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PRIME MINISTER

BUDGET PROPOSALS

You already have my Budget proposals for indirect taxation. This minute covers my other tax proposals.

2. My room for manoeuvre this year is limited, but that should not be allowed to stand in the way of a range of useful measures to encourage enterprise and employment. In addition, I wish to carry further the process of tax reform started in last year's Budget.

Income Tax

3. I am sure it is right to put the main emphasis, as last year, on raising tax thresholds. This improves incentives for the low paid and takes many people out of tax altogether. I have it in mind to raise the main personal allowances by 9.2 per cent, twice the amount required by indexation. This would mean an increase of £190 in the single allowance, to £2,195, and £290 in the married allowance, to £3,445. These increases would cut tax by £1.10 per week for a basic rate single taxpayer and £1.67 per week for a married man paying tax at the basic rate. They will take about 800,000 people out of tax compared with no increase and 350,000 compared with indexation.

4. As last year, I propose to revalorise the higher rate thresholds and bands in line with inflation, but no more. I propose to make the same cash increases in the age allowance as in the main personal allowances. This is more generous than last year, when these increases were restricted to indexation, but still concentrates the biggest proportionate increases on the working population.

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5. These changes will cost £670m in 1985-86 and £860m in 1986-87.

National Insurance Contributions

6. In addition, however, and as a wholly new feature this year, I have in mind a major restructuring of National Insurance Contributions, without in any way departing from the contributory principle. The object of this is to improve job prospects at the bottom end of the pay scale, where such encouragement is most needed.

7. A major defect of the present system is the way in which the Lower Earnings Limit, at present £35.50 a week, operates for employees and employers alike. For an employee on £35 a week there is no NIC to be paid either by the employer or the employee. But at £36 a week the employee has to pay £3.24 a week in NICs (9 per cent of £36) and the employer £3.76 a week (10.45 per cent of £36). This abrupt entry to NIC liability is a disincentive to the employee to work, and the employer to take people on, at these levels.

8. I believe the answer is to retain the LEL at £35.50 but to taper the approach to the full rates for employee and employer alike. Thus for a worker earning between £35.50 and £55 a week the rate would be only 5 per cent on total earnings for employee and employer alike; between £55 and £90 a week it would be 7 per cent on total earnings for employee and employer alike, and between £90 and £140 a week it would be 9 per cent for employee and employer alike. Thereafter the employee would continue to pay 9 per cent up to the upper earnings limit of £265 a week, as now; but the employer would pay 10.45 per cent, without any upper earnings limit. The abolition of the anomalous upper earnings limit for employers is of course necessary to

contain the cost of the restructuring. But while it would increase the cost of employing the higher paid, this would be (slightly) more than offset by the reduced cost of employing the lower paid.

9. There would be a compensating benefit for the self-employed, who would have their flat-rate Class 2 contributions reduced from £4.75 a week to £3.50 a week.

10. The scheme could not start until 1 October and as from April 1986 the benefit to the public sector would be clawed back, as we did for the National Insurance Surcharge. On this basis the total cost of the restructuring, which I have agreed with Norman Fowler, would be £200m in 1985-86 and £530m in 1986-87. I would expect it to have a very positive effect on employment. The combined effect of the income tax and NIC changes amount to a total relief heavily weighted in favour of the low paid.

Business Taxation

11. Last year's Budget contained a thoroughgoing reform of corporation tax, so little change is needed here this year.

12. Following the phasing-out of 100 per cent first year allowances, the new structure of capital allowances allows most plant and machinery to be written off for tax over a reasonable period of time. But I recognise that there is a particular problem so far as short life assets are concerned. I therefore propose that companies should be able to take such assets out of the general capital allowances pool. This will ensure that assets scrapped within 4 to 5 years of acquisition will be fully written off within that period. It will be of particular help to high technology industries, where plant and equipment tends to become obsolete more quickly. I shall

also be announcing the retention of the 100 per cent allowance for scientific research.

13. I have two detailed changes to propose in the successful Business Expansion Scheme. I intend to extend its coverage to R&D companies, as a further measure of support for research and innovation. But I also intend, to counter some well-publicised abuses, to provide that property development should no longer be a qualifying trade. Building and construction generally will however remain within the scheme.

14. As last year, I propose to increase the scale charges for assessing the taxable value of the benefit of company cars by 10 per cent. This will still leave it well below the actual value of this benefit.

15. I also have it in mind to encourage the growth of profit sharing schemes by reducing from 7 years to 5 the period after which there is no income tax liability on an employee's shares.

16. So far as oil taxation is concerned, I expect to agree some minor changes with Peter Walker within the next few days.

Tax Reform

17. Last year's tax reforms were widely welcomed. I propose to take the process of reform further in this Budget, although on a more modest scale.

18. Last year I was unable to do anything about Capital Gains Tax and announced that I hoped to be able to tackle it in 1985. I now propose to do so, by building on, and remedying the defects of, the indexation relief introduced by Geoffrey Howe in 1982. This relief is incomplete in three important respects:

First, the indexation formula excludes the first 12 months
of inflation altogether;

Second, the indexation does not apply to losses carried
forward;

Third, assets acquired before 1982 are particularly harshly
treated, since the post-1982 indexation formula is applied
not to their value in 1982, but to their original
acquisition cost.

19. I propose to remove all these defects and leave a fairer
and simpler tax. The package has to a considerable extent
been made possible by the action I took on bond washing last
week.

20. I propose to sweep away completely a number of tiresome
minor stamp duties, including in particular one on gifts.

21. I also propose to abolish Development Land Tax. After
taking account of the consequential effects on other taxes
the cost is only £20m next year and £50m in a full year.
Sweeping away this tax will encourage the bringing forward
of land for development, assist the construction industry,
and enable us to dispense with some 200 pages of the Statute
Book.

22. Finally, and something to which I attach particular
importance, I wish to announce the publication later this year
of a Green Paper putting forward a major reform of the personal
income tax system. I shall be letting you have a summary of
the proposed Green Paper within the next few days.

Minor Measures

23. These will include:

(a) Some action to tighten up the tax rules applying to partnerships. You will remember that I consulted you about the document we issued last year in the light of the well-founded PAC criticisms. The proposals were not badly received and they will not interfere with normal business operations or add to compliance costs.

(b) Bringing new mortgages above the tax relief ceiling into MIRAS with effect from April 1987 at latest. This will produce useful administrative savings without in any way affecting liability to tax.

(c) Extension of the Capital Transfer Tax exemption for amenity land surrounding historic houses. This will be warmly welcomed by the heritage lobby who have campaigned for a relief in this area for some time.

(d) An increase from £5,000 to £10,000 in the limit to which relief at the higher rates of tax is allowed to individuals for covenants to charities. This will continue our record of gradually extending the tax reliefs which encourage giving to charities.

Total Cost

24. The total revenue cost of the direct tax and NIC changes amounts to £950m in 1985-86 and £1,390m in 1986-87, over and above indexation. The increases in indirect tax which you have already agreed reduce those figures to £650m and £1,040m respectively. On top of that, however, there is the public

expenditure cost of the proposed improvements to the Youth Training Scheme and Community Programme, amounting to only £75m in 1985-86 but some £300m in 1986-87. I attach a table showing the broad breakdown.

PSBR

25. As you know, the biggest problem I have this year is the need to accommodate - and explain - a £2½b a year increase in our latest estimates for public expenditure. Nevertheless, despite this, I believe I can accommodate the £¼bn of tax cuts I am proposing within a published PSBR of some £7bn, or 2 per cent of GDP, as foreshadowed in the 1984 Red Book, with a safety margin of as much again. This compares with a PSBR for the current year which is likely to be as high as £10¼bn, partly of course as the result of the coal strike.

26. While this year's measures will be something of an anti-climax after last year's, and the scale of the tax cuts will disappoint many of our supporters, they are I believe well attuned to a particularly difficult set of circumstances and can be presented very positively. However, provided we allow no further slippage on the public expenditure front, the prospect is distinctly better for the remaining Budgets of this Parliament.

N.L.

N.L.

7 March 1985

BUDGET SECRET**NOT TO BE COPIED**Revenue Effects of Budget Changes (£m)

| | <u>1985-86</u> | <u>1986-87</u> |
|-----------------------------------|----------------|----------------|
| Employer NICs | -70 | -140 = |
| Employee NICs | -100 | -290 = |
| Self-employed NICs | -30 | -100 |
| Tax relief for self-employed NICs | -25 | -55 |
| Income Tax | -670 | -860 = |
| CGT: Indexation extension | - | -50 |
| Bondwashing | - | +150 |
| DLT Abolition | -20 | -40 |
| CTT and Stamp Duty | -20 | -25 |
| Other Direct tax changes | -15 | +20 |
| | <hr/> | <hr/> |
| Total direct tax & NIC changes | -950 | -1390 |
| | <hr/> | <hr/> |
| Indirect tax changes | +300 | +350 |
| Public expenditure | -75 | -300 |
| | <hr/> | <hr/> |
| Total | -725 | -1340 |
| | <hr/> | <hr/> |

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