

CONFIDENTIAL

COVERING BUDGET SECRET: BLO

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for P GRAYREF NO. F 88/2
Copy No. of 6Treasury Chambers, Parliament Street, SW1P 3AG
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2 February 1988

Paul Gray Esq
10 Downing Street
Whitehall
SW1*Dear Paul,*

I attach an Aide Memoire on the Budget. You will have received a copy of the Budget Security Instructions, and I should stress that the Aide Memoire should not be shown to anyone other than the Prime Minister and yourself.

Yours
Alex

A C S ALLAN

AIDE MEMOIRE ON BUDGET

Income tax

Basic personal allowances increased by twice the amount indicated by indexation (to £2,600 for single person and £4,100 for married man). Basic rate cut to 25p. Higher rate threshold raised to £20,000 of taxable income. All higher rates above 40p abolished, leaving a single higher rate of 40p.

CGT

As with new US system, gains to be added to income and taxed at IT rates (25 per cent/40 per cent). Helps basic rate taxpayers with small gains, and for higher rate taxpayers removes most of bias against income and in favour of capital gains. CGT (and CT on companies' gains) to be rebased to 1982 (when indexation began), thus ending taxation of paper gains.

Mortgage interest relief

One portion of mortgage interest relief to be allowed per residence, thus stopping cohabiting unmarried couples claiming two lots of relief; ends tax penalty on marriage. Relief on new home improvement loans to be abolished; widely abused, and predominantly used for improvements such as double glazing which could reasonably be met out of income or savings. In all cases, change will apply only to new mortgages/loans.

Maintenance and covenants

System substantially simplified. For maintenance payments, stop taxing recipients and stop giving unlimited relief to donors. Take new covenants (except for those to charities) out of tax system altogether. To compensate for ending of tax relief on covenants to students, make offsetting reduction in parental contribution to grants. No change for any existing covenants or maintenance payments.

Car benefits

Car scales (which determine amount of taxable benefit from company car) to be doubled; this will raise taxable benefit from about a quarter of true value of benefit to about a half.

Corporation tax

Small companies CT rate to be reduced to 25p in line with basic rate of income tax.

Inheritance tax

IHT threshold to be raised from £90,000 to £107,000, with a single rate of 40 per cent (compared with present 30%/40%/50%/60% scale). Large numbers of small estates taken out of tax altogether, and substantial benefits to family businesses. Taken with other changes, means no direct tax rate in excess of 40 per cent.

Excise duties

Broadly uprated in line with inflation, but with some variations: eg. duty differential between leaded and unleaded petrol to be increased to 10p.

VAT

No change.

Other proposals

- (i) Forestry to be exempted from taxation in future (produces revenue yield: offset by increased grants for forestry).
- (ii) Some relief to stimulate private rented sector: probably an extension of Business Expansion Scheme.
- (iii) Some administrative reforms of assessment system for Lloyd's.
- (iv) Action on company residence and migration to prevent potentially substantial tax loss.

Independent taxation

From 1990-91, husband and wife to be taxed separately. Each will have their own tax allowance, own CGT annual exemption etc. Ends married women's tax grievances. Married man's allowance replaced by new married couples' allowance, normally given to the husband. Transitional provisions will ensure no losers - and many will gain (especially pensioners).

Some other changes in allowances: unmarried couples with children living together will be restricted to one Additional Personal Allowance; some minor personal allowances to be scrapped: housekeeper's allowance, dependant relative's allowance, and sons' and daughters' services allowance.

ANNEX

APPROXIMATE COSTS(*)

£ billion

	<u>1988-89</u>	<u>1989-90</u>
Increased personal allowances	-0.7	-0.9
25p basic rate	-2.5	<u>-3.1</u>
Increased higher rate threshold	-0.2	-0.4
Abolition of rates above 40p	-0.8	<u>-1.7</u>
CGT changes	nil	-0.3
Abolition of relief on improvement loans	+0.1	+0.2
Covenants/maintenance reforms	-	+0.1
Increased car scales	+0.3	<u>+0.4</u>
Inheritance tax reform	-0.1	-0.3
Other changes	+0.1	-
TOTAL	<u>-3.8</u>	<u>-6.0</u>

* Net of indexation/revalorisation.

Independent taxation will cost £0.6 billion in 1990-91.