



PM/85/71

PRIME MINISTERHong Kong Force Levels

1. I endorse the conclusions of the paper on Hong Kong Force levels, which was prepared in conjunction with FCO officials and circulated under cover of the Defence Secretary's memorandum OD(K)(85)1 of 25 July.
2. The financial and operational arguments for reducing the garrison by one battalion are convincing. On the political side, the most important factors to consider are the likely reactions in Hong Kong and Peking. We need to take care to ensure that our move is not interpreted in Hong Kong as a sign of a declining British commitment to the territory. Equally, the Chinese have indicated to us that they hoped that we would not reduce the garrison in the next two years. Our proposal is in fact for a reduction in 1987, and with careful presentation we believe that we can convince the Chinese that the action is justified and not a threat to stability. It will be important to persuade them of this. EXCO's advice is that if the decision is properly explained in Hong Kong, it will not be seen as a lessening of commitments, and indeed may be taken as a sign of confidence in the stability of Hong Kong. Certainly earlier Press reports about the impending cut do not seem to have caused dismay: also people in Hong Kong are very conscious of what they pay for the garrison. The key points to put across will be that the reduction will entail no added risks to security, but will produce considerable resource savings. With Peking it can be explained that the reduction will merely be a return to pre-1980 force levels, a situation justified by the fall in illegal immigration. It can be underlined that we remain fully committed to preserving Hong Kong's stability up to 1997.

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Prime Minister
Agree to the
proposal to reduce
the Hong Kong
garrison by one
battalion (5 down to 4)
in 1987?

CDC
27/7



3. Care will also be needed in presenting the reduction to the Nepalese Government. We shall need to convince them before the decision on the garrison becomes public that any decision on the redeployment or disbandment of the battalion has no implications for the future of the rest of the Brigade of the Gurkhas. We shall also need to be ready to reassure the Brunei Government that the decision will not affect the Gurkhas' commitment to Brunei.

4. Timing of a formal announcement of the decision will need to be discussed further between officials here and with Hong Kong. There may well be pressure in Hong Kong to make an announcement sooner rather than later. But before any announcement is made, we will need to inform EXCO, the Chinese and the Nepalese and thereafter allow a short period for any reaction from the Chinese before a formal announcement is made in Hong Kong.

5. In sum, I agree with the Defence Secretary that we should accept the Hong Kong Government's proposals. A reduction of the garrison by one battalion in 1987 can go ahead without prejudice to plans for the long term future of the garrison. We should, as the Defence Secretary proposes, commission a study on this question in 1986 that should take full account of Hong Kong's internal security requirements, including the role and size of the police forces.

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6. I am copying this minute to colleagues on OD(K)
and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
26 July 1985

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SPW

From the Private Secretary

29 July 1985

HONG KONG FORCE LEVELS

The Prime Minister has considered the memorandum circulated by your Secretary of State - OD(K)(85)1 of 25 July - proposing a reduction in the Hong Kong garrison from five to four battalions in 1987. She has also noted the Foreign Secretary's minute of 26 July on this subject.

The Prime Minister is content with the proposals, while agreeing with the Foreign Secretary that great care will be needed in presenting this decision to the Chinese Government.

I am copying this minute to the Private Secretaries to members of OD(K) and to Richard Hatfield (Cabinet Office).

(C. D. POWELL)

Richard Mottram, Esq.,
Ministry of Defence.

RMH

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MR POWELL

Covered in the
comments made
C.D.P.
29/7.

29 July 1985HONG KONG FORCE LEVELS

Memorandum by the Defence Secretary OD(K)(85) 1 of 25 July,
and minute by the Foreign Secretary of 26 July.

I think the recommendation for reducing the garrison by one battalion in 1987 is right. The tricky aspect will be securing Chinese agreement. Chinese sensitivities on this go to the very top. Deng wants us to maintain a firm grip on Hong Kong until 1997 and the Chinese have already said they hope we will not reduce the garrison over the next two years. Even if they agree, they may in return seek commitments about no further reductions. This would cut across our ideas of gradually shifting the burden from the garrison to indigenous forces of law and order, (paragraph 12 of the paper by officials), ideas the Chinese will not find attractive.

With careful presentation we ought to be able to square the Chinese, but we should allow ample time for it.

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PERCY CRADOCK

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ccpc



H. STEEL, CMG OBE
LEGAL SECRETARY

LAW OFFICERS' DEPARTMENT
ROYAL COURTS OF JUSTICE
LONDON, WC2A 2LL

1 August, 1985

R C Mottram Esq
Private Secretary
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See below,

HONG KONG FORCE LEVELS

The Attorney-General has seen your Secretary of State's Memorandum OD(K)(85)1 of 25 July and has asked me to report that he is content with what is proposed in it.

I am copying this letter to Charles Powell in No.10 and to the Private Secretaries to the other members of OD(K) and also to Richard Hatfield.

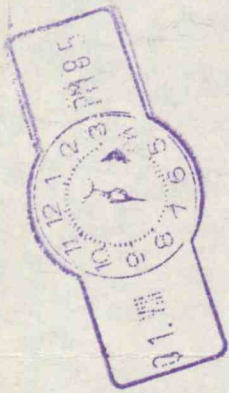
For en,
Henry Steel

H STEEL

SECRET

Harry Kung PT 18

Future.



*With the compliments of
the Legal Secretary*

H. STEEL

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D/GF3/29/1/3/12
 /20 (57/85)
 TMF/121/85

4 July, 1985

HONG KONG GARRISON AND VAT

You wrote on 7 May asking me to reconsider my earlier advice that the stationing of a British Garrison in Hong Kong is not a business activity for VAT purposes and that as MOD is not a taxable person in this regard it cannot recover tax incurred on equipment and ~~staff~~ for the Garrison. I am grateful for the additional information provided in your letter of 14 June and reassured that a "business" ruling in the Hong Kong case would not create a precedent with unexpected repercussive effects. I have taken a further careful look at the DCA and what has been said in the letters from yourself and Roy Dewhurst.

2. The decisions of the Courts and VAT Tribunals since the start of the tax have produced a fair amount of case law which bears on the question of what constitutes a business activity for VAT purposes. For example, it has been said that the absence of a profit does not preclude a particular transaction from being in the course of business and also that a body can be a taxable person for VAT purposes in respect of activity carried on other than for purely commercial reasons. These points are not inconsistent with your suggestion that we should see the provision of the Hong Kong Garrison as a business activity of MOD but, on the other hand, they are obviously not criteria which establish that an activity is business and the fact is that nowhere in the UK law is there a definitive statement of what amounts to business for the purposes of the tax. Where our own law leaves room for doubt one refers - as do the Courts - to the EC Sixth Directive which is designed to secure the harmonisation of VAT practice amongst member states. Article 4 of the Directive deals with taxable persons and 5. leaves me in no doubt as to how the provision of the Hong Kong Garrison should be regarded for VAT purposes.

The first two paragraphs states:

"5. states regional and local government authorities and other bodies governed by public law shall not be considered taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection with these activities or transactions.

However, when they engage in such activities or transactions, they shall be considered taxable persons in respect of those activities or transactions where treatment as non-taxable persons would lead to significant distortions of competition."

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3. MOD are covered by the types of body mentioned at the beginning of the indent and even if one were to concede that you made a supply to the Hong Kong Government in connection with the Garrison, it is evident that it would not place commercial concerns at a competitive disadvantage. If MOD does "supply" British armed forces it does so as a monopoly - there is simply no competition to distort and no requirement to see this Governmental function as activity within the scope of the tax.

In the light of this clear guidance I am afraid that I cannot change my original advice that the British Garrison in Hong Kong is not a business activity of MOD and that as your department is not a taxable person in this regard it is not entitled to recover the tax it incurs in this function. I am sorry if this eliminates a possible remedy to your problem over the tax incurred on equipment and ~~stocks~~ *stores* issued to the Garrison from MOD's stocks in the UK.

4. I am not sure exactly what line is pursued in paragraph 2 of your letter of 14 June.

If you are referring to "international collaboration arrangements" which may be relieved under Group 15 Item 3 of the Zero Rate Schedule, this provision is designed to cover joint projects of research, development or production and to save them from incurring sticking VAT on taxable transactions which take place in the UK.

Alternatively, if you are thinking of the five patrol boats provided for use by MOD personnel in Hong Kong outside the DCA, I know, of course, that my branch did rule this to be a zero-rated supply. Looking briefly at those papers it is clear that while the supply and export angles were considered in detail the "business" aspect does not appear to have been considered. Thus that decision is, as I hinted in my letter to Roy Dewhurst, somewhat suspect and should not be taken as a precedent. As the patrol boat ruling was given in 1983 it is a matter that I am content to leave undisturbed.

4 July, 1985

P D CHAPMAN
VAH2

37. There are many degrees of error which might be involved and the criterion is not whether the error is considered serious enough to warrant disciplinary action but simply whether the department's performance has been at fault in incurring or not avoiding the liability to make the payment.

38. A constructive loss need not be noted in the Losses Statement, but should be recorded under "other notes" if significant (F141). It occurs when, for example, stores or services are correctly ordered, delivered or provided, and are paid for as being in conformity with the order but, owing to an unavoidable error of judgement, change of policy or comparable reason, which cannot be attributed to a culpable cause, prove not to be needed or to be less useful than when the order was placed.

CLAIMS WAIVED OR ABANDONED

39. Waiver⁽¹⁾ of a claim implies a voluntary decision, taken with Treasury agreement, for a political, administrative, or other reason, not to present or pursue a claim which could properly be made. A simple example is a decision to reduce the rate of interest on a loan and so to waive the right to receive the amount of the reduction (for remissions of principal see F135).

40. Abandonment of a claim arises in any other case where a claim can properly be made, and where payment is not received. The term includes:-

- (a) claims actually made and then reduced in negotiations or for policy reasons;
- (b) claims which it was intended to make, but which could not be enforced, or were never presented, eg due to inability to identify the persons to whom they should be addressed, or because the whereabouts of those responsible could not be established;
- (c) failure to make claims or to pursue them to finality, eg due to procedural delays allowing the Statute of Limitation (0150) to become applicable;
- (d) claims arising from actual or believed contractual or other legal obligations which are not met, whether or not pursued, eg under default or liquidated damages clauses of contracts;

(1) As between Exchequer departments 'waiver' of a right, eg to charge for departmental expenses incurred in carrying out an 'agency' service (F76) is a domestic matter that does not have to be noted in the appropriation account. Such a waiver in connection with a repayment service to a non-Exchequer body would require prior Treasury sanction if it entailed charges of a lower amount than those calculated in accordance with P78-83.

- (e) the amounts by which claims are reduced by compositions in insolvency cases, or in out-of-court settlements, other than reductions due to corrections of facts;
- (f) claims dropped on legal advice, or due to an inability to determine the amounts of liabilities.

A claim not presented should normally be noted at the original figure.

41. If a claim is presented in error, or is proved not to be well-founded in fact, it should be withdrawn (whether or not presented) and need not be noted. The fact that there is doubt as to whether it would succeed if pursued in a court of law, or the liability of a debtor has not been or cannot be accurately assessed, does not justify withdrawal of a claim.

42. Where more than one department is involved each should note their records to the extent of their interest, but time should not be wasted on over precise apportionment of the amount involved.

43. A waiver of a claim in the nature of a remission of tax should not be treated as a claim abandoned. The Revenue departments have special rules about remissions of tax and any other departments should consult the Treasury when a case arises.

44. If a claim for refund of an overpayment fails or is waived the loss involved is not a claim abandoned but a cash loss.

SPECIAL PAYMENTS

45. Payment in satisfaction of claims settled out of court are sometimes described as *ex gratia* for legal purposes. A narrower definition of *ex gratia* is used and other categories introduced for the purpose of government accounts.

Extra contractual and ex gratia payments to contractors

46. An extra contractual payment is one which, although not legally due under the original contract or subsequent amendments, appears to be an obligation by the department which the courts might uphold. Such an obligation will usually be attributable to departmental action or inaction in relation to the contract. A payment is regarded as extra contractual even where there is doubt whether or not the department is liable to make it, eg where the contract provided for arbitration but a settlement is reached without recourse to arbitration. A payment made as a result of an arbitration award is contractual.