

PRIME MINISTER

CCB/UP

Green Paper on Personal Taxation
Meeting of Ministers at 9 am on Wednesday, 12 February

BACKGROUND

At the last meeting of the Group on 29 January the Chancellor of the Exchequer was asked to reconsider, in consultation with the Social Services Secretary, the presentation of the economic and distributional effects of the proposed change to transferable allowances, and to submit a revised text of the complete Green Paper for consideration at tomorrow's meeting. Particular concerns expressed at the discussion were:-

- the importance of reconciling the presentation with that of the social security changes, so as not to add to the problems faced by the Social Services Secretary in steering them through the House;
- continuing concern also about the reaction of the financial markets to the apparent commitment to a very large tax "give away".

2. The text has now been extensively revised following discussions between the Treasury, Inland Revenue, DHSS and the Cabinet Office, and, subject to the one major outstanding point discussed in paragraphs 5 to 10 below, has now largely been agreed between the Chancellor and Mr Fowler. They have, for example, resolved their differences on the presentation of the relationship between the tax and benefit systems in Part III of the draft, and on the treatment of the Additional Personal Allowance (APA) in Chapter 4 of part II (Chapter 4.16 now exhibits the DHSS favoured alternative of linking entitlement to the receipt of one parent benefit(OPB) rather than replacing it by OPB). However, the most important changes are to Chapter 3, which sets out

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the case for a system of transferable allowances, and I suggest you concentrate discussion on this Chapter.

Chapter 3: Transferable Allowances

3. This Chapter has been recast to meet the objections that it put excessive weight on the distributional rather than the "equity" case for the reform, did not in any case come clean on the distributional effects, and went dangerously close to committing the Government to a £5 billion give away in 1990 or thereabouts, which would preempt any other major tax or expenditure reforms. Thus:-

- the chapter has been re-ordered so that the husband and wife "equity" case is stated before the distributional arguments;
- although the text (Chapter 3.3) states that the Government would aim to make the change in such a way that no one suffered a loss in cash terms, Chapter 3.6 onwards makes it very clear that the change could be phased in over a period and that decisions on introduction could only be taken nearer the time "in the light of economic circumstances at the time and in particular the scope for tax reductions";
- the presentation of the distributional implications is now consistent with that of the Social Security Reform. Annex 4 show two pole cases. The first (tables 1 to 3) gives the effect of making the change in one year. There are no losers, and the real gains are the same as the cash gains. The second (tables 4 and 5) shows the real effects of phasing in the transferable allowances over time and financing this by using the indexation allocation (ie a revenue neutral option). The Government could not, therefore, fairly be accused of not showing a full range of

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possibilities, but paragraph 6 of Annex 4 again makes it clear that in practice the revenue neutral option is an extreme one and that the Government would not intend to be in the business of increasing the real burden of taxation;

- there is now no reference to the likely date of legislation (you will recall that at the last meeting you opposed the then proposal to use the 1987 Finance Bill which would be likely to put the scheme on the statute book before the next election).

4. In general, therefore, I think the Chancellor can fairly claim to have gone a long way to meet the concerns expressed by the Group - in particular by the Social Services Secretary and yourself - in the previous discussions, and unless other Ministers still have problems, you may be able to conclude fairly quickly that the revised text is acceptable. This is, however, subject to the one important outstanding issue discussed in Mr Fowler's minute to you of today's date.

OUTSTANDING ISSUE: FAMILY TAX ALLOWANCE (FTA)

5. Although this issue has been extensively discussed between both Ministers and officials, the Chancellor's covering minute of 10 February avoids any reference to it. It has therefore been left to Mr Fowler to raise it in his minute of today. In brief, DHSS have consistently argued that the Government would be criticised if they failed at least to acknowledge in the Green Paper that, in contemplating such a major change, they had considered (and had had good reason to reject) alternative options for securing the same objectives. More specifically, they argue that there is a good case for considering a family tax allowance (FTA) which could be combined with transferable allowances but target the benefits more specifically at families with children (a Government policy priority).

6. Mr Fowler therefore proposes in his minute to you that, for the

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same £5.3 billion cost as the Chancellor's "no losers" option, there might be:-

- a single transferable allowance of £2,700 (instead of £2,830);
- a FTA of £750.

The advantages claimed for this are summarised in Mr Fowler's minute. Nearly 1.5 million more families with children would gain (mostly in the £2-£5 category); there would be beneficial effects on the poverty and unemployment traps, and on the numbers caught in both the tax and benefit nets; and the numbers in receipt of family credit would also be reduced.

7. As he hints in the second paragraph of his minute, the Social Services Secretary is also concerned about the contrast between the Chancellor's proposals as they affect families and the interim uprating statement he is due to make on 24 or 25 February, which will take effect from July prior to the first April uprating next year under the new uprating timetable. So far as child benefit is concerned, the uprating is likely to include either no increase, or an increase of 10p at most. The issue will need to be decided when the relevant RPI figure (covering price movements between May 1985 and January 1986) is available next week. If the figure is more than 1%, Mr Fowler may wish to argue that this would justify a rounded up increase of 10p, on the basis that he would find from another source the expenditure savings on child benefit to which he is committed. But in either case, the Government's posture (so Mr Fowler would argue) would not sit easily with Green Paper proposals which ignore the possibility of directing further help to families in a manner consistent with their main objectives.

8. The main arguments against the Social Secretary's proposal (which I understand the Chancellor is likely to rehearse in a further minute to you later today) are:

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- while admittedly benefitting families, there would be some 2.5 million cash losers (though mostly less than £2 a week) mainly among childless couples where both partners are working;
- to introduce a FTA would add a new complication to the tax structure at a time when the Government's aim is to simplify it. It would also appear to reverse the policy accepted since the introduction of child benefit that support for children should be concentrated in the social security benefit system and not duplicated in the tax system;
- a number of alternative options were displayed in the 1980 Green Paper. The time has come to concentrate in this new Green Paper on a single preferred option which the Government clearly favour (conversely, it might look odd only to display one alternative);
- under present and foreseeable arrangements (at least until sometime into the 1990s) a FTA would present serious operational problems, requiring many additional staff;
- it would be impossible to work out this option fully and properly for a Green Paper to be published with the budget.

9. You will want to seek the Group's views on whether this option should be displayed. There is little doubt that it will be canvassed when the Green Paper is published, and the Government will be asked whether they have considered it. Although not mentioning this particular variant, the recent (6 February) Financial Times article by Michael Prowse discussed a number of alternatives to the Chancellor's (expected) proposals and put emphasis on the need to help families. On the basis of the work done by DHSS economists (though we have not yet seen the detailed figures), the FTA option also appears to have

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considerable attractions. So far as married couples are concerned, it would achieve the Chancellor's equality and privacy objectives; and it would at the same time target help more effectively on families. It is true that time is short to work the options out properly; but the Treasury must take some responsibility for this as a result of their failure to consult DHSS more thoroughly at an earlier stage in preparing the Green Paper. Inclusion of this option would also add to the "greenness" of the Green Paper, and prepare the ground for moving in this direction if the consultation process elicited strong support for tilting the reform more in the direction of families with children. On the other hand, the Government would be faced with a problem of cash losers among (mainly) childless couples; an FTA would not sit happily with child benefit; and it can be argued that, having canvassed a wide range of possibilities in 1980 (though not this specific one), the time has now come for the Government to focus on a single preferred option and not muddy the waters further.

10. On balance, I think there is a case for at least acknowledging the option in the Green Paper. The Chancellor of the Exchequer is, however, strongly opposed to it and it would not be necessary to display it as fully as Mr Fowler suggests. A possible compromise, if the Group support Mr Fowler, would be to include in the text at most the draft paragraph attached to Mr Fowler's minute but without adding to Annex 4 the detailed exemplification he suggests. A compromise of this kind would meet the Treasury objections that there is not time to work out the option in detail in time for publication with the Budget; but it should meet Mr Fowler's point by showing that the possibility had not been overlooked, and (hopefully) enable an agreed text to be taken to Cabinet.

NEXT STEPS

11. The Chancellor of the Exchequer proposes that, if the draft is agreed tomorrow, he should circulate it to the Cabinet. You will no doubt want the Cabinet to have an opportunity of discussing it. That is clearly not possible this week (nor very sensible given the likely tenor of the pre-Budget macro-economic discussion). I suggest,

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therefore, that, subject to the discussion tomorrow, you invite the Chancellor to circulate the draft to Cabinet for consideration on 20 February. Although time would be very short, this should still enable the Treasury, assuming Cabinet approval, to get the Green Paper out on Budget Day (a real difficulty for the Treasury is that the figures in the present draft will need to be revised to take account of the Chancellor's Budget tax proposals).

HANDLING

12. You will wish to invite the Chancellor of the Exchequer to introduce the revised text, and the Social Services Secretary to comment on it and to explain his proposal for including a family tax allowance option. You will then wish to seek the views of the other members of the Group, starting with the Lord President, on whether the text is now generally acceptable to them.

CONCLUSIONS

13. You will want the Group to decide:-

- (i) whether the draft Green Paper is now broadly acceptable for publication with the Budget;
- (ii) specifically, whether it should include a reference to a family tax allowance option, and if so in what form;
- (iii) subject to decisions on the above, to invite the Chancellor of the Exchequer to circulate the full revised text for consideration by the Cabinet on 20 February.



J B UNWIN

11 February 1986
Cabinet Office