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From the Private Secretary

21 June 1979

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The Prime Minister has expressed concern about the current provisions for corporate stock relief. Her impression is that it has a distorting influence on company behaviour in that companies tend to increase their stocks unnecessarily at the end of the financial year; and this also results in a loss to the Exchequer. I would be grateful if you could let me have comments on this point. It would be helpful if you could also let me know what are the Chancellor's plans for reviewing Corporation Tax generally: the Prime Minister has expressed the view that Corporation Tax has become an "optional tax", and she thinks that consideration should be given either to abolishing it altogether or to making it operative.

The Prime Minister has also asked what progress is being made in devising a "standard of living" index, which will include tax as part of the cost of living. She considers the creation of such an index to be very important in the context of future pay negotiations, and I should be glad if you would let me have a progress report.

TPL

A.M.W. Battishill, Esq.,  
HM Treasury.





Original filed  
Gen. Pol. (Budget)  
Pt 2.

WJFS - Statistics  
Sir D Wain  
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Treasury Chambers, Parliament Street, SW1P 3AG  
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5th July 1979

Dear Sir,

In your letter of 21st June you asked for comments on points which the Prime Minister had made on stock relief and corporation tax. As a separate matter your letter also said that the Prime Minister had asked what progress was being made in devising a 'standard of living' index, which will include tax as part of the cost of living.

#### Corporation tax and stock relief

The Chancellor has already set in hand a wide-ranging review of the corporation tax system.

—Although stock relief has undoubtedly provided a good deal of help for industry, it is true that it is rough and ready and can to some extent be manipulated. For this reason it is already being looked at as part of the review; the Chancellor will certainly take account of the Prime Minister's observations.

Meanwhile, it would be wrong to understate the effectiveness of the corporation tax, although it is clearly uneven in its present form. It yielded nearly £4 billion in 1978-79, and is forecast to rise to nearly £5 billion in the current year. Certainly, it has been less buoyant than income tax. But this was in some aspects inevitable, with company profitability as low in real terms as it has been recently. Corporation tax remains the third largest revenue-raiser, after income tax and VAT.

Before bringing forward any proposals for change, the Chancellor will be consulting both with colleagues and with outside interests; and he will, of course, in due course be reporting to the Prime Minister.

/Development of

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### Development of a tax and price index

As for a 'standard of living index' a group of officials, with representatives of the Treasury, CSO, Department of Employment and the Inland Revenue under Ian Byatt's chairmanship, was set up to consider this question some time ago. It reported to the Chancellor early in June. The group report concluded that while it would be unacceptable to consider ceasing publication of the retail prices index (RPI), or changing the basis on which it is calculated, there was a strong case for developing supplementary statistics which would reflect more adequately the effect on the purchasing power of households of changes in the balance between direct and indirect taxes. The most fruitful approach seemed to be to develop a "tax and price" index. This appeared to fulfill the essential objective of Ministers in that it is an indicator which takes account both of movements in retail prices and in direct tax liabilities.

The group's general approach has been endorsed by the Chancellor. He has however stressed that the objective should be to construct a single overall index, rather than a number of indicators relating, for example, to different household types, income levels, etc. Officials explained that a number of technical problems remained to be resolved and that the development of an overall index which would stand up to critical examination, and therefore be credible, would take time. Nothing of this kind would be available before the autumn. However, while work on an overall index would continue, figures for specimen households could be prepared quite quickly and should be available for publication in time for the July RPI (which will reflect most of the effect of the Budget package), due to be published in August, and well in time for the start of the coming pay round.

The Chancellor asked the group to follow up this work with all speed, emphasising the critical importance of getting the presentational aspects right. For the next stage of the exercise the group will carry out calculations to show (for specimen households) how the index would have performed in the recent past, in comparison with the RPI and earnings indices, and how it is likely to behave over the next 12-18 months. The group will concentrate on the presentational aspects of the index and prepare a draft press notice. They hope to complete this next stage of the work in about a week. Ministers will then be in a position to make final decisions about publication of the index. A fuller report on the characteristics and properties of the index will also be prepared.

*Yours ever,*  
*A.M.W. Battishill*

(A.M.W. BATTISHILL)



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