

PRIME MINISTERGreen Paper on Personal Taxation:Meeting of Ministers at 11.30 am on Tuesday 14 January

I suggest that the main purpose of this meeting should be to take at least a preliminary decision on whether the Chancellor should publish with or after the Budget a Green Paper on Personal Taxation on the lines he has proposed; and to make arrangements for further work and consideration.

BACKGROUND

2. You are familiar with the background. The Government first canvassed options for the reform of personal allowances in the Green Paper (The Taxation of Husband and Wife, Cmnd 8093) published in 1980 by Sir Geoffrey Howe as Chancellor. In the response to this there was widespread agreement on the need to change the present system, but no agreement on the means. No specific follow-up action was therefore taken. The present Chancellor reaffirmed the Government's intention to proceed with a major reform of personal income tax in his 1985 Budget statement. The relevant passage is at Annex 1. You will see that this promised Green Paper "later this year"; and made it clear that the Chancellor strongly favoured a system of transferrable allowances of the kind now proposed. The statement also said that the Green Paper would "discuss a range of options opened up by computerisation, from non-cumulation to closer integration between the tax and benefits systems"; and indicated that, 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".

3. The Chancellor has also trailed these proposals publicly on other occasions. For example, in a speech to the Equipment Leasing Association on 28 May 1985 he outlined the likely contents of the Green Paper in some detail, making clear his own preference for a system of independent taxation with transferrable allowances, and his scepticism


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about the scope for integration of the income tax and social security systems (while also asserting that he did not wish "to prejudge the matter one way or the other"). In addition, at the last Conservative Party Conference he said that proposals in the Green Paper would enable the Government to "do far more to deal with unemployment and poverty traps which damage incentive for those on low incomes ... they will also once and for all remove the discrimination against married women which so disfigures our present tax system."

4. There is, therefore, strong public commitment to, and widespread expectation of, the Green Paper and its likely contents. While it would not be impossible to shelve the idea, or to postpone publication further, it would be difficult to do so. Publication is already overdue.

CONTENTS OF GREEN PAPER

5. The Green Paper will represent a major statement of the Government's medium term taxation strategy, and, despite the caveats, in effect amount to a major pre-emption by the Chancellor of the scope for tax cuts in several budgets to come. The central proposal is to replace the present structure of allowances for husbands and wives with a simpler system of transferrable allowances. The various consequentials include replacing the additional personal allowance for single parents with a higher One Parent Benefit (OPB) and the end of age allowances for pensioners. Significantly, these structural changes are to be achieved on a no-cash-loser basis, costing between £2.5 and £5.25 billion, depending on assumptions about inflation and the prevailing rate of tax. The Chancellor's intention is that legislation would be introduced in 1987 and the new structure implemented by stages from April 1990.

6. Part I (Chapters 1-3) of the draft paper deals with the reform of personal allowances and the tax treatment of husband and wife; Part II (Chapters 4 and 5) considers the treatment of particular groups (eg the elderly and single parents); and Part III (Chapters 6-8) discusses



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possible longer term options for the development of the tax system. Chapter 6 rejects the possibility of full integration of the tax and social security systems and is less than enthusiastic about "partial integration"; Chapter 7 rejects the notion of merging the national insurance contribution and tax systems; and Chapter 8 discusses positively, but without commitment, the possibility of moving from cumulation to non-cumulation. The Chancellor stresses throughout the opportunity for radical reform that computerisation of PAYE, which is well under way, now presents.

MAIN ISSUES

7. You will not at this meeting want to get into detailed discussion of the contents of the Green paper. The immediate question is whether the political case for publication with the budget or later is a good one; and if so, what further work needs to be done, and how it should be organised. In reaching conclusions on these issues you may wish to concentrate on the following points:-

(i) General case for publication: in view of the expectations aroused by the 1985 Budget statement, and the other statements referred to in paragraph 3 above, it would now be very difficult not to publish a Green Paper. You will, however, wish to pause to consider likely reactions. The financial markets are looking with some nervousness for signs of fiscal laxity. Subject to the rest of the Budget package, there could be some concern at the prospect of a £5 billion "give away"; or alternatively, at the price that might have to be paid to achieve this (eg indirect tax increases or forgoing revalorisation). Nor is it clear that the proposals on sex equality will universally be welcomed, particularly since it may be argued that they would introduce a disincentive for married women to go out to work. This point has already been made in the press and by a report by the House of Lords Select Committee on the EC. On the other hand, the proposals for simplifying the present



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system of allowances and taxing married women on the same basis as their husbands are bound to be welcomed, and by making the Paper a good deal "greener" than at present, it would be possible to make it clear that the changes would only fully be introduced if they could prudently be afforded.

(ii) Substance of the transferrable allowances and related proposals: You may want to have a 'second reading' discussion of these, without going into great detail. The Chancellor now appears to be justifying the proposals more through their distributional effects than the sex equality arguments. The reform is presented as being primarily aimed at helping families in the poverty and unemployment traps. The supporting analysis, however, is far from complete. For example, it compares the effects in terms of changes in tax liability rather than in terms of net income. It largely ignores the inter-relationship between the tax and benefit systems, which will mean that under the new social security system some of the benefit from reduced tax for the lower paid will be offset by reduced entitlement to income-related benefits. This must mean that low income families, especially those with children, gain less from the changes than the better off. Similarly, there is little analysis to support the claimed improvements in the poverty and unemployment traps. Nor is there any discussion of alternative tax strategies which might achieve the Chancellor's objectives more effectively and perhaps at less cost. For example, it could be argued that a family tax allowance (or improved family credit) would be a better targetted way of tackling incentives and of helping families with children. On these and other points, and bearing in mind the exhaustive analysis that underlay the decisions on social security and rates reform, Ministers may feel that they should be provided with some further supporting analysis before a virtual commitment to preemption of resources on such a large scale is entered into.



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(iii) Relationship with the Social Security White Paper:

As the Chancellor argues, there seems to be no major conflict between the tax and social security proposals. However, there is a substantial difference in the thrust of the two documents. The Social Security White Paper is designed to make large public expenditure and PSBR savings, and to target transfer payments on those who most need them. There are in consequence many losers. By contrast, the Chancellor's proposals are on a no-cash-loser basis, and necessarily only a relatively small part of the additional cost will benefit the poor. The contrast between the two approaches is bound to be drawn, particularly as the Social Security Bill will be in the House at the time of publication of the tax Green Paper. The answer, of course, is that the Government are committed to reducing the burden of personal taxation, and the very reason for reducing social security and other public expenditure is to make way for tax cuts. But there could be presentational problems over the contrast between the promise of several £ billion for tax reforms, which will not be universally popular, so soon after the issue of the social security White Paper showing several million losers. The Social Services Secretary will no doubt refer to this.

(iv) Integration of tax and benefit systems: The Chancellor notes in his covering paper that there has been considerable public interest in the longer-term relationship between the tax and social security systems. The somewhat dismissive treatment in Part III of the paper may, however, disappoint expectations and risk criticism for appearing unduly negative in tone and content. There is a good deal of support for greater integration among the Government's own supporters, as well as the Opposition parties. If, therefore, this material must be published in the Green Paper, Ministers may wish to consider whether a more positive gloss could be given to the discussion and the options left more genuinely open. For



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example, Chapter 7, on integration of national insurance and income tax, does not discuss the possibility of devising an integrated tax/NIC on earnings, with separate machinery to deal with taxation of unearned income and pensions. There may be major disadvantages in this; but if so, perhaps they should be aired and explained. More could probably also be said about what the Government already are doing (especially through the proposed family credit) to bring the two systems together, to reduce "churning", and (in effect) to let recipients keep more of their own money. Again, the Social Services Secretary will no doubt have views on those issues.

NEXT STEPS

8. If you decide, even only provisionally, that the Green Paper should be published with the Budget, there is another six weeks or so for further work and consideration. The Treasury would want to put the draft to bed by about the end of February. On the basis of discussion with the Treasury (who believe the Chancellor would go along with something like this) I suggest that you might think in terms of two or three further meetings of this group under your chairmanship with the following possible agenda:-

2nd Meeting:

(i) Fuller consideration of the distributional implications of the proposals (notably the effects on the poverty and unemployment traps) and alternative means of securing the same objectives - on the basis (preferably) of a joint paper by the Treasury and DHSS, in consultation with the Department of Employment.

(ii) consideration of alternative options for achieving the sex equality objectives (eg through partially transferable allowances), on different assumptions about cost and/or phasing in period (eg revenue neutral basis and phasing in over 3 or 4 years rather than 2) - on the basis of a Treasury paper;



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(iii) consideration of any outstanding points on the proposals (in Chapters 4 and 5) on other allowances and implications for the tax system - perhaps on the basis of a paper by Mr Fowler on the implications for the new social security system.

3rd Meeting:

Fuller consideration of Part III of the paper on the longer-term development of the tax system, particularly the relationship between the tax and social security systems - perhaps, again, on the basis of a paper by Mr Fowler.

4th Meeting:

Consideration of revised draft in the light of the above discussions.

9. A work programme on these lines would give Ministers a much better opportunity to consider the proposals in a measured and informed way before final decisions are taken. It should also help to eliminate the bugs in the present draft, expose those passages which ought to be greener than at present, and make it possible to launch the proposals with less risk of an adverse reaction. It would also, by confirming discussion to this Group, not trespass too far on the Chancellor's traditional prerogative in tax matters.

HANDLING

10. You will wish to invite the Chancellor of the Exchequer to speak to his proposals. You might then ask the Social Services Secretary for his comments; and then invite the other Ministers present, beginning with the Lord President, to comment generally on whether they think it would be right to publish a Green Paper of this kind at or after the Budget.



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CONCLUSIONS

11. You will wish the meeting to decide:-

(i) whether the Chancellor should publish a Green Paper on the lines he has proposed;

(ii) if so, whether it should be published with the Budget, or later;

(iii) whether further work should be done before final decisions are taken, and if so how it should be organised (eg on the lines of the programme in paragraph 8 above).

J B UNWIN

10 January 1986
Cabinet Office

EXTRACT FROM HANSARD, TUESDAY 19 MARCH, Vol 75,

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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.

