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28 June 1988

Paul Gray, Esq
Private Secretary
No.10 Downing Street
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Dear Paul,

NHS REVIEW

... I enclose the Chancellor's paper on tax relief for discussion at Thursday's meeting of the Review. The Treasury's other paper - on financing hospitals - will be circulated separately, later today.

I am copying this letter and the enclosure to Sir Roy Griffiths, Geoffrey Podger, Jenny Harper (DHSS), and Richard Wilson (Cabinet Office).

Yours,
Moira

MOIRA WALLACE
Private Secretary

NHS REVIEW: TAX RELIEF

Paper by the Chancellor of the Exchequer

1. At the meeting on 7 June we agreed that:-
 - a. the question of restricting tax relief for the elderly to the basic rate should be looked at again; and
 - b. a more limited benefits-in-kind exemption, targeted on those with earnings below a specified level, should be considered.

This paper reports on both points.

Tax Relief for the Elderly

2. Providing tax relief for private medical insurance for the over-60s at basic rate only would benefit 300,000 existing policyholders at a deadweight cost to the Exchequer of about £25 million. Allowing relief at the higher rate, as well, would be of additional benefit to about one-quarter of this group - 75,000 policyholders. The Exchequer cost would rise to a little over £30 million. There would also be some additional administrative complication. That is because, while basic rate relief would be provided at source through a MIRAS-type arrangement, higher rate relief would have to be dealt with by tax offices, through individuals' PAYE codes or tax assessments.

The question is whether these additional costs are likely to be worthwhile.

3. Clearly, in principle, the higher the rate of tax relief, the greater will be the effect on behaviour of those who benefit: a 40 per cent relief is likely to bring in more new subscribers than a 25 per cent relief. But a 50 per cent increase in take-up would be needed before the extra money going into private health care exceeded the cost of tax relief, compared with an increase of 33 per cent if relief were given at basic rate only. Only those over-60s with incomes comfortably over £20,000 would benefit from this further concession: those with income below that level would gain nothing at all from higher rate relief. So, on the one hand, the additional impact of higher rate relief would be strictly limited; while, on the other, it will give further ammunition to opponents of the scheme.

4. There is a further complication with giving higher rate relief. In my previous paper I pointed out that it might be attractive to let tax relief flow to whoever paid the premiums for a person over 60, so there would be encouragement for people of working age to pay their elderly parents' BUPA subscriptions, and this was generally welcomed. But if higher rate relief were available in such a case, it could provide a strong incentive to dress up payments by the parent as payments by the son or daughter - regardless of the true position - thus adding to the cost of the relief. In order to guard against this abuse, some additional irritating safeguards would be unavoidable.

5. In conclusion, tax relief for the elderly at the higher rate would increase the complications of the scheme, and provoke unnecessary criticism. The closest precedent for health insurance premium relief, life assurance premium relief, was (and, for pre-1984

policies, still is) given at half the basic rate, for basic rate taxpayers and higher rate taxpayers alike.

Benefit in Kind Treatment

6. For company health insurance schemes, the suggestion was to raise the limit below which employees escape tax liability on this particular benefit in kind. Since company schemes at the moment are concentrated among the higher paid, this would have the advantage of reducing the deadweight cost and targetting the incentive where it is most needed.

7. I have therefore considered the possibility of raising the limit from its present £8,500 to something in the region of £20,000 - roughly the point at which higher rate income tax liability starts. It would mean that the proportion of employees who would be exempt from tax on medical insurance would go up from 17 per cent to 65 per cent at a deadweight cost of some £m25.

8. But while this approach has its attractions, it also has some further disadvantages to add to those relating to a general benefits-in-kind exemption which I described in my minute of 3 June.

9. First, having a second income limit would be a significant added complication for employers, increasing their administrative costs. The Revenue, in conjunction with the Deregulation Unit, is currently engaged in finding ways of minimising the compliance costs of taxing benefits-in-kind: this would be a move in the opposite direction.

10. Second, it would increase the pressure to raise the £8,500 P11D limit across the board. Our consistent

policy has been gradually to bring the tax treatment of payment in kind and cash into line by allowing the real value of the P11D limit to fall. The limit has not been increased since 1979. It is now widely recognised that it is anomalous to have any income limit in taxing benefits, and that it is right to let the present limit wither away. We are well on the way to success with this policy, since there are now relatively few full-time employees with cash pay plus benefits of less than £8,500. But there also continues to be pressure, as we have seen again in this year's Finance Bill debates, to increase the limit substantially. Setting a new limit for medical insurance - one of the commoner benefits-in-kind-would clearly add to this pressure, and make it more difficult to resist.

11. Third, it would add to the sense of unfairness already felt by those whose employers do not run a company health insurance scheme, or who are self-employed.

Benefits-in-kind and Relief for the Elderly

12. But if we decide to introduce a new tax relief for premiums paid for the over 60's, then we could, I believe, provide a parallel relief for the benefits-in-kind charge on corresponding premiums. The argument is exactly the same in relation to the over 60's as it is for employees and the self-employed generally - we should ensure that there is no difference in tax treatment between those who pay their premiums privately, and those who get them paid by their employers.

13. Including benefits-in-kind in the relief for the over 60s, and confining relief to the basic rate, would

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increase the cost, at current levels of provision, to £35 million and would benefit 65,000 employees as well as 300,000 individual policyholders. This is the most far-reaching tax package I would be prepared to recommend.