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PRIME MINISTER

*In following piece - PREM 19/1/709
J. Gray
4/11/14*

- on Folder attached to file.

... I enclose a draft of the promised Green Paper on Personal Taxation. This is still rough at some of the edges (and I would like to think further about the charts), but it is virtually complete, save for a Foreword that I will write later.

As you will recall, I announced that we would be issuing the Green Paper later this year in my Budget speech in March. (I attach the relevant extract.) The announcement attracted a great deal of interest, which continues to persist, and most of the comments so far have been very favourable; at least so far as transferable allowances are concerned. There may be some disappointment that we do not propose to go further, and integrate either the tax and benefit systems or the tax and national insurance systems; but the Green Paper explains very clearly why we are not persuaded.

When you have read this draft, you will obviously wish to discuss it with me. I would then like to consult Norman Fowler on a bilateral basis. I very much hope it will be possible to publish this Autumn.

N.L.

27 September 1985

*Needs before
its content
was known.*

EXTRACT FROM HANSARD, TUESDAY19 MARCH, Vol 75, Col 794-795**TAX REFORM**

Mr. Lawson: I now turn to taxation.

This Budget carries forward the theme of tax reform I set out last year. Reform designed to make life a little simpler for the taxpayer. And above all reform designed to improve our economic performance over the longer term, on which the jobs of the future will depend.

In my Budget last year I announced a radical reform of the corporation tax system. This had been preceded by the Green Paper on corporation tax issued by my predecessor in 1982.

I am satisfied that the right way to proceed with major tax reform is to issue a Green Paper first, as a basis for full and informed discussion, followed by legislation when the results of that discussion have been fully digested.

I therefore propose to issue a Green Paper later this year on the reform of personal income tax.

The computerisation of PAYE makes this the right time to review the system of personal taxation. Most of the work will be complete by the end of 1987 and the full range of facilities will be available by 1989. The Green Paper will therefore discuss a range of options opened up by computerisation, from non-cumulation to closer integration between the tax and benefit systems, and including in particular a reform of the present system of personal allowances.

It is the Government's firm policy to reduce the burden of income tax, but we need to make sure that the reliefs we can afford are concentrated where they will do most good.

The present structure of personal income tax is far from satisfactory. Too many young people start paying tax at too low a level, and too many families find themselves in the poverty and unemployment traps. The system discriminates against the family in which the wife stays at home to look after the children. It denies to the partners in a marriage the independence and privacy in their tax affairs which they have a right to expect.

There is therefore a strong case for changing to a new system of personal allowances more suited to today's economic and social needs. Under this, everyone, man or woman, married or single, would have the same standard allowance; but if either a wife or a husband were unable to make full use of their allowance, the unused portion could be transferred, if they so wished, to their partner.

This reform would produce a more logical and straightforward system. Far more people could be taken out of the poverty and unemployment traps, and indeed taken out of tax altogether, for a given sum of overall tax relief than is possible under the present system. It would end the present discrimination against the family where the wife feels it right to stay at home, which increasingly nowadays means discrimination against the family with young children.

Husbands and wives would each be taxed separately on their own income irrespective of the income of the other. The aggregation for tax purposes of a wife's earned income and investment income with her husband's would end, thus removing what has become an increasing source of resentment among women.

The Green Paper will set out full details of the proposals I have just outlined, as a basis for public discussion. After an appropriate period for consultation, it would be possible to legislate in 1987 and have a system on these lines in place by the end of the decade.

cc BG
cc DAS
cc B. Chinn

REFORM OF PERSONAL TAXATION
NOTE BY THE CHANCELLOR OF THE EXCHEQUER

In my 1985 Budget speech I promised to publish a Green Paper on the reform of personal taxation, and outlined the approach I thought we should adopt (see annex 1). Since then a considerable amount of effort has gone into working out both the presentation and the details of this proposal. The result is incorporated in the attached draft Green Paper, which we are to discuss on 9 January.

The case for reform

2. Since 1979, we have made a lot of progress in reforming the tax system, with the aim of creating a simpler and fairer tax structure as well as one which will encourage enterprise and improve the prospects for growth and employment. But we have not yet tackled the personal tax system, which remains essentially as it emerged, forty years ago, after the war. I am convinced that the reform of personal income tax should be a major priority for the next Parliament. The computerisation of PAYE, now well under way, will provide an important opportunity for imaginative reform. And if we are to seize this opportunity, we must plan for it now. who?

3. I have benefited from the work done by Geoffrey Howe during his period as Chancellor. His Green Paper (The Taxation of Husband and Wife, Cmnd 8093) published in 1980, canvassed a number of options for the reform of personal allowances. Virtually everyone who responded to Geoffrey Howe's Green Paper - including the Conservative Women's National Committee, professional organisations such as the Law Society and the Chartered Accountants, as well as social and political commentators of all persuasions - agreed that the present system needs changing.

4. The response identified two main options: replacing the present married man's allowance by an increased level of cash benefits for those with children and other dependants, and a system of independent taxation with transferable allowances. Like my predecessor, I am convinced that the first approach, supported by

the Labour party and the SDP as well as the Child Poverty Action Group, would be quite wrong, economically and politically. It would mean a further large increase in social security benefits; and it would do nothing to raise tax thresholds, rightly identified as a priority by many of our own supporters. The alternative, independent taxation with transferable allowances, was supported by the WNAC and by the professional organisations. It would provide a system of personal allowances which would both recognise the independence of women, and the special status of marriage, bringing us much closer to best practice in other European and North American countries. It is an approach that is consistent with the importance which we as a party give to the family; as well as one that fits well with the philosophy of giving voters more freedom to spend their own money as they wish, and reducing, as far as prudently possible, the burden of taxation - especially on incomes.

Transferable Allowances

5. The case for adopting a system of transferable allowance is set out in detail in Chapter 3 of the Green Paper. I attach particular importance to the following points:-

(i) Since 1979 we have devoted considerable resources to raising tax thresholds, while leaving the existing structure intact. A move to transferable allowances would target future increases in tax thresholds where they will do most good. It would particularly benefit those groups who are most severely affected by the poverty and unemployment traps - married couples where the wife is either not earning at all, or earns very little (typically because she works part-time). And, by combining it with a step increase in the single person's allowance, it would take many young people out of tax altogether, thereby helping to reduce the problem of youth unemployment.

(ii) A system of transferable allowances would be better attuned to the needs of couples over their working lives. Most women nowadays take paid work for a good part of their working lives. But the present tax system is hardest on

married couples at just that time when they have the responsibility of a young family and the wife is least able to take paid work. Transferable allowances would meet this problem, by giving everyone a tax allowance in their own right; and allowing them to transfer the balance to their spouse where they had insufficient income of their own to use it up.

(iii) My proposals would completely remove the many tax penalties on marriage, all of which spring from the anachronistic - and widely resented - rule that for tax purposes a married woman's income is treated as her husband's. They imply the independent taxation of investment as well as earned income.

6. Annex 2 of this note summarises the implications of my proposals for the different groups of taxpayers, highlighting in particular the effect on married couples at different points in their lives. Further detail is given in the annexes to the Green Paper itself.

7. I would also draw colleagues' attention to part II of the Green Paper which outlines the ways in which the proposed reform would allow us to simplify the host of minor personal allowances, including the highly complicated system of age allowance.

8. The move to transferable allowances will fit well with the major reform of social security outlined in Norman Fowler's White Paper - although some drafting changes will be required to bring the draft Green Paper fully into line both with the White Paper and, later, with whatever changes are made in the 1986 Budget.

The tax system in the longer term

9. Section III of the Green Paper discusses, without commitment, a number of other long term changes in the taxation system, such as a move towards self assessment and a non-cumulative system. It also fulfils my promise to examine the longer term relationship between the tax and social security systems - a subject of

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Spectrum
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to be
tested.

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considerable public interest. The draft rejects the idea of complete integration which, in my view, would mean a further and undesirable blurring in the distinction between the money people earn themselves, and the money they receive from the state. There is however a strong case for rationalising the two systems for reasons of efficiency and greater simplicity. Norman Fowler's proposed changes already go some of the way. While major progress must await computerisation in both the Inland Revenue and DHSS, we must show ourselves prepared to discuss the case for going further.

10. The remaining chapter in this Section considers the scope for integrating income tax and national insurance contributions. I see little practical merit in moving in this direction; it would destroy the contributory principle and create many losers, especially among the elderly.

Phasing in the new system

11. The Green Paper examines in some detail the practical consequences of moving to a system of transferable allowances. This is discussed both in Chapter 3 of the main text and in the annexes. The Green Paper figuring, which at this stage is purely illustrative, shows the implications of phasing in the reform over 2 years on a no cash losers basis.

12. I should stress that the Green Paper represents no new commitment to reduce taxation: it merely shows how part of the tax reduction programme outlined in the 1984 Green Paper ("The Next Ten Years: Public Expenditure and Taxation into the 1990s" - Cmnd 9189) might be put to best use. We have made it very clear that our policy is to reduce the overall burden of taxation in general, and of income tax in particular, as and when we have the scope prudently to do so. But colleagues will need no reminding that my proposals are contingent on there being scope for tax reductions.

13. It is difficult to estimate precisely what the tax reductions implicit in the Green Paper, on a no cash losers basis, would amount to. On the assumptions given in the Green Paper the figure comes out at £5.3 billion (or nearly £2½ billion a year). This is

sensitive to a number of factors, in particular the level of inflation in the early 1990s (since "no cash losers" implies that the cost of statutory indexation would be appropriated towards the cost of the reform). Also important will be the level of the basic rate of tax by then. The following table indicates the sensitivity of the calculations to these assumptions.

Real loss of Revenue over a 2-year period

		£ billions; total		
		Basic Rate		
		25%	27%	30%
	0	4 $\frac{3}{4}$	5	5 $\frac{1}{4}$
Inflation	2 $\frac{1}{2}$	3 $\frac{3}{4}$	4	4 $\frac{1}{4}$
(%p.a.)	5	2 $\frac{3}{4}$	3	3 $\frac{1}{4}$

14. As the table makes clear, the figure quoted in the Green Paper implicitly assumes zero inflation and a basic rate of 30 per cent. Other assumptions would result in a lower global figure.

15. Moving to transferable allowances will not necessarily imply a net reduction in the overall tax burden of the same magnitude; it would be in line with the policy we have consistently pursued since 1979 to finance income tax reductions in part by raising indirect taxation. Thus, despite the difficulties we have had in recent years, we have been able in the last three Budgets to reduce income tax by raising thresholds by £6 $\frac{1}{2}$ billion, implying a real loss of revenue (ie. in excess of statutory indexation) of almost £3 $\frac{1}{2}$ billion.

16. Of course the draft Green Paper represents no commitment to reduce even income tax by any particular amount by a particular date; implementation of these proposals would have to depend on overall economic constraints in the normal way, and would occur as and when the scope for it occurs. But - subject to these provisos - I see considerable political advantage in giving some indication of the Government's tax strategy for the medium term.

Conclusions

17. I believe that the proposals for personal income tax in this Green Paper will be attractive to a wide range of political opinion, both within and outside the party - and especially to women voters. The response to Geoffrey Howe's Green Paper showed that there is a substantial body of opinion in favour of radical reform of the personal tax system. Informed opinion is aware of the opportunities created by the computerisation of PAYE. Since I outlined my proposals in my Budget speech there has been sustained and favourable interest both in the press and in the party. I also hope that the Green Paper proposals will strengthen support for the reduction in the burden of taxation to which we are committed, by showing how the scope for tax reductions can be most effectively used to encourage enterprise and employment.

N.L.

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IMPLICATION OF PROPOSALS IN TAX GREEN PAPER FOR DIFFERENT GROUPS OF TAXPAYERS

This note summarises the implications of the proposals in the Personal Tax Green Paper for different groups of taxpayers.

2. The note looks at the following groups:

two earner couples;
one earner couples;
single people;
lone parents;
pensioners.

It considers the effect of transferable allowances on these groups, as well as the effect of the Green Paper proposals on disaggregation of investment income and capital gains.

TRANSFERABLE ALLOWANCES

3. Table 1 shows the effect of transferable allowances on various groups.

Two earner/one earner couples

No - this can't be considered together

4. These groups can be considered together because it is common for the same couple to move from being a two earner couple to a one earner couple, and back again. This reflects the growing number of married women in work who cease work on having children, but increasingly return to the labour force after a relatively short period of a few years.

5. In 1984, the latest year for which figures are available, married women represented 27 per cent of the labour force.

6. The proportion of married women in the labour force as a percentage of all married women rose from 38.1 per cent in 1966 to 49.4 per cent in 1983. The proportion of married women of working age in employment is higher, at 62.4 per cent.

7. Over 80 per cent of women leave the labour market shortly before the birth of their first child, but return to paid employment at some point. The average length of time they spend completely out of the labour force is now some 3-4 years. However, most women, when they return to work, take part time jobs and indeed most of them subsequently remain in part time work. The proportion of women working part time is now 46½ per cent, compared with 40 per cent in 1977; and as much as 60 per cent of working married women are part-time. Of these part-timers, roughly 60 per cent earn below the £2,205 tax threshold.

Regional variations

8. Table 2 shows regional variations on the proportion of married women of working age who are either employed or seeking employment. On the whole this shows little significant difference between the various regions of England, but a noticeably lower proportion in Scotland and Wales.

Effect of the proposed system of transferable allowances

9. As noted above, many couples move from being two earner couples to one earner couples with the arrival of children; and return to being two earner couples as the children grow up. Transferable allowances are designed to recognise this typical cycle by removing the additional tax burden currently imposed at a time when many couples face heavily family commitments on sharply reduced gross family incomes.

10. As can be seen from Table 1, two-thirds of the 9.7 million married couples paying tax will be better off under transferable allowances. This is made up of all one earner couples and 40 per cent of two-earner couples. Two earner couples will be better off where the wife earns less than £2,205 pa (almost certainly because she is working part-time); or where the couple have elected for

This is the most likely situation where the wife can witness

separate taxation of earned income; or in the case of some higher rate taxpayers, where disaggregation leads to a lower rate of tax.

11. It can be seen from Table 1 that in no case will a working wife pay more tax as a result of transferable allowances. In fact, in all cases where earnings are above the tax threshold, a working wife as such could pay less tax than under the present system. This is because she will be entitled to an allowance some £635 above the present Wife's Earned Income Allowance. (But her husband will of course pay correspondingly more tax).

She will
under
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12. Because transferable allowances will improve the family's financial position either where the wife does not work at all, or where she earns very little, the relative financial advantage to the family of a married women taking a job will be less than it is now (because the couple's extra earnings would effectively be taxed at 30 per cent from the first pound). Although this would be a disincentive to some married women to go out to work it needs to be kept in perspective: for any wife contemplating earning above £2,205 a year the marginal rate of tax will normally be the same with transferable allowances as it is under the present system.



13. There are, moreover, many factors other than the present tax treatment which lead women to work outside the home and these are likely to remain important. Social attitudes are in practice crucial, and these have changed dramatically since the 1940s. This is suggested by experience in those countries (see Table 3) which have systems similar to transferable allowances - such as Scandinavia and Canada, where married women's propensity to take paid work has increased as fast as or even faster than in the UK, and where it is currently at an even higher level.

14. All single people paying tax will be better off under transferable allowances. About one-third of single people are under 25. Lower tax bills for this group (some will be taken out of tax altogether) should improve their employment prospects.

why?

Lone parents

15. Lone parents will have their tax allowance reduced under transferable allowances, but the difference will be made up by increased one-parent benefit of equal value. Overall their position will be unchanged.

Taxpaying pensioners

16. Single pensioners (the largest group) will all be better off under transferable allowances. *why?*

17. Couples where the wife does not work or have her own pension will all be better off.

18. Couples where the wife works or has her own pension will either be better off, or in the same position, depending on the size of the wife's earnings. *why?*

DISAGGREGATION OF INVESTMENT INCOME

19. At present the wife's unearned income is added to the income of her husband and taxed at his marginal rate. It is proposed that following the introduction of transferable allowances, a wife's earned income should be taxed at her marginal rate. Couples will benefit where the husband's marginal rate of tax is higher than that of his wife (see Table 1).

SEPARATE TREATMENT OF CAPITAL GAINS TAX

20. Under the present arrangements, the gains and losses of each spouse are aggregated, and the couple are entitled only to one annual amount of tax free capital gains (currently £5,900). The Green Paper proposes that after the introduction of transferable allowances, each spouse should be entitled to an annual exempt amount, the unused part of which would be transferable to the other spouse. The provisions which allow the losses of one spouse to be set against the gains of another would be withdrawn.

EFFECT OF TRANSFERABLE ALLOWANCES

TABLE 1

<u>Category</u>	<u>No of taxpayers in category</u>	<u>Present Position</u>	<u>Position under Transferable allowance</u>	<u>Better off/ Worse off</u>
<u>(a) Two earner couples</u>				
1. Wife earning less than £2,205 pa.	1.8 million	Wife pays no tax, but couple cannot benefit from any unused portion of total allowances of £5,660 to which they are entitled.	Wife need pay no tax. Couple get benefit of £5,660 of allowances between them.	Couple better off. Wife's position the same.
2. Wife earning more than £2,205 pa.	3.1 million	Wife makes full use of £2,205 allowance to which she is entitled	Wife entitled to higher allowance (£2,830), but husband's allowance reduced as a result.	Position of couple unchanged. Wife better off. <i>Handwritten: Husband worse off.</i>
3. Higher rate taxpayers * where couple have elected for separate taxation of earned income.	0.2 million	Wife and husband each have allowance of £2,205 pa.	Wife and husband each have allowance of £2,830 pa.	Both husband and wife better off.
4. Higher rate tax payers * where couple have <u>not</u> elected for separate taxation.	0.2 million	Wife has allowance of £2,205, husband has allowance of £3,455	Wife and husband each entitled to allowance of £2,830.	Position of couple <u>either</u> unchanged or improved, if disaggregation leads to lower rate of tax. In either case, wife better off. <i>Handwritten: ? Husband may be worse off.</i>

* These couples include some where the wife has unearned income taxed at her husband's marginal rate. In such cases the couple will be better off if the wife's marginal rate is lower than her husband's since the investment income will be taxed separately.

TABLE 1

<u>Category</u>	<u>No of taxpayers in category</u>	<u>Present Position</u>	<u>Position under Transferable allowance</u>	<u>Better off/ Worse off</u>
(b) <u>One earner couples</u> *	4.4 million	Couple have only married man's allowance £3,455	Couple get benefit of £5,660 allowances between them.	Couple better off.
(c) <u>Single people</u>	7.4 million	Have single person's allowance of £2,205	Gain allowance of £2,830	Better off.
(d) <u>Lone parents</u>	0.4 million	Receive single allowance plus additional personal allowance so effectively have married man's allowance of £3,455	Lose additional personal allowance but replaced by increased one parent benefit of equal value. Tax allowance falls to £2,830.	Position unchanged.
(e) <u>Pensioners</u> **				
1. Single	1.2 million	Have age allowance of £2,690 which tapers out when income over £8,800 falls to single allowance at income of £9,527.	Age allowance abolished but replaced by higher allowance of £2,830	Better off
2. Couples where only one partner has income	0.8 million	Man has age allowance of £4,255 which tapers out when income over £8,800 - falls to £3,455 when income £9,990 or over.	Each partner has own allowance of £2,830 - combined £5,660	Better off.
3. Couple where wife's earned income below £1,405	0.2 million	Have age allowance of £4,255 which tapers out when income over £8,800 - falls to married man's allowance at income of £9,999. Also have wife's earned income allowance against all of wife's earned income giving total allowances of £5,660	Each partner has single allowance so combined allowance £5,660.	Better off or unchanged depending on wife's earned income.
4. Couples where wife's earned income above £1,405	0.3 million	Have age allowance of up to £4,255 plus wife's earned income allowance of £2,205 giving maximum of £6,460.	Allowances protected to ensure no losses.	Better off or unchanged.

** Only 40% of pensioners pay tax.

PROPORTION OF MARRIED WOMEN OF WORKING AGE EMPLOYED OR SEEKING WORK
- GREAT BRITAIN 1984

	%
Great Britain	62.4
North	61.8
Yorks and Humberside	62.8
East Midlands	64.0
East Anglia	60.0
South East	64.1
South West	61.5
West Midlands	61.1
North West	64.7
Wales	58.0
Scotland	57.6

TABLE 3

Denmark

1. Basic system: Fully transferable allowances for earned income; aggregation of investment income with the income of the spouse with the highest earned income.

2. Trends:

	Married women's participation rate*(%)	All women's participation rate**
1965	31.8	49.3
1970	49.0	58.0
1975	56.4	63.5
1979	60.9	69.9
1983	66.6	74.2

Sweden

1. Basic system: A married person whose spouse has little or no income is entitled to a tax credit which reduces as the spouse's income increases.

2. Trends:

	Married women's participation rate*(%)	All women's participation rate**
1965	42.8	54.1
1970	50.5	59.4
1975	57.6	67.6
1979	63.1	72.8
1983	66.9	76.6

Canada

1. Basic system: A married person supporting a spouse is entitled to a further allowance over and above that available to single taxpayers. This further allowance is reduced \$ for \$ if the spouse's income exceeds a set level.

* Married women in the labour force as a percentage of all married women.

** All women in the labour force as a percentage of all women of working age. (Exact comparisons not available.)

2. Trends:

	Married women's participation rate*(%)	All women's participation rate**
1966	not available	39.7
1970	not available	43.2
1975	40.9	50.0
1979	45.7	55.5
1983	50.5	60.1

United Kingdom comparison

Trends:

	Married women's participation rate*(%)	All women's participation rate**
1966	38.1	52.9
1971	42.3	54.8
1981	47.2	60.7
1983	49.4	63.3

