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PRIME MINISTER

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GREEN PAPER ON PERSONAL TAXATION

This is an extremely important document because:

- It aims to set out a possible tax strategy on which to  
fight the next Election.
- The Chancellor's approach to tax cuts in his next two  
Budgets will be influenced by his long-term objectives  
for 1990.
- Of course this Government must cut taxes, but any  
commitment must be credible. How will the Chancellor  
find the £5 billion his reforms will cost?

This Green Paper also needs to be set beside the rates and  
benefits reforms. For all these reasons, you will want to  
discuss it fully with the Chancellor, and maybe also with  
colleagues such as Mr Tebbit and Mr Fowler. I wonder if  
your diary would permit a Tax Policy Seminar at Chequers one  
weekend?

Two-earner couples

There are 5.3 million two-earner couples, many of whom no  
doubt vote Conservative. The Chancellor's message is that

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they will not enjoy any of the benefits of over £5 billion  
of tax cuts in the Conservatives' third term. This doesn't  
look like good politics, though the Chancellor would reply  
that:

- The Why Work? problem is concentrated on single-earner families. Getting these people out of tax encourages them to get work.
- Most of us are one-earner and two-earner couples at different stages of our adult lives. It is rather perverse for the tax system to act as a sort of negative Child Benefit - you get more generous reliefs when your children have grown up and you are both working than when the mother is at home looking after the children, and only the husband is earning.

## Women

There is widespread discontent amongst working women that their tax affairs in general, and their investment income in particular, are tied in with their husbands. Full and genuine separate assessment, including investment income, will be widely welcomed by them. The question is whether this more than offsets the political cost of improving the relative tax treatment of non-working women.

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Alternative approaches

The Chancellor's Green Paper has turned out White. He eloquently argues for fully transferrable allowances. But the Green Paper does not consider any other options. At least two other courses should be given a fair run for their money.

First, cutting the basic tax rate. For £5 billion, you could bring the basic tax rate down to 25p. The political attractions are obvious. In addition, there would be a very powerful effect on incentives, as everybody's marginal tax rate would fall. Raising allowances does nothing for most people's marginal tax rate, yet it is what matters for incentives.

The second option, which I floated during the Benefit Reviews, would be to reintroduce a tax allowance for children. The Conservative Party is supposed to be the Party of the family; and yet the previous Labour Government changed the tax and benefit system so that the only way of helping families is to increase public expenditure on Child Benefit. The option of helping them by easing the tax burden - the Conservative approach - has been taken away. The Treasury don't like a child or family tax allowance, because they see them as complicated and expensive to administer. But helping families through the tax system would be politically attractive. Moreover, if tax computers

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can speak unto benefit computers, it might be possible to use the existing information held on Child Benefit computers.

Tax strategy over the next 2 years

The Chancellor's long-term objectives also have important implications for his next Budget. It is time for a new look at the conventional policy of putting all our money into increasing tax allowances. Reducing the tax rate for everybody may be politically more attractive and have a better effect on incentives. Moreover, the less that we increase tax allowances between now and 1990, the lower would be the eventual cost of introducing fully transferable allowances with no losers.

Conclusion

You cannot be expected to accept or reject the Green Paper at this stage. It needs proper consideration. Meanwhile, we recommend that you ask the Chancellor about alternative options which might also be included in the Green Paper.

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