in the 1985 Finance Bill the matter has since been kept under close review.

The proposal in the Senate version of the US Tax Reform Bill is for dual resident companies to be prohibited from "consolidating" with other members of a US group. Effectively a loss-making dual resident company is being denied a deduction in the US for its interest payments and a UK/US dual resident will therefore only be able to get a single deduction in the UK. The nature of the proposal is similar to that of the UK proposal set out in the consultative document under which dual resident companies would be denied the ability to surrender their losses under group relief rules to other members of the UK group. The principal difference between the proposals is that the US proposal would not apply to US-owned dual resident companies whereas the UK proposal made no such distinction. I would agree, therefore, that the US proposal discriminates against foreign-owned dual residents by disallowing their expenses for US tax purposes but not disallowing the expenses of US-owned dual residents. As it would thus discriminate against UK-owned dual resident companies, and is intended to override the non-discrimination provisions of the UK/US Double Taxation Convention, the proposal is not acceptable to the United Kingdom and representations have been made to the US Treasury accordingly.

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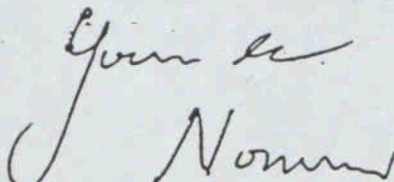
However, I cannot agree with your suggestion that all the benefit of the US proposal will go to the US Treasury, with none to the UK Exchequer, or that UK-owned dual resident companies will be at a major disadvantage compared to US single resident companies. It is not possible to say how groups currently operating through dual resident companies would rearrange their affairs if the US proposal is passed into law. In the absence of any information to the contrary it is reasonable to assume that both exchequers would gain over the long term. As regards the competitive position of US single resident companies it must be remembered that such companies do not receive the benefit of a deduction in the United Kingdom and that, under the Tax Reform Bill, the US corporate tax rate would be reduced to 33% thus reducing the disparity between the UK and US deductions.

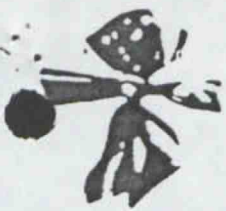
The UK/US dual resident company is a phenomenon arising because of differences between UK rules on company residence and US rules on company residence. The double relief for losses is a product of the domestic legislation of each country and a tie-break provision in the UK/US Double Taxation Convention would not affect that domestic relief as it would only determine the residence status of the company for the purposes of the Convention. It could not determine the residence status of the company for domestic law purposes. Nor is it possible to use the Convention to determine the country in which relief should be given. The Convention would then be denying relief in the other country and a double taxation agreement may only grant relief, it may not withdraw it.

While we regard the present US proposal as fundamentally flawed, because it offends against the UK/US Double Taxation Convention, there would not be the same objection in principle if it were applied to all dual resident companies rather than just foreign-owned dual residents. There would then be no discrimination and, as I have indicated, the proposal would then be very much akin to our own proposal of 1984.

Against this background you will appreciate why we cannot press our representations any further than we have done. But I can assure you that the US Government have been made well aware of our objections to legislation which would discriminate against UK-controlled dual residents and override the Double Taxation Convention.

I am sending a copy of this letter to Sir Geoffrey Howe.


NORMAN LAMONT



~~GTAX~~

HM TREASURY - MEU	
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August 1, 1986

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Dear Nigel -

USA - The Proposed Tax Reform Act

Here is a letter I have sent to Geoffrey Howe on a matter of very considerable importance to Hanson Trust - and not only to us, but to other British companies and to the UK generally.

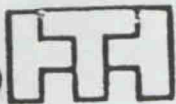
We have made a lot of inquiries over here - as has Gordon White on the other side, where he has been very well received on this subject by Senator Dole and others, but we are forced to the conclusion that HMG is not taking a tough enough position.

There is little time left, hence my request to the Foreign Secretary for urgent action. I shall be most grateful for any help which you may be able to give.

As ever
James

The Rt. Hon. Nigel Lawson, MP,
 Chancellor of the Exchequer,
 Treasury Chambers,
 Parliament Street,
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Directors: Lord Hanson (Chairman) D. N. Rosling (Vice-Chairman)
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July 31, 1986.

Dear Geoffrey -

I should not be asking for your help when you are engaged in such critical affairs on South Africa if it were not a matter which is both serious and urgent.

As major investors in the USA we are very concerned at the discriminatory nature of Section 983 of the proposed Tax Reform Act of 1986 currently being debated in the US Joint Committee of the Senate and Congress. This is harmful in that:

- (a) It discriminates against UK owned Dual Residents by disallowing their expenses in the USA for tax purposes without disallowing expenses of USA owned Dual Resident companies.
- (b) It gives the full benefit of the expenses disallowance to the USA Treasury and none to the UK Exchequer.
- (c) It puts some UK owned groups in the USA at a major disadvantage to similar USA owned groups with which they compete, in that the former groups' interest costs can be disallowed, whilst a wholly owned USA group operating only in the USA would not suffer any disallowance.

In the USA Sir Gordon White has been very active in drawing attention to the serious consequences - not just for Hanson Trust but also for many other British companies - both through American channels and through your Embassy in Washington. In turn, we here have been pursuing the same arguments with the Treasury and with the Inland Revenue. From all these talks we have formed the view that the representations being made by the British Embassy to the Americans concentrate on the argument in (a) above and have not at all pursued the arguments in (b) and (c). It seems to us that the possible effect of this course is that the US authorities will adopt legislation disallowing all Dual Resident deductions in the belief that this will satisfy the UK Government.

As you are aware, Hanson Trust has been actively building up a substantial investment in the USA over the last twelve years, and we feel that we shall be severely harmed if the UK passively permits the USA to pass such discriminatory legislation without the strongest protest.

Continued..

In a nutshell, we fear that representations in their present muted terms may seem to the Americans tantamount to the UK offering acquiescence in the American proposals. We feel strongly that the better way to address the subject of residence is to have it settled by joint negotiations between the two governments by treaty, and not by unilateral action by either side. An equitable arrangement could thus be agreed for deciding where a particular company should be resident, or where expenses should be allowed.

I understand that the Joint Committee will deal with this legislation over the next two weeks, so there is very little time if, as I hope, you feel able to instruct the Embassy to make their protest in much stronger terms.

As ever

James

The Rt. Hon. Sir Geoffrey Howe, QC, MP,
Secretary of State for Foreign & Commonwealth Affairs,
Downing Street,
London SW1A 2AL.