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PRIME MINISTER

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REFORM OF PERSONAL TAXATION

The Chancellor's Green Paper is certainly now rather greener, though its tone still creates a strong presumption in favour of making the change.

I suggest you concentrate on Chapter 3, but you will also want to look at paragraphs 5.13 - 5.16 about mortgage interest relief.

Within Chapter 3, paragraphs 3.5 - 3.9 are most important, and probably the most important in the whole Green Paper.

I have suggested one small change on paragraph 3.5.

I remain concerned about the way the costs are presented in paragraph 3.6 and in the table. The assumption made in both places is that all of the money from indexation would be devoted to paying for the move to transferable allowances. The figures in the table show the amount which is left over, after using up the money from indexation, which is needed to finance the transfer. Or, to put it in another way, the figures show the amount of fiscal adjustment which is needed after the money from indexation has been used up. That is why the apparent costs in the table fall as the rate of inflation rises.

But it seems entirely unrealistic to assume that over a five-year transition period with inflation at 5% a year, the real value of the married man's allowance would not be increased at all, which I believe is what the table implies. To place so much emphasis on using up the money for indexation is surely not a good way of winning a constituency for tax cuts. (The sentence marked X in paragraph 3.8 is surely disingenuous: it refers to holding allowances unchanged)

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in cash terms over a period of a year or more, while the table illustrates a position in which allowances would be held unchanged for five years.)

An alternative presentation would be to include a table which took only the first line from each of the three sections of the table. The result would be to show how the cost varied with the basic rate of income tax and the length of the transition period. This table is shown on the sheet attached. In effect, this would be a table showing the cost of introducing transferable allowances financed entirely out of the fiscal adjustment, with no reduction in the real value of allowances. (When inflation is zero, indexation is of course also zero.)

The text would then refer to the possibility of using money from not fully indexing the allowances if there were a widespread acceptance that a more rapid move to fully transferable allowances was desirable. The amounts of money which could be gained by less than full indexation at various rates of inflation could be shown if the Chancellor wished, but the presumption would be that the cost of introducing transferable allowances would be found in the first place from the fiscal adjustment.

My only other suggestion is that the first sentence of paragraph 3.23 should not state so firmly that the "Government's priority is to reduce the tax burden on one-earner couples". (Stated this way it looks like a priority with or without transferable allowances.) This is not stated in Chapter 2, and it may be better to say:

"Chapter 2 explains why it is important to reduce the tax burden on one-earner couples."

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I have mentioned these points to Mr. Tebbit's Office.

Monty Alexander
Duty Clerk

PP DN

11 February, 1986.

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Phasing in Transferable Allowances
Average annual cost

<u>Period of Transition</u>	<u>Basic rate of income tax</u>		
	25%	27½%	30%
Two years	2.3	2.5	2.7
Three years	1.6	1.7	1.8
Five years	0.9	1.0	1.1

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