



Prime Minister

REFORM OF PERSONAL TAXATION

Nigel Lawson and I have held further discussions on the Green Paper on personal taxation and have resolved most of the detailed questions which were outstanding after the last meeting of your Ministerial Group. There is, however, one important general issue which I thought it right to raise in advance of tomorrow's meeting: whether we should recognise in the Paper the possibility of combining transferable allowances - the Paper's main proposal - with a family tax allowance. The latter would be specifically aimed at families with children; the necessary information would be provided through computer links between the Revenue and my Department.

Transferable allowances clearly have major attractions. But, taken on their own, their distributional results appear to be in conflict with much of what we have said about focussing more clearly on the needs of families with children. Not only did the proposals produce over a million substantial gainers amongst couples without children where the wife is not working, but such couples gain more than couples with children where the wife is not working. Critics will inevitably seize on this, especially in view of the controversy about our recent decision in last November's uprating to reduce the value of child benefit. We shall certainly be asked whether other options have been considered and why we have rejected them.

Our further analysis suggests a positive way through this might be to illustrate a reformed system based, as Nigel proposes, on single transferable allowances but with an element of the relief going in the form of a family tax allowance, payable to families with children (or even more widely to families looking after disabled relatives). We have modelled the effect of a scheme applying to families with children. This would combine smaller transferable allowance than Nigel's proposal with a family tax allowance of £750. For the same cost as Nigel's "no cash loser" option, this approach would meet almost all the Green Paper's stated objectives to a greater degree than the transferable allowance proposal alone. Compared to transferable allowances alone:

- around 1.4 million more families with children would gain, 650,000 of them by more than £5;
- most of the new gainers would be in the £2 - £5 category;
- the numbers caught in the poverty trap would fall even more markedly - there would be 40 per cent fewer (180,000) with marginal rates of over 80 per cent;
- the impact of the unemployment trap would be reduced by rather more;
- "churning" would be reduced by much more. Only 200,000 families would be left paying tax and receiving income-related benefit.

- Under transferable allowances alone, the figure would be ~~700~~₃₀₀,000;
- there would be 30,000 fewer families in receipt of family credit.

Against these clear advantages, I recognise that this option would also entail some losers. These would be overwhelmingly childless couples where both partners are working; most of the losses would be very small (less than £2 a week), and would affect families on above average earnings. In a phased programme of change it may be possible to reduce this problem still further.

In summary, transferable allowances with a family tax allowance produce results which are in many important respects more attractive than transferable allowances alone, and which can be presented as more consistent with the Government's overall social objectives.

I suggest therefore that such an option is mentioned and illustrated in the Green Paper. I attach a draft paragraph which might be added after para 3.31.

I am copying this to Willie Whitelaw, Nigel Lawson, Norman Tebbit, David Young, John Wakeham, John Moore and to Sir Robert Armstrong.



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3.32 The introduction of transferable allowances would not rule out further changes to the tax structure, designed to meet specific social or economic objectives. If, for instance, it was desired to provide more directly targetted help to families with children, it would be possible at a given revenue cost, to combine a slightly lower level of transferable allowance with a family flat allowance payable specifically to families responsible for children (or other dependents such as aged relatives). Targetting available relief in this manner would mean additional help for such families, whether or not the wife was working, but could provide relatively less help to single people or families with non-working wives who were not caring for children. Such a combination would also reduce further the number of families in the poverty and unemployment traps. The effects of such an illustrative package, are discussed in Annex 4.