

CCB/UP.

PRIME MINISTER

Tomorrow afternoon you are to meet the newspaper proprietors, Rupert Murdoch, David Stevens, and Conrad Black. You may recall that they asked to see you entirely privately to discuss the question of VAT on newspapers before the issue becomes too political.

The Economic Secretary will be present as well on behalf of the Chancellor. Detailed briefing is attached.

Bernard and Charles will both be present, and I have arranged the meeting in the White Room.

PM

P.A. Bearpark

11 November 1987

VALUE ADDED TAX AND NEWSPAPERS

Points to make

(i) **[Government's future intentions for VAT]** Prime Minister and Paymaster General have made position perfectly clear. In exceptional circumstances of election campaign, Prime Minister gave undertakings about several specific zero rates (ie food, gas, electricity and young children's clothing). Declined to go beyond these commitments because unwilling unnecessarily to constrain Chancellor's freedom to take decisions on tax in light of circumstances of future budgets. That remains case.

(ii) **[European Commission's tax proposals and zero rating]** Again position quite clear. Adoption of package will require unanimity and Prime Minister has given firm commitment to reject any proposals which would restrict UK's ability to use zero rating.

(iii) **[VAT and free newspapers]** Are aware of possible distortions of competition between free and other newspapers if VAT were imposed. Complicated issue and one which would have to be taken into account in any decision about extending VAT to newspapers.

BACKGROUND

Arguments likely to be raised

(i) Taxing information and news is wrong in principle;

(ii) The imposition of VAT would be harmful, in particular to local newspapers, which operate in a highly competitive market and have made strenuous efforts to modernise and become more efficient in recent years;

(iii) VAT could undermine the independence and diversity of the British press;

iv) VAT on paid-for newspapers alone would put them at an unfair disadvantage compared to free newspapers.

VAT zero rating

The UK currently applies a zero rate of VAT to a number of goods and services, including food, fuel and power, new construction, drugs, passenger transport, young children's clothing and books, newspapers and periodicals. During the election campaign the Prime Minister gave clear commitments not to impose VAT on food, gas, electricity and young children's clothing. She declined to go beyond these commitments in order not to constrain the Chancellor in future Budgets. That line has been consistently maintained since the election.

VAT and free newspapers

The Newspaper Society, in particular, has made much of the strong competition which paid-for regional newspapers face from the free press. If VAT were applied to paid-for newspapers and there were no VAT charge on free newspapers their competitive advantage would undoubtedly increase. It is argued that this could force other regional newspapers either out of business or into the free sector themselves, leading to a decline in the standard of news reporting and editorial content. Legal advice at the time taxation of newspapers was last considered (before the 1985 Budget) suggested that free newspapers would have to account for VAT on the value of papers distributed. This raised a number of complex legal and technical issues involving in particular valuation for VAT purposes, and the definition of what should be included in the tax net. In the event, no action was taken.

Removal of fiscal barriers - EC Commission proposals for tax approximation

The White Paper proposals: The Commission's White Paper, 'Completing the Internal Market', included a set of tax measures designed to remove fiscal barriers to intra-community trade. For VAT, these consisted of:

- Completion of structural harmonisation (adoption of a range of existing and new directives on the tax base and machinery).

- 'Approximation' of rates (fixing central VAT rates - standard, reduced and maybe higher - from which national rates could diverge by no more than a set amount, illustratively + or - 2.5 percent).
- A 'clearing mechanism' to re-allocate revenue displaced because of changes in the rules for charging VAT on imports from the exports to other Member States.

The Commission envisaged parallel measures for the excise duties.

Discussion to date: The White Paper's fiscal measures were not included in the list of areas for priority action drawn up by the Milan European Council in June 1985. ECOFIN reviewed the subject in June 1986 and concluded that more detailed proposals were needed before political decisions could be taken. These were promised for 1 April 1987 but were not approved by the Commission until 15 July. Discussion of procedural issues is expected at ECOFIN's next meeting, on 16 November, but substantive Ministerial discussion is unlikely before the end of the year.

Commission's tax approximation package:
VAT.

The Commission proposes 2 rates of

- A standard rate of 14-20 percent.
- A reduced rate of 4-9 percent.

Member States would be free to fix their national VAT rates at any point within these bands. The reduced rate band would cover: foodstuffs, energy, water, pharmaceuticals, books, newspapers and periodicals and passenger transport.

The Commission recognises the difficulty which the proposals will cause for the UK and Ireland where zero-rates are applied extensively and does not rule out the possibility of a ^{temporary} derogation allowing relevant Member States to continue zero rating in 'case of particular difficulty'.

Zero rating: Zero rating is permitted under a derogation from the EC's basic VAT law, the 6th VAT Directive. That derogation is set to expire when fiscal frontiers are abolished - hence Lord Cockfield's refusal formally to provide for zero rating in his approximation package. The Prime Minister has already made it clear that the UK will not accept proposals which restrict our right to apply zero rating. That commitment was underlined by the Paymaster General in a statement issued on 15 July (see Annex).

1984-85 Campaign:

The last major campaign by the industry against the imposition of VAT was mounted in the run-up to the 1985 Budget. This followed the extensions made to the VAT base (notably to hot take-away food) in the 1984 Budget. The campaign, which was run in conjunction with the book industry, generated considerable interest among both MPs and the public. At least in part to prevent a repetition of the campaign the Chancellor said in his 1985 Budget Speech that he did 'not intend to make any further extensions of the VAT base during the life time of this Parliament'.

The newspaper and book industry have renewed their campaign against VAT since the general election, because of the Government's failure to give a firm commitment not to tax publications. There are two Early Day Motions, signed by 125 MPs, which specifically refer to newspapers and we have dealt with 43 Ministerial correspondence cases since 1 June 1987 on the subject.