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Mr Turnbull

To see of.

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31/12

MA

20 December 1984

Secretary of State for Trade and Industry

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1P 3AG

Rue Muntz

Mr Tebbetts budget

suggestions

D. Nigel.

25/12

1985 BUDGET

As usual at this time of year suggestions for changes in the tax regime for next year's Budget are pouring in from industry; and as ever they are very wide ranging. It may be helpful to you if I set out my priorities in the field of business taxation and other taxes as they affect business. Enclosed is a paper setting out these thoughts and proposals in detail. First, however, I would like to make a general point. I share your views on the desirability of reduced taxation as opposed to increased public expenditure and on the shifting of the balance between direct and indirect taxation. However, on the first point I hope you will not feel that no concession however small could be made without breaching the essential principle and that on the second you will not underestimate the power of the press to whip up a campaign which would spill over from the particular issue to a concerted long term attack on your policies.

2 The industrial backdrop to the 1985 Budget looks promising. Indeed, I understand that the CBI will not be urging on you this year - the first time in many years - a higher PSBR. That is encouraging; perhaps our message at long last is getting home. I therefore share your view that this time priority should be given to personal taxation. It is clear that industry is also of this view. But I would not want personal taxation to pre-empt all the head-room offered by the fiscal adjustment. While we have done much in recent years in improving the tax climate to encourage enterprise, industry and expansion, I am sure we need to maintain the momentum. In particular I am concerned to do what we can to ensure that the gains made in industrial performance are consolidated and built upon; only in that way will we achieve our objective of sustained expansion into the medium term.

3 I would recommend a number of industrial measures outlined

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below. I believe their importance will far outweigh their cost which will be relatively modest. I very much hope that you will be able to take up these suggestions in the 1985 Budget.

4 I would give priority this year to a group of measures designed to improve industry's research, development and innovation performance. As you know, I have had to announce a moratorium on SFI applications and the SFI Budget for future years will be cut back. These proposals therefore have additional importance in encouraging industry to take up a greater proportion of the cost of R&D. Within this package I attach particular importance to the retention of 100% Scientific Research Allowances for non-oil exploration research activity. I understand your concerns about these allowances being available to the oil companies for exploration activity, but I would have thought that this problem could be handled separately. It is essential that we do not throw out industrial research with the bathwater. The importance of R&D to the economy's future performance cannot be exaggerated and the case for retention, set out in the detailed paper, is powerful. To withdraw SRAs now would give industry completely the wrong signal.

5 The other R & D/innovation measures - more explicit definition of 'scientific research', qualification of R & D companies for the BES, allowing R & D expenditure by enterprises not yet technically carrying on a trade and capital gains tax exemption for hands-on venture capital companies - will all be helpful in raising the inadequate levels of R & D and innovation at very small cost. You will recall that I wrote to you earlier this year about the capital gains tax treatment of venture capital companies. Concern about possible abuse prevented action this year; but I understand that officials have now found a satisfactory way round the problem. I hope we can now end this double taxation anomaly in an area we are actively trying to foster.

6 I attach high priority to two measures affecting the City which will reinforce other steps we are taking to stimulate more competition and efficiency in the provision of financial services. First, a further halving of stamp duty on stocks and shares, with final abolition in 1986 to coincide with completion of the Stock Exchange reorganisation. This phasing of abolition will aid the orderly development of the market and usefully limit the cost in 1985/86, especially as the resulting increase in volume, as witnessed this year, should keep the cost to less than half the currently forecast tax take. It will further emphasise our commitment to wider share ownership. Second, the taxation of futures; here my proposal is that individuals and institutions' speculative investment in futures should be charged to capital gains tax. This will remove a current brake on the market, remove a distortion between types of investment and reinforce our



forthcoming White Paper proposals to remove anomalies in the regulatory framework.

7 My third area of priority is to give further encouragement to enterprise and small business. Since it is to the small business sector we must mainly look for net new employment, I am sure we should continue the practice of recent years in removing fiscal disincentives to small firm creation and expansion. David Trippier has already discussed some of our suggestions with John Moore.

8 In this area my top priority is the proposal to charge only basic rate income tax on undrawn profits of unincorporated traders; not only to redress the disadvantages to them of this year's corporation tax reform but also to remove a serious distortion between the incorporated and unincorporated sectors. This would provide an incentive to the self-employed trader to expand his business rather than his immediate income; and would increase the interest-free funds needed for growth.

9 I hope you will also consider favourably a number of other measures to help small firms including revalorisation of the VAT registration limit, hold-over relief for capital transfer tax on family businesses, improvements in roll over relief and indexation (or exemption limit) for capital gains tax, allowing the notional element of the self-employed Class 2/4 national insurance contributions against tax, some improvements to the BES and a change in the tax treatment of the Enterprise Allowance. I will write further about the Small Workshops Scheme when the results of our internal evaluation are available. The annex to the detailed paper sets out some further highly desirable, if more narrowly focussed, measures, such as the matter of VAT relief for bad debts, on which Alex Fletcher and Barney Hayhoe have been in correspondence.

10 There are three areas where I do not have specific proposals but where I would welcome an early sight of any changes you may be contemplating. I am particularly concerned about major changes in the tax treatment of pension contributions and lump sums which could have serious consequences for business through increased pressure on wages. Second, the tax regime on mining; and third, the taxation of groups where we need to keep a delicate balance between discouraging avoidance and genuine group trading behaviour.

11 Finally, on personal income tax changes, my strong preference which I know is shared by industry, is for help to be concentrated on raising the personal allowances in real terms to help alleviate the poverty and unemployment traps. Looking beyond the 1985 Budget I would hope that this encouragement to employment could be reinforced by changes in the national insurance contributions, their level as well as structure, to reduce this jobs-specific tax on business.

12 My officials are, of course, ready to discuss with yours any

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points which you may have on this letter and the detailed paper.

13 I am copying this letter and attachment to the Prime Minister, David Young and Sir Robert Armstrong.

A handwritten signature in cursive script, appearing to read 'Norman Tebbit', with a horizontal line underneath.

NORMAN TEBBIT

JH2AAY



1985 BUDGET

DTI REPRESENTATIONS

The industrial background for the 1985 Budget is encouraging. The recovery is well established and continuing, although it looks as if the growth rate of non-coal output will be somewhat lower in 1985 than 1984. Productivity is substantially higher than at the previous output peak; profitability of industrial and commercial companies has recovered rapidly, our international competitiveness has improved somewhat further and investment intentions for 1985 are buoyant. Industrial confidence, as reported by the CBI Industrial Trends Survey, is sustained with expected continued increases in exports and output.

2. Against that background and following the major changes to both the structure and rates of business taxes announced by the Chancellor in the 1984 Budget, industry agrees with the Chancellor's publicly stated view that priority in the 1985 Budget should be given to personal taxation.

3. But it is hoped that the fiscal adjustment as outlined by the Chancellor in his Autumn Statement will also allow scope for improvement in the business tax climate. While much has been achieved in changing attitudes and performance within industry and commerce over the past few years, much remains to be done. The tasks now mainly fall to business itself but Government can help by ensuring that the tax system acts to let markets work more effectively and to encourage efficiency, enterprise and competitiveness. Major progress was made in the 1984 Budget, in particular with the reform of the corporation tax structure, more favourable tax treatment of share options and reduction in stamp duty. And the measures introduced in recent years to encourage enterprise and small business have already resulted in a substantial increase in the self-employed and in expansion of the small firm sector. Yet important measures remain to be taken to maintain the momentum of industrial reform and the improvement in efficiency and international competitiveness which will be needed to sustain the recovery into the medium term.

4. The Department has examined carefully representations from industry and representative bodies in drawing up its priorities for inclusion in the 1985 Budget. The Department's carefully selected proposals are set out below in broad order of priority. Their cost, individually and in total, will be fairly modest.



RESEARCH, DEVELOPMENT AND INNOVATION

5. Within business taxation, the Department gives top priority to the encouragement of research, development and innovation.

Scientific Research Allowances

6. Scientific Research Allowances (SRAs) are the main form of encouragement in the UK for basic and applied research. Following the announced withdrawal of accelerated capital allowances on plant and machinery and buildings by the Chancellor in the 1984 Budget, SRAs are the one major case where accelerated capital allowances remain. The Chancellor has announced that SRAs are to be reviewed.

7. The Department believes that continuance of SRAs at 100% on non oil exploration activity is essential to continued improvements in international competitiveness and economic performance. Any action to restrict or withdraw the benefits of SRAs for oil exploration activities should not spill over into non oil company business. As to the eligibility of oil exploration for SRAs, it is difficult, logically, to defend the privileged position granted to oil compared with mining exploration.

8. For non oil exploration activity the case for continuance of SRAs at 100% is very strong:

i) R & D is particularly important in, as now, a period of rapid technological change. The future development and success of the economy will be dependent on our R & D performance. Technical specification and quality and reliability which stem from R & D effort will become increasingly important factors in international trade.

ii) There is a strong empirical link between success in the market and research intensity.

iii) Our civil R & D has consistently been below that of our major competitors. But there is a growing realisation by companies that they have not spent enough on R & D. Reduction of SRAs would do enormous damage to this arousal of interest in applied research. It would give business the wrong signal that the Government no longer considered R & D so important.

iv) The consequences would be particularly serious at a time when following this year's PES round, the Department's financial assistance under the Support for Innovation



programme will have to be cut back in 1985/6 and 1986/7. A moratorium on all new applications has already been announced.

v) The rationale behind the withdrawal of accelerated capital allowances in the 1984 Budget, which the Department supported, does not apply to SRAs. Removing the bias against the employment of labour, which was an important objective of the abolition of accelerated capital allowances, is not important as regards expenditure on research. The policy objective in fact is quite the reverse. There are severe shortages of skilled personnel in R & D, particularly in the information technology field. Better equipment helps both to compensate for shortages of experts and to increase the productivity of scarce research engineers.

vi) Then there are the classic arguments for the necessity of Government incentive in the R & D field; that market forces, left to themselves, will not produce an adequate level of research and development because:

a) the high risk and long term nature of much R & D makes companies unable or unwilling to raise finance on the scale required;

b) individual firms are often unable to keep the fruits of the research to themselves and therefore to recover the full cost. The benefits of research are spread widely.

vii) Whereas the announced reductions in capital allowances will remove distortions between sectors and bring the UK more in line with industrial competitors, reduction in SRAs would leave the UK with a much less favourable tax regime on R & D capital expenditure than competitors. Our major competitors are increasing their support for R & D and improving their R & D tax incentives.

9. There are a number of other measures which the Department sees as being particularly effective in stimulating research, development and innovation.

"Scientific Research" definition

10. At present the position is confused with companies never sure which development expenditure is allowable; and this uncertainty will become more serious with the withdrawal of accelerated capital allowances. Given the importance the Government attach to innovation and the use of research there would be important



presentational advantages in "research and development" rather than "scientific research" allowances. We are not asking for all development work to be included; product-specific development would be excluded. It would minimise the uncertainty, if the class of activity which is allowable were spelt out in greater detail along the lines of US legislation.

Business Expansion Scheme qualification for R & D companies

11. The proposal is to allow R & D companies to qualify for business expansion scheme relief, even though income may be received mainly as royalties. (Film production which falls foul of the royalties/licences provision was specifically included within the BES in the 1984 Finance Act). One way of overcoming Inland Revenue concern about possible abuse by "hobbyists" would be to require companies to be individually approved by the Secretary of State as qualifying under the BES. This measure would be particularly helpful in encouraging dynamic research teams to set up their own companies.

Earlier Offset of R & D Expenditures

12. Some of the problems associated with the long-term and risky nature of R & D could be lessened by allowing R & D expenditure by enterprises not yet actually carrying on a trade (as in the US, following *Snow v Commissioner*). This would be of particular help in stimulating R & D companies and R & D limited partnerships by allowing expenditures to be offset much earlier than is currently possible.

Capital gains tax exemption for hands-on venture capital companies

13. The hands-on venture capital industry needs to play an increasing role in the development of the small firm sector if the successful small firms are to make the transition to medium sized firms and beyond with all that entails for availability of finance and management expertise. Yet these hands-on venture capital companies, because of the disadvantage to them of "authorised investment trust company" and "investment company" requirements currently are subject to capital gains tax. They are therefore at a disadvantage in competing for institutional funds with investors in effect suffering double taxation.

14. The Secretary of State put forward a specific proposal to overcome this disadvantage before this year's Budget; but Inland Revenue were concerned about the possibility of tax avoidance. Since the Budget officials have examined ways of exempting those venture capital companies from capital gains tax which would be proof against abuse by individual portfolio investors. In the Department's view, a satisfactory solution



has been found, although it is accepted that it may be necessary for the Secretary of State to approve individual venture capital companies as qualifying for capital gains tax exemption. It is hoped that this overdue reform can now be included in the 1985 Finance Act.

15. Because this reform would mainly redirect institutional funds, it should result in little loss of tax revenue.

FINANCIAL SERVICES

16. The Department's reform of the City to stimulate more competition and efficiency in the provision of financial services will be to the benefit of both the financial sector itself and to business in general as users of financial services. Realisation of the full benefits of reform will be encouraged by two changes to the taxation of financial instruments and services.

Stamp duty on stocks and shares

17. First, a further reduction in stamp duty on stocks and shares to improve liquidity in the market and the market's international competitiveness; and to encourage wider share ownership. Substantial progress was made in the 1984 Budget with the halving of stamp duty to 1%; but the tax remains far higher than in other financial centres which raises dealing costs to uncompetitive levels and deters activity in UK markets. A particular concern has been the effect of stamp duty on the development of the American market in UK equities. Over the past year the American Depositary Receipt (ADR) market has become the main market for some leading UK equities. Although stamp duty is not the only factor underlying the growth in ADR trading, it has undoubtedly resulted in reduced volume on UK markets. The depressive impact of stamp duty on market liquidity has been only too clear. In 1983 the UK market had about the lowest turnover as a percentage of capitalisation, higher only than Milan and Singapore. But since the 1984 Budget Stock Exchange figures show that the average monthly turnover has increased from under £5 billion in 1983 to around £6 billion.

18. Reduction in stamp duty would also widen the appeal of share ownership, in particular to the small investor. It would usefully continue the higher levels of interest aroused in particular by the BT sale.

19. There are strong arguments for the abolition of stamp duty on stocks and shares, but in view of the substantial reforms that are taking place in the City abolition would best be achieved in two stages; a reduction of $\frac{1}{2}$ per cent in the 1985 Budget with final abolition in the 1986 Budget to coincide with the completion of



the reorganisation of The Stock Exchange. This phasing of abolition would have the additional advantage of spreading the cost, especially if it is not considered feasible to confine stamp duty changes to stocks and shares. Moreover, if this year's changes are any guide the increased volume resulting from halving the duty should result in a smaller tax loss in 1985/86 than half currently anticipated receipts.

Futures

20. The second financial services measure is reform of the taxation of futures, both commodity and financial futures. The current position of generally charging dealings in futures which fall short of trading to Schedule D income tax Case VI is severely limiting the development of the futures markets, particularly the new financial futures market, by deterring both institutional and personal investors. The purpose of the financial futures markets is to provide liquidity to the cash market, ie stocks and shares traded on The Stock Exchange. The development of a buoyant futures market is essential if the City is to be able to offer a comprehensive financial service, on which international competitiveness and overseas earnings depend.

21. The proposal is to charge to capital gains tax investments in futures by non-trading individuals and institutions. The charging of isolated dealings to capital gains tax is a useful precedent in establishing the principle that futures are capital assets, although it is recognised that, as a result of case law, primary legislation would be required to treat multiple dealings similarly. Capital gains tax treatment of futures, by putting them on an equal footing with the treatment of financial instruments (individual investments in stocks and shares are already charged to capital gains tax) would remove a distortion in the investment market. The forthcoming White Paper on financial services will, for its part, seek to remove similar anomalies in the current regulatory framework.

SMALL FIRMS

22. Continuing priority needs to be given to ameliorating the tax regime as it affects small businesses and, where effective, to using tax incentives to overcome the more important problems deterring their establishment and expansion. It is mainly to small businesses that we must look for the creation of net new jobs and the tax regime looms large in their decisions. A number of measures could usefully be taken in the 1985 Budget to maintain the momentum. The Department has considered a large number of possibilities but considers the following measures to have particular merit.



Reduced tax burden on undrawn self-employed profits

23. There is widespread dissatisfaction that this year's Budget seriously disadvantaged the self-employed. They lost the benefit of accelerated capital allowances but did not gain from the offsetting (in aggregate) reductions in corporation tax. While the self employed have benefited from the reductions in personal tax over recent years they are disadvantaged in one important respect compared with the tax regime on their incorporated competitors. Unincorporated businesses pay income tax at the individuals' (or partners') marginal rates on profits net of capital allowances and retirement annuity relief. So even if sums drawn for personal use are less than this, because profit is retained for investment for example, full taxation still applies. For companies, however, retained profits attract tax only at the corporate rate - now 30% for small companies.

24. The proposal is that undrawn profits should be charged at the basic rate of tax only. This would be of benefit to the growing unincorporated business whose main problem is often the raising of funds to finance expansion; it would provide an incentive for businessmen to expand their businesses rather than their immediate income; it would introduce greater neutrality into the tax system between the unincorporated and incorporated sectors; and it would be a useful presentational response to the perceived discriminatory impact of the 1984 Budget. The concession should be limited to traders falling within Case I Schedule D, and thereby exclude the professions.

25. We believe that this change is feasible both practically and presentationally. Practical difficulties and any increased accounting burdens on the self-employed should be minimal if the concession operated through a basic rate tax investment reserve. The proposal would mainly benefit the higher rate unincorporated taxpayer; but it is precisely this class of person that is disadvantaged relative to the incorporated taxpayer. But a measure of relief could be given to most basic rate Case I taxpayers if Class 4 NIC were relieved on undrawn profits. Restriction to Case I traders is justified because relatively few professional persons will have been disadvantaged to any significant extent by the withdrawal of accelerated capital allowances and stock relief. It is Case I traders, because of the nature of their business, who have been most seriously affected and where the balance therefore needs to be redressed. Restriction to Case I has the welcome additional advantage of curtailing the cost.



Raising the value added tax registration limit in line with inflation

26. Now that the Government has decided to take a robust line with the Commission to defend our past practice of maintaining the real value of the threshold at its 1 April 1973 level, the threshold should again be revalued; anything less would weaken the strength of our case with serious consequences. The revenue cost of revalorisation is very small but there is a major benefit to small businesses through lower administrative burdens. VAT administration is the most heavily felt burden by small businesses; it explains the popularity of non-registration even though businesses lose the ability to reclaim tax on inputs.

Capital Transfer Tax holdover relief

27. Under this proposal no CTT would be payable until assets are sold for cash or otherwise realised in a liquid form. Hold over relief would apply only in cases qualifying for business or agricultural relief. It would allow the transfer of a business by the proprietor to his chosen successor without any danger that the business will have to be broken up, or at least realised in part, to pay the tax. In spite of the measures which have been taken since 1979 to relieve the worst features of this tax, it remains a major headache to the substantial smaller firm and a discentive to expansion. In some cases it is still necessary to sell a proportion of shares or business assets to pay the tax; and a good deal of unproductive time and money currently has to go into planning for the tax.

Capital Gains Tax

28. Against the background of the proposed review of Capital Gains Tax, it is worth giving serious consideration to two changes. First, roll over relief, which at present applies only to business buildings and land, to fixed plant and to goodwill, could be extended to cover gains from the disposal of or into the acquisition of unquoted company shares which in effect represent the value of business assets. It is recognised that such a relief presents scope for abuse, but this could be controlled with appropriate legislation, along the lines applying to retirement relief, for instance. Second, reform of the indexing provisions is needed urgently. The present system is widely criticised as being too complicated and for not extending indexation retrospectively back beyond 1982, to the first 12 months ownership of any asset or to assets giving rise to losses. If it is not possible to tackle these criticisms directly, consideration should be given to raising the exemption limit substantially.



Taxation of self-employed NIC

29. To allow the notional employers' element in Class 2/4 national insurance contributions for tax, in line with secondary Class 1 NIC. It is sometimes argued that the whole of a self-employed person's contributions represent a payment for personal benefit and must therefore be disallowed on basic tax principles; and further that if the self-employed person takes advantage of the ability to take tax-relieved contributions to a pension plan to make up the difference between his and an employee's pension, the proportion of total contributions attracting relief for the self-employed person compares favourably. But it remains the case that there is an inconsistency between allowing Class 1 secondary contributions for tax but not the Class 2/4 analogue, even though the notional employer's element can easily be identified. And many of the self-employed, not unreasonably, choose to provide for their retirement from the eventual disposal of their business rather than paying into a pension plan. Current practice acts as a disincentive to becoming self-employed.

BES

30. We continue to believe in the importance of continuity and we are not therefore attracted to fundamental changes in the Business Expansion Scheme; such as the CBI's proposal for Small Firm Investment Companies. But three changes within the current BES framework would be helpful:

- to modify the rule that requires the wholly owned subsidiaries of a claimant company to be all themselves UK resident and carrying on activities wholly or mainly in the UK; so that the test would be whether the Group as a whole carried on its activities mainly in the UK. The current legislation excludes many companies where it is essential to have a US registered subsidiary, but where the benefit of relief would be UK production and employment;
- to reduce the relevant period, during which a company benefiting from BES relief must remain unquoted, from 3 years to 2 years. This restriction can hinder the growth of the very high risk but high growth companies.
- to increase the maximum qualifying investment an individual can make in any one year from £40,000 to £45,000.



Taxation of Enterprise Allowance

31. The Enterprise Allowance should be charged to tax as a separate item within Case VI Schedule D. Payments under the Enterprise Allowance scheme count as taxable trading income. This means that as a result of the special rules relating to the assesment of newly commenced businesses, these payments can be included in profits which form the basis for 3 years of assesment; so that the tax paid on them can be almost as much as the allowance itself. This is unsatisfactory and could be quite damaging to the Scheme if this particular quirk in the tax law became highly publicised. If the second and third years' profits on an "actual" basis are less than those computed from the first year, the taxpayer may elect to be taxed on the former. But in practice the opening year's profits are usually low and the commencement basis provides useful help to the new businesses; help which is effecively reduced through multiple taxation of the enterprise allowance.

32. The Small Workshops Scheme is due to end on 26 March 1985. There is a case, as with Enterprise Zones, for retaining certain specific generous reliefs designed to achieve particular aims. The Small Workshops Scheme has worked well. The Department is curently undertaking a study to determine whether there is a case for expending it further or whether it has achieved its purpose. The results should be available shortly.

33. Some additional useful but more technical proposals to encourage enterprise and small firms are considered in the Annex.

VAT

34. Mr Fletcher has already written to Mr Hayhoe proposing a change in bad debt relief to allow relief from output tax not received from companies in receivership; and there has been a sdbussequent exchange of correspondence. Inclusion in the 1985 budget is important because the changes would remove the incentive to creditors to petition for a company to be wound up and ensure consistency with the Cork proposals on insolvency law reform.

35. There has been a huge number of suggestions for relief from the ending of the postponed accounting system for the payment of VAT on imports. Nearly all the suggestions would be costly and probably illegal under Community law. But one proposal - relief for goods "imported" from overseas owners solely for repair and maintenance - is worth serious consideration if effective provisions could be introduced without great complexity.

DTI

December 1984



ANNEX

ADDITIONAL SMALL FIRMS MEASURES

1984 Share Option Scheme: Participation Limit

1. The "material interest" definition in the legislation should be raised to 25% for unquoted companies. The current 10% limit on participation, while a welcome relaxation from the original 5% limit, still discriminates against smaller companies with limited equity capital. Executives of many smaller unquoted companies are currently disqualified from taking advantage of the Scheme.

Interest Relief For Employee Controlled Companies

2. The special interest relief for employee controlled companies introduced in the 1983 Finance Act has been helpful; but the relief is available broadly only where the shares are acquired within twelve months after the company becomes employee controlled. Without creating a precedent for a general relief for employees taking out loans to invest in the companies in which they work, it would be helpful to extend the employee buy out relief so that all new employees in an employee controlled company have the chance to make use of the relief upon joining. The relief might be extended to all employees within twelve months of taking up employment with an employee controlled company.

Disincorporation Reliefs

3. While it is fairly easy for an unincorporated business to become a company without tax penalty, movement from company to partnership or sole trader is penalised. Appropriate reliefs - for retention of losses brought forward, and in respect of Capital Gains - exist for businesses incorporating, but not for those going in the reverse direction. There appears to be no good reason for this other than the need to find legislative space, and appropriate reliefs should be introduced.

Associated Small Companies

4. The problem of associated companies sometimes paying extra tax because they are unable to choose how the small companies' tax rate band should be spread among them has long been recognised. The Green Paper 'Corporation Tax' drew attention to certain administrative difficulties in overcoming this problem, but given the will these should not be insurmountable. Now that Corporation Tax will continue in substantially its present form for the foreseeable future, action should be taken to deal with this anomaly.



Share Option (Finance Act 1980) and Share Incentive (Finance Act 1978) Schemes

5. A particular problem arises with both these reliefs where, for good commercial reasons, usually connected with the presence of an institutional shareholder, there is more than one class of share. The different classes usually arise from genuine differences in interest between institutional and employee shareholders, rather than from a wish to manipulate the tax system. The legislation requires that, where there is more than one class of share, the class held by employees should be owned in the majority by persons other than employees. It should be possible to deal with this problem by substituting a rule which requires that the employee shares should, in the material respects, have no better rights than other shares.



20 DEC 1984



CABINET OFFICE

70 Whitehall London SW1A 2AS Telephone 01-233 3299

From the Minister without Portfolio
The Rt Hon Lord Young of Graffham

CONFIDENTIAL

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

21 December 1984

Nigel

Norman Tebbit has sent me a copy of his letter of 20 December to you covering his paper which sets out the Department of Trade and Industry's suggestions for the 1985 Budget.

I would like to associate myself with his various suggestions which seem to me to be exactly on the right lines. I very much agree with him that in framing your proposals you should have very much in mind the interrelated questions of the tax threshold and the poverty trap problem. I know you are well seized of the point and I do not wish to labour it but if you can do something about these then a great deal more will follow automatically.

In addition to this general point I have a couple of specific suggestions. My first concerns the extension of the provision for tax allowances for equipment donated to schools, ITECH's, polytechnics and universities. These institutions are crying out for the latest CAD equipment, CNC machines, and other computer items. It is vitally important for our economic future that trainees and students have experience of working with new equipment. Our institutions, and their students, know that their opposite numbers in our competitor countries such as the USA and Japan benefit from a flow of "state of the art" equipment from manufacturers while they have to make do with out of date equipment. Indeed, in a number of areas it is even worse than this because since development is so fast-moving new items are available which are capable of performing functions which old equipment simply cannot do. Our trainees and students need the latest examples to train on if we are going to be able to hold our own with our competitors. Increasing the flow of donated equipment would help here.

As I understand the position, our companies can already claim as tax deductible the cost price of equipment they donate to educational and training institutions. This provision is fairly

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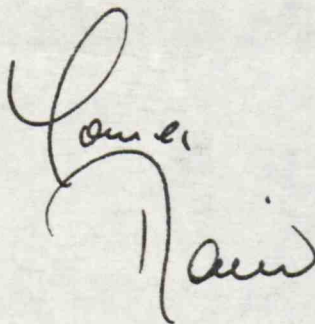
The Rt Hon Nigel Lawson MP

21 December 1984

widely used by equipment manufacturers but, even so, there is a long way to go before we approach the level of donations which companies in the USA make to their educational and training institutions. Our universities, polytechnics, colleges, etc are desperately short of up to date high tech equipment and there is evidence that the expansion of technical and vocational education in schools is being slowed down by lack of equipment. There seems to me a strong argument for following the US system by allowing a profit element (in whole or part) as tax deductible. This may be alien to one or two of our tax law traditions but, in a number of fields, including taxation, we are making radical changes and I would hope that you would be able to take this point on board.

My second suggestion concerns the extension of BES to companies building housing for rental. I know that you want to leave the BES alone as far as possible but we do need to stimulate the rented sector. I am particularly seized of the importance of developing a vigorous rented sector because of the benefits which would follow in terms of improved mobility of labour. I would hope that you and your officials could devise a modest extension to BES which would not create a major loophole.

I am copying this letter to the Prime Minister, Norman Tebbit, Keith Joseph and Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to read 'Nigel Lawson'. The signature is written in a cursive style with a large initial 'N' and 'L'.

Elon Pa

1985 Budget





25th April 1984

BARCLAYS BANK PLC

ANNUAL GENERAL MEETING

The Annual General Meeting for 1984 of Barclays Bank PLC commenced at 2.30 p.m. on Wednesday 25th April 1984 at the Head Office of the Bank, 54 Lombard Street, London, E.C.3, with Sir Timothy Bevan (the Chairman) presiding.

In his opening remarks, the Chairman said:

"Before calling for questions on the Report and Accounts, there are a number of matters on which I think Stockholders would like me to comment:

1) Group Reorganisation

First of all, I think I should bring you up to date on where we are with our Parliamentary Bill which, if approved, will lead to the effective merger of Barclays Bank PLC and Barclays Bank International Limited. The Bill attained its Second Reading after a debate on 29th February. Two petitions were lodged against it, one by the Banking Insurance and Finance Union. The Barclays Group Staff Union had previously reached a decision to give support. I am pleased to say that the petitions have now been withdrawn and the Bill has passed the Committee stage and, subject to passing the Third Reading in the House of Commons, will go through a similar process in the House of Lords. We expect that the Bill will obtain the Royal Assent in good time to allow implementation of the effective merger of the two banks on 1st January 1985.

2) Securities Industry

Secondly, I ought to report an important development with regard to the securities industry. We announced on 12th March that we had reached agreement in principle with Wedd Durlacher Mordaunt and Co and with de Zoete Bevan that Barclays would take a stake in each firm with the object that, if Stock Exchange rules permitted, these might increase to 75%.

As Stockholders may be aware, the current Stock Exchange rules restrict us to a maximum of 29.9% in one firm and a maximum of 5% in a second firm. Arrangements are being completed to enable the Group to become a limited partner holding 29.9% in Wedd Durlacher with effect from 28th April 1984. This involves us in injecting additional funds of some £6.0m in capital and in making a loan to the Partnership of some £23.9m.

We hope to conclude negotiations with de Zoetes with the intention, as I have mentioned, that the Barclays' stake should be raised eventually to 75% when and if rules permit.

As we said at the time of the announcement, we see these investments as forming the core and basis of the development of a powerful new British based international securities company supported by Barclays' extensive worldwide resources and network, coupled with the long-established experience of Wedds and de Zoetes. We are convinced that this is an important investment for the future.

I would only add that nothing in these plans is intended to reduce the present freedom of our customers to choose their own brokers.

3) The Budget

The recent Budget statement has important implications for your Group.

Firstly, in respect of the so-called "composite rate", from 1st April 1985 notional income tax on deposit interest will be deducted at source in the same way and at the same rates as apply to building society interest. We have made it clear that this is entirely contrary to the recommendations of the Wilson Report on the Financial Institutions which was published in 1980 and the report last year of the National Consumer Council, both of which recommended that the tax differences between deposits in building societies and banks should be removed by the abolition of the composite rate. We have also made it clear that we deplore the introduction of a system which means a reduction in interest received by many of our customers who do not themselves pay tax and who will be unable to reclaim it. In addition, there are some very

substantial costs in computer work and in staff time involved in the changeover to the new system. We are continuing to make representations on this subject.

Secondly, the Chancellor's intended changes to capital allowances will, if given Parliamentary approval, affect your Group in two ways, both in respect of the Bank's own investments in capital equipment, and, more importantly, of the leasing business of our subsidiary, Mercantile Credit Company.

First year capital allowances of 100% have been in existence for many years and we have followed standard UK accounting practice in allowing the benefit of the reduced taxation payable each year to be added to our reserves. However, as a matter of prudence we have maintained a provision of 25% of the potential deferred tax liabilities in respect of our UK leasing business. We have kept Stockholders advised of this treatment and in the 1983 Accounts we reported that the amount of potential taxation liabilities not provided totalled £827m at the end of last year. The effect of the change proposed in the Budget is that a significant part of this deferred taxation is now likely to become payable over the next ten years or so and we have therefore decided to raise in the 1984 Accounts an additional provision to meet likely future payments. Another implication is that certain of our leases have clauses which allow rentals to vary with changes in tax rates.

The calculation of the effects of these Budget changes is very complicated and, whilst we are not yet in a position to determine the precise figure, our current estimate is that taking into account reductions in the rate of Corporation Tax we would expect to provide up to £550m which will be met out of our accumulated reserves.

The tax will, however, be payable over quite a considerable number of years and, until such time as payments are made, the money will remain available to support our business.

I should add that this is certainly not the end of leasing business. Leasing existed before 100% capital allowances began and will continue to have attractions, irrespective of the amount of tax benefits, to many customers who wish to finance the acquisition of capital equipment in this way.

4) Capital Adequacy

I think that you would like me to give you some reassurance on the Capital Adequacy of your Group in the light of these remarks. In my report I stressed that last year we were able to increase our capital resources by over £700m. Already this year we have increased our loan capital by a successful raising of \$350m on the Euromarkets. I can confirm that we are thus in a strong position to make the provision for deferred taxation to which I have referred and to support the continued growth in our business.

5) Dividend Payments

Finally, I would like to say just a few words about the timing of dividend payments. Stockholders may have read a note in the Report of the Directors saying that we are giving consideration to the possibility of bringing forward the timing of the dividend which in recent years has been paid in mid-May. This follows a number of requests made by Stockholders and we hope that there will be general support for payment of a second Interim Dividend in place of the Final Dividend shortly after the end of the income tax year 1984/85. Thus Stockholders may expect the first Interim Dividend for 1984 to be paid as usual in early October and the second Interim Dividend to be paid on or just after 9th April 1985."