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FILE
DA
C/G

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From the Private Secretary

17 December 1986

VAT AVOIDANCE

The Prime Minister has seen the Chancellor's minute of 16 December about the proposed package of measures aimed at reducing VAT avoidance.

The Prime Minister would like to know a little more about the proposals, how the changes will work, and whether legislation will be required. She is also concerned that the announcement could look like a mini-budget.

I am sure you will be able to reassure the Prime Minister on these points. You will need to put down a Question tomorrow if the announcement is to be made before the Recess, and I should be grateful for your reply to this letter by close of business tonight.

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(DAVID NORGROVE)

Mrs. Cathy Ryding,
HM Treasury.

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JB



I think we need
to know a little more
than this. Does it
have to be changed through legislation. It
looks like a
mini-budget

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

Prime Minister

Agree that an
announcement should be
made this week?

16/12

PRIME MINISTER

VAT AVOIDANCE

what changes?

I think you should know that I propose to announce this week a package of measures aimed at eliminating a substantial source of VAT avoidance. The problem arises essentially from manipulation of the rules by which businesses reclaim the VAT charged on their purchases. Companies making large volumes of exempt supplies can distort competition by forming a group with wholly taxable businesses and recovering all their input tax. For example, the bank which is part of British Petroleum's group registration - and the Opposition are aware that the financial sector figures prominently in this practice - can claim back all its input tax, unlike direct competitors and small businesses. The changes I propose, if implemented from April 1987, would yield £300 million in 1987-88 and £400 million in a full year.

With my authority Customs and Excise issued a consultation paper in August, on which written representations and meetings followed. Probing by Customs and Excise has served to indicate that the problem is even larger than first thought. I am sure we must put a stop to it.

There are however some sensitive areas. One consequence of tightening the rules is that a concession granted to the brewers in 1984 would have to be withdrawn. Unfortunately the brewers' chosen route for relieving the dilemma (taxing tied house rentals) is politically unattractive for quite separate reasons. However, there are other ways of tempering the loss of the concession to the brewers, and there is evidence they are ready to negotiate on these once the main issue has been settled. Peter Brooke has seen the Brewers' Society.

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Second, there is an understandable preoccupation with compliance costs. I propose to enable smaller businesses to recover the whole of their input tax, and thus to increase the number of smaller firms receiving favourable VAT input tax treatment. There will be an obligation on larger firms to engage in detailed calculations designed to prevent over-recovery of the tax but Customs and Excise will be ready to agree special methods either for whole trades or for individual firms. Moreover, compliance costs also fall on Customs who have a mutual interest in simplicity, and there will be an emphasis on practicality, accuracy and fairness.

Finally, just as I am concerned to secure early change for understandable reasons of revenue and anti-avoidance, there are also concerns about the length of time that will be available for agreeing and setting up new systems. I am particularly anxious, therefore, to make the announcement by arranged PQ before the Recess, for implementation from April 1st 1987. (Given that charges occur only quarterly in this area, delay until the New Year could cost us up to £100 million.)

Handwritten signature

N.L.

16 December 1986