



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Prime Minister
You might also
raise this with
M. Delors.

CDP
21/5'

xref

FOREIGN AND COMMONWEALTH SECRETARY

**THE PRIME MINISTER'S INITIATIVE ON DEREGULATION IN THE
EUROPEAN COMMUNITY: OUR VAT THRESHOLD**

As you know, the Prime Minister raised this question with Arthur Cockfield when they met on 1 May. Arthur's response was to suggest that I might raise the matter with my ECOFIN colleagues in order to seek their support for a higher threshold.

2. I intend to follow up this suggestion and am planning to air the question at the July ECOFIN. My approach will be to place the question firmly on the political level and to argue strongly for greater flexibility to mitigate the impact of VAT on small businesses. Most Member States recognise the difficulties in this area, in that special arrangements are a feature of their VAT systems, whether for small traders generally or for individual sectors (like farming) that would be particularly hit by the regulatory burden of the full tax system. Our chosen path is to ease the administrative load by simply excluding many small firms from the VAT net; but this approach is not qualitatively different from the schemes employed elsewhere. Without freedom under Community law to set our exemption threshold at the optimum level for the prevailing economic circumstances, the European Community would be seen in this country as directly hampering job prospects.

3. If the Council is prepared to lend a measure of support, we shall be able to put increased political pressure on the Commission both to propose suitable amendments to the present Community VAT law and to set aside their legalistic challenge to the present level of our threshold. It would be helpful if you were able to reinforce this message when you meet Delors on 24 May. I shall equally take advantage of opportunities over the next few weeks to underline the importance of this matter.

CONFIDENTIAL



... 4. I enclose a background brief on the VAT threshold issue which you may find helpful next week.

5. A copy of this minute goes to the Prime Minister.

A handwritten signature in black ink, appearing to be "N.L." with a horizontal line underneath.

N.L.

17 May 1985

**THE PRIME MINISTER'S INITIATIVE ON DEREGULATION IN THE
EUROPEAN COMMUNITY: OUR VAT THRESHOLD**

BACKGROUND BRIEF

Current UK threshold

- raised to £19,500 in 1985 Budget
- equivalent in real terms of £5,000 limit set when VAT introduced in 1973
- this revalorisation is consistent with UK interpretation of 6th Directive, now disputed by Commission

Threatened infraction proceedings

- Commission maintain we can revalorise only from May 1977 (when 6th Directive was adopted)
- this would reduce current threshold to £14,815
- Commission considering whether to issue Reasoned Opinion, as preliminary to case before European Court
- Law Officers advise we would be likely to lose

Harmonisation of thresholds

- independently of infraction proceedings, Commission favour harmonisation of thresholds in all Member States
- likely to propose 10,000 ECU (about £5,800)

Prime Minister's initiative

- Prime Minister launched 'deregulation' initiative at March European Council to relieve small businesses from burdens of EC legislation

CONFIDENTIAL

- considerable pressure in UK to maintain or increase VAT threshold; part of Prime Minister's initiative
- aim, on VAT, is to achieve flexibility to set UK limit in light of economic circumstances

Arguments for flexibility

- all Member States face problem of small traders, but cope in variety of ways - eg low exemption limits and graduated tax schemes, no exemption limit but special flat rate schemes
- no evidence that variety of solutions affects competition in Community
- for example, most Member States have simplified schemes for farmers; but UK and Denmark - with larger and more efficient farming units - do not need them. Conversely, UK and Ireland choose to keep more very small traders out of VAT net than other Member States. And Italy now proposes flat-rate arrangements for up to 94 per cent of all its taxable traders
- this demonstrates economic circumstances very different from one country to another. So harmonisation would fly in face of economic reality

UK aims

- convince Commission and Member States of need for flexibility and reassure them that distortions of competition (and own resources payments) will not follow
- argue for freedom and set exemption limit at higher level (up to, say, £50,000), and keep it there, if desired, in real terms
- challenge infraction proceedings on political grounds (is it really Commission policy to impose unnecessary uniformity and stifle enterprise at vital small business level, thus damaging prospects for jobs?)

21 MAY 1985

in 172 ii
9 1 24
But 4 38