



Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

Prime Minister &

PRIME MINISTER

BUDGET PROPOSALS

The Chancellor has already mentioned most (perhaps not all) of these proposals to you. Content? *ARS 5/3*

You already have my Budget proposals on indirect taxes. I still have to reach a final view on income tax, in the light of the latest economic forecast, which I shall want to discuss further with you when we next meet. This minute covers my remaining tax proposals, none of which depend on what is done on income tax. In addition, as you know, I am discussing with David Young a package of public expenditure measures to help the long-term unemployed, on which I hope to be able to report early next week. The cost of these will be met from the Reserve.

None of the measures described below will have significant effects on revenue next year. Taken together, they are more or less revenue-neutral. But overall they should help to encourage enterprise and improve the performance of the economy - and hence, of course, employment. In particular, I have been concerned to devise measures which carry further forward the themes of my previous Budgets.

Business and Enterprise

First, measures for business and enterprise. The Business Expansion Scheme is due to end next year and I have been reviewing its future with the help of a report from Peat Marwick. This report confirms that the BES has been an outstanding success in its aim of attracting new equity capital into unquoted companies, a high proportion of them new



and small businesses. I therefore propose to continue the Scheme indefinitely. At the same time I feel I must take action to prevent abuse of the Scheme by excluding from its scope companies holding more than half their assets in the form of land and buildings and certain other activities which are threatening to bring the BES into disrepute (eg. investment in fine wines). These exclusions will serve to target the scheme more firmly on risk investment. I propose at the same time to improve the scheme further, by exempting BES shares issued after Budget Day from Capital Gains Tax on first sale.

My major proposal in this field is on Capital Transfer Tax. I intend to abolish the tax on lifetime gifts, which has had a particularly damaging effect in locking up assets and impeding the mobility of capital. You will recall the fierce attack we mounted on the taxation of lifetime giving when it was first introduced by Labour in 1974. This cost will be £35m in 1986-7 and £55m in 1987-8. The charge on death would of course remain, supported by a tapered charge on gifts made within seven years of death. In recognition of the radically changed nature of the tax I propose to rename it the Inheritance Tax. This will, in effect, be the fourth tax abolished since 1983. I believe this proposal will be warmly welcomed by all those who own and run family businesses. — The Unquoted Companies Group will feel it doesn't go far enough.

I shall also be proposing a number of smaller measures to help business, including the extension and improvement of the Loan Guarantee Scheme, under which the Government guarantees bank loans to small and new businesses. In addition, I am planning to announce that we will embark on very preliminary discussions with employers and others about the feasibility of devising incentives for profit-sharing agreements in industry, perhaps through some temporary measure of tax relief, as a means of increasing the flexibility of the labour market.

*Prime Minister
Is "Inheritance
Tax" a
good name.
Shades of
"Death"
Duties.
NLU*



As last year, I propose to increase the scale charge for assessing the taxable benefit of company cars by 10 per cent. At the same time, in response to representations from the motor industry, I shall be changing the engine scale break points to come into line with the break points in the new European Community directive on exhaust emissions. The fuel scale will remain unchanged but, as from April 1987, it will also be used to assess the VAT due on petrol used by registered traders and their employees.

I should also like to rectify an anomaly in the taxation of overseas entertainers and sportsmen visiting the UK. In virtually every other major country - including the US, Germany and France - a tax is imposed on visiting British entertainers and sportsmen. There is no reason to give foreign visitors here more favourable treatment than British visitors receive abroad. If the necessary legislation can be drafted in time, I propose to impose a withholding tax of 30 per cent on the earnings of these people. The change will bring in extra revenue of up to £100 million in 1987-8. No doubt there will be complaints (although most of the tax will be at the expense of Revenue authorities overseas) but there is an indisputable case for taking this action and the best time to do so is now.

This has to be right - but it will increase the pressure for greater support for the Arts Council.

Savings and Investment

There is clearly a very strong case for reducing - if not abolishing altogether - the Stamp Duty on equities to coincide with the Stock Exchange's Big Bang in October. With no tax at all on share transactions in New York and only half a per cent in Tokyo, the current rate of duty of 1 per cent threatens to make London uncompetitive in the fast developing world market for financial services. If London cannot win a major share of



the global securities market its present world pre-eminence in other financial services will be threatened. I would therefore like to cut the rate to $\frac{1}{2}$ per cent in October. But I believe it would be politically awkward in the present climate of opinion about the City to reduce the overall contribution which financial services make to the Exchequer. I therefore propose to recoup the entire cost of the rate reduction by applying the duty to other transactions which currently escape it, such as intra-account transactions and takeovers and mergers. There will also be a special rate of 5 per cent on the conversion of UK shares into American Depository Receipts, the method increasingly used to escape Stamp Duty and transfer dealings abroad.

This change will have the incidental benefit of reducing the cost of share dealings by individuals. But I am anxious to find more immediate ways of promoting our policy of encouraging direct share ownership by individuals. I therefore intend to propose a radical new scheme under which individuals can invest up to £2,400 a year in equity shares to be held in a special account known (unless I can think up a better name) as a Personal Equity Plan. While in the Plan investments will be entirely free of all capital gains tax and income tax on dividends. They need be held only for a short qualifying period (under two years) before they can be withdrawn tax-free. The cost will be negligible in 1986-7, and about £25 million in 1987-8. The cost in later years will depend on take-up, but it is bound to rise. I am sure that over time this measure will dramatically extend share ownership in Britain, just as the rather different Loi Monory has in France.

I plan to announce in the Budget Speech my intention to introduce in next year's Finance Bill provisions which will, in effect, give personal pensions the same highly favourable tax



treatment as is enjoyed by other funded pension schemes. I shall reiterate the assurance I gave last year, that I have no plans to change that favourable tax treatment in any way. But I do need to clarify the Revenue's discretionary rules for dealing with the growing problem of pension fund surpluses. As inflation has fallen and the climate for investment has improved, many pension funds have become heavily, and undesirably, over-funded. This is now attracting some attention in the press. Excessive surpluses are a clear abuse of the tax privileges enjoyed by the funds. Nor are they in the interests of pension fund members who are denied the higher benefits or lower contributions they might otherwise enjoy. At the same time the Revenue is having to use its discretionary powers to turn down many of the increasing number of requests for refunds from companies which, in the 70s, had to top-up funds which were then in deficit.

The result is an inevitably arbitrary state of affairs which is causing dissatisfaction all round. I therefore propose clear and objective legislation under which funds with surpluses of more than 5 per cent (calculated on standard published guidelines, based on the most conservative funding and actuarial methods) will be required to eliminate their excess over a period of years. How they do so will be entirely a matter for the trustees: they can choose to increase benefits, or reduce contributions, or make a refund to the company. But if there is a refund, there will be a tax of 40 per cent on the company (not the pension fund) to recover at least part of the tax relief it will have obtained on its contributions, and to discourage abuse of this tax relief through "parking". These changes should bring in an extra £20 million in 1986-7 and £120 million 1987-8. In devising this scheme, I have had the benefit of the advice of the Government Actuary.



Charities

Finally, I have decided to make major changes in the tax treatment of charities. Charitable giving substitutes private action for State action and we have already done much to encourage it. I have been urged by many colleagues to do more. I have three proposals: first, I intend to abolish the upper limit on relief at the higher rates of tax on charitable covenants, while at the same time stopping the abuse of the tax system by certain sorts of private charity. Secondly, I propose to allow companies, other than close companies, tax relief on one-off gifts up to a maximum of 3 per cent of their dividend payments. Thirdly, I shall propose a new scheme of payroll giving under which, if employers agree, employees can have charitable donations of up to £100 a year deducted from their pay, and get tax relief on them. These new measures will of course be in addition to the present tax relief for covenants by both companies and individuals. They should in time lead to a substantial increase in charitable giving. The cost will be negligible in 1986-7 and about £60 million in 1987-8 in gross terms, partly offset by a yield of around £20 million from the anti-abuse measures.

As I told you last week, I also wish to make a number of minor but carefully chosen concessions to charities on the VAT front.

I would be glad to know if you are content with this package of measures.

Richard Lawson

N.L.

5 March 1986

6

(Approved by the Chancellor & signed in his absence)

Revenue Effects of Budget Changes

Cost-/Yield+	1986-87	1987-88	£m
--------------	---------	---------	----

Business and Enterprise

Business expansion scheme	neg	+10	
Capital transfer tax	-35	-55	
Car and fuel benefits	neg	+15	
Overseas entertainers	nil	+100	

Savings and investment

Stamp Duty	neg	+10	
Personal Equity Plan	neg	-25	
Pension fund surpluses	+20	+120	

Charities

Package of reliefs	neg	-60	
Anti-abuse measures	neg	+20	
VAT concessions	-10	-10	

Total	-25	+125	
--------------	------------	-------------	--

Memo

Loan Guarantee Scheme (+additional expenditure)	nil	10	
--	-----	----	--

CONFIDENTIAL



hte

SN

10 DOWNING STREET

From the Private Secretary

5 March 1986

BUDGET PROPOSALS

The Prime Minister is content with the Budget proposals set out in the Chancellor's minute to her of today. (minute with DAN 6/3/86)

DAVID NORGROVE

Mrs Rachel Lomax,
H M Treasury

CONFIDENTIAL



4
COPY NO: 1 OF 8
REF NO: 22J

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

PRIME MINISTER

*Copy replaced by later
version: this one has errors.*

BUDGET PROPOSALS

You already have my Budget proposals on indirect taxes. I still have to reach a final view on income tax, in the light of the latest economic forecast, which I shall want to discuss further with you when we next meet. This minute covers my remaining tax proposals, none of which depend on what is done on income tax. In addition, as you know, I am discussing with David Young a package of public expenditure measures to help the long-term unemployed, on which I hope to be able to report early next week. The cost of these will be met from the Reserve.

None of the measures described below will have significant effects on revenue next year. Taken together, they are more or less revenue-neutral. But overall they should help to encourage enterprise and improve the performance of the economy - and hence, of course, employment. In particular, I have been concerned to devise measures which carry further forward the themes of my previous Budgets.

Business and Enterprise

First, measures for business and enterprise. The Business Expansion Scheme is due to end next year and I have been reviewing its future with the help of a report from Peat Marwick. This report confirms that the BES has been an outstanding success in its aim of attracting new equity capital into unquoted companies, a high proportion of them new



and small businesses. I therefore propose to continue the Scheme indefinitely. At the same time I feel I must take action to prevent abuse of the Scheme by excluding from its scope companies holding more than half their assets in the form of land and buildings and certain other activities which are threatening to bring the BES into disrepute (eg. investment in fine wines). These exclusions will serve to target the scheme more firmly on risk investment. I propose at the same time to improve the scheme further, by exempting BES shares issued after Budget Day from Capital Gains Tax on first sale.

My major proposal in this field is on Capital Transfer Tax. I intend to abolish the tax on lifetime gifts, which has had a particularly damaging effect in locking up assets and impeding the mobility of capital. You will recall the fierce attack we mounted on the taxation of lifetime giving when it was first introduced by Labour in 1974. This cost will be £35m in 1986-7 and £55m in 1987-8. The charge on death would of course remain, supported by a tapered charge on gifts made within seven years of death. In recognition of the radically changed nature of the tax I propose to rename it the Inheritance Tax. This will, in effect, be the fourth tax abolished since 1983. I believe this proposal will be warmly welcomed by all those who own and run family businesses.

I shall also be proposing a number of smaller measures to help business, including the extension and improvement of the Loan Guarantee Scheme, under which the Government guarantees bank loans to small and new businesses. In addition, I am planning to announce that we will embark on very preliminary discussions with employers and others about the feasibility of devising incentives for profit-sharing agreements in industry, perhaps through some temporary measure of tax relief, as a means of increasing the flexibility of the labour market.



As last year, I propose to increase the scale charge for assessing the taxable benefit of company cars by 10 per cent. At the same time, in response to representations from the motor industry, I shall be changing the engine scale break points to come into line with the break points in the new European Community directive on exhaust emissions. The fuel scale will remain unchanged but, as from April 1987, it will also be used to assess the VAT due on petrol used by registered traders and their employees. The result will be a fairer system, which will also bring in £40 million in 1987-88.

I should also like to rectify an anomaly in the taxation of overseas entertainers and sportsmen visiting the UK. In virtually every other major country - including the US, Germany and France - a tax is imposed on visiting British entertainers and sportsmen. There is no reason to give foreign visitors here more favourable treatment than British visitors receive abroad. If the necessary legislation can be drafted in time, I propose to impose a withholding tax of 30 per cent on the earnings of these people. The change will bring in extra revenue of up to £100 million in 1987-8. No doubt there will be complaints (although most of the tax will be at the expense of Revenue authorities overseas) but there is an indisputable case for taking this action and the best time to do so is now.

Savings and Investment

There is clearly a very strong case for reducing - if not abolishing altogether - the Stamp Duty on equities to coincide with the Stock Exchange's Big Bang in October. With no tax at all on share transactions in New York and only half a per cent in Tokyo, the current rate of duty of 1 per cent threatens to make London uncompetitive in the fast developing world market for financial services. If London cannot win a major share of



the global securities market its present world pre-eminence in other financial services will be threatened. I would therefore like to cut the rate to $\frac{1}{2}$ per cent in October. But I believe it would be politically awkward in the present climate of opinion about the City to reduce the overall contribution which financial services make to the Exchequer. I therefore propose to recoup the entire cost of the rate reduction by applying the duty to other transactions which currently escape it, such as intra-account transactions and takeovers and mergers. There will also be a special rate of 5 per cent on the conversion of UK shares into American Depository Receipts, the method increasingly used to escape Stamp Duty and transfer dealings abroad.

This change will have the incidental benefit of reducing the cost of share dealings by individuals. But I am anxious to find more immediate ways of promoting our policy of encouraging direct share ownership by individuals. I therefore intend to propose a radical new scheme under which individuals can invest up to £2,400 a year in equity shares to be held in a special account known (unless I can think up a better name) as a Personal Equity Plan. While in the Plan investments will be entirely free of all capital gains tax and income tax on dividends. They need be held only for a short qualifying period (under two years) before they can be withdrawn tax-free. The cost will be negligible in 1986-7, and about £25 million in 1987-8. The cost in later years will depend on take-up, but it is bound to rise. I am sure that over time this measure will dramatically extend share ownership in Britain, just as the rather different Loi Monory has in France.

I plan to announce in the Budget Speech my intention to introduce in next year's Finance Bill provisions which will, in effect, give personal pensions the same highly favourable tax



treatment as is enjoyed by other funded pension schemes. I shall reiterate the assurance I gave last year, that I have no plans to change that favourable tax treatment in any way. But I do need to clarify the Revenue's discretionary rules for dealing with the growing problem of pension fund surpluses. As inflation has fallen and the climate for investment has improved, many pension funds have become heavily, and undesirably, over-funded. This is now attracting some attention in the press. Excessive surpluses are a clear abuse of the tax privileges enjoyed by the funds. Nor are they in the interests of pension fund members who are denied the higher benefits or lower contributions they might otherwise enjoy. At the same time the Revenue is having to use its discretionary powers to turn down many of the increasing number of requests for refunds from companies which, in the 70s, had to top-up funds which were then in deficit.

The result is an inevitably arbitrary state of affairs which is causing dissatisfaction all round. I therefore propose clear and objective legislation under which funds with surpluses of more than 5 per cent (calculated on standard published guidelines, based on the most conservative funding and actuarial methods) will be required to eliminate their excess over a period of year. How they do so will be entirely a matter for the trustees: they can choose to increase benefits, or reduce contributions, or make a refund to the company. But if there is a refund, there will be a tax of 40 per cent on the company (not the pension fund) to recover at least part of the tax relief it will have obtained on its contributions, and to discourage abuse of this tax relief through "parking". These changes should bring in an extra £25 million in 1986-7 and £140 million 1987-8. In devising this scheme, I have had the benefit of the advice of the Government Actuary.



Charities

Finally, I have decided to make major changes in the tax treatment of charities. Charitable giving substitutes private action for State action and we have already done much to encourage it. I have been urged by many colleagues to do more. I have three proposals: first, I intend to abolish the upper limit on relief at the higher rates of tax on charitable covenants, while at the same time stopping the abuse of the tax system by certain sorts of private charity. Secondly, I propose to allow companies, other than close companies, tax relief on one-off gifts up to a maximum of 3 per cent of their dividend payments. Thirdly, I shall propose a new scheme of payroll giving under which, if employers agree, employees can have charitable donations of up to £100 a year deducted from their pay, and get tax relief on them. These new measures will of course be in addition to the present tax relief for covenants by both companies and individuals. They should in time lead to a substantial increase in charitable giving. The cost will be negligible in 1986-7 and about £60 million in 1987-8 in gross terms, partly offset by a yield of around £20 million from the anti-abuse measures.

As I told you last week, I also wish to make a number of minor but carefully chosen concessions to charities on the VAT front.

I would be glad to know if you are content with this package of measures.

Richard Lawson

N.L.

5 March 1986

(Approved by the Chancellor & signed in his absence)