chex.ps/aa/49

CHX/1/89 A

REF. NO.
COPY NO. 1 OF 12

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

downgraded to:
CONFIDENTIAL

BUDGET

SECRET B.L.O.

PRIME MINISTER

This minute sets out my proposals for the Budget this year.

2. I have decided to give priority to a major reform of employees' national insurance contributions, and to measures which will further encourage wider share ownership. I am not therefore proposing further reductions in the basic rate of income tax this year, or increases in allowances over and above the rate of inflation. I do not propose to raise excise duties. I can finance these and the other measures I am about to describe while continuing to repay debt on a very substantial scale. I shall send you a separate note shortly about the MTFS, including my proposals for monetary targets and the precise level of the PSDR.

National insurance contributions

3. My main reason for giving priority to the reform of national insurance contributions is to deal with the so-called "steps", those points on the earnings scale at which people can find themselves worse off if they earn more, because they lose more in national insurance contributions than they gain in extra pay. The NIC reform is also the best way to lighten the load on the lower paid and will leave everyone on just under half average earnings or more with £3 a week more of their own money.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

CONFIDENTIAL

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

4. Under the present system, anyone earning less than £43 a week pays no NICs at all. Anyone earning between £43 and £75 pays 5 per cent on the whole of his or her earnings, including the first £43. Anyone earning between £75 a week and £115 a week pays 7 per cent, again on the whole of their earnings. Anyone earning between £115 a week and the upper earnings limit of £325 pays 9 per cent on all their earnings.

5. There are thus three steps, at £43, £75 and £115. At each of these points, an extra pound of earnings can trigger more than an extra pound of NICs.

6. I propose instead that, from 2 October (1 October is a Sunday), employees who pay NICs will do so at only 2 per cent on their earnings up to £43. On their earnings above this they will pay 9 per cent, up to an unchanged upper earnings limit.

7. This will increase by £3 a week the take home pay of those earning £115 a week or more. That is about 40 per cent of male average earnings. With indexation of the personal allowances for income tax, the combined burden of income tax and NICs for someone on half average earnings will fall by over 2 per cent of gross pay.

8. The reform will greatly reduce marginal rates at the present steps. It will abolish altogether the steps at £75 and £115, and reduce the last remaining step at £43 to only 86 pence. I have thought it right to retain this modern-day equivalent of the old national insurance stamp because it is the entry ticket to contributory benefits and essential to the contributory principle.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

CONFIDENTIAL
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

9. There may need to be a consequential reduction in the voluntary NIC rate which those not in employment can make, if they so wish, to maintain their national insurance records. This detail is yet to be finally decided. There will be no change for employers or the self-employed. (The steps are nothing like such a problem for employers as for employees; and to extend the changes to employers would roughly double the cost.)

10. The reform needs primary legislation, which will be introduced at the Report Stage of the Current Social Security Bill. It will cost £1 billion in 1989-90 and £2.8 billion in 1990-91. I have discussed these proposals with John Moore, who greatly welcomes them. They will meet the concerns expressed by colleagues and others that the Budget should reduce the burden on the lower paid.

Income tax

11. I do not propose to change the basic or higher rate of income tax. I shall increase the personal allowances and the basic rate limit by the amount required for statutory indexation, which is 6.8 per cent rounded up. The main personal allowances will thus be maintained at a level 26 per cent higher in real terms than when we came to office.

The elderly

12. I think it right to do something for the elderly.

13. First, I propose to redeem our 1979 election pledge by abolishing the pensioners' earnings rule from 2 October. If people wish to defer taking their pensions, they will continue to be free to do so, and to earn a higher pension when they retire; but that will be entirely a matter of

BUDGET SECRET
B.L.O. SECRET
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

CONFIDENTIAL
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

choice. The public expenditure cost will be about £185 million in 1989-90, and about £370 million in 1990-91 and will be met from the Reserve. The net cost will be considerably less, because we shall get back additional revenue from the increased pensions in payment, and from pensioners' higher earnings. I have agreed this, too, with John Moore.

14. Second, I propose to extend the higher age allowance which currently applies to those aged 80 and over to take in all those aged 75 and over. This will take an additional 15,000 pensioners out of tax. Single pensioners in the 75-80 age band will have a tax reduction of £1.73 a week, and married couples £2.55.

15. Third, I propose to reduce the rate at which the age allowances are withdrawn. This has given rise to complaints because, after last year's abolition of the top rates of income tax, the withdrawal rate now exceeds the higher rate of tax. It will come down from nearly 42 per cent to 37½ per cent.

16. Finally, the Finance Bill will include the new tax relief for pensioners' health insurance premiums announced in the Health White Paper; it will come into effect in April 1990.

Company car scales

17. I plan a further increase in the scales for taxing the benefit from company cars, which continues to be undertaxed. I have decided they should be increased by a third, a significant increase but less than is generally expected. The great majority of company car drivers will be better off from the Budget as a whole; and in the second half of the year, when the effects of the NIC reform come in, significantly so.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

CONFIDENTIAL
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET SECRET

Schedule E

18. I propose to simplify the taxation of income under Schedule E, to remove a major complication which stemmed from the days when there were many different higher rates, and which mainly affects directors. In future, they will be taxed when they receive income, instead of when they are deemed, after complicated adjustments, to have earned it. This will have a short-term cost, but in the long-term will save a significant number of Revenue staff and produce a revenue yield.

Excise duties

19. I propose to make no changes in excise duties this year save for two areas.

20. First, I shall reduce the tax on unleaded petrol by getting on for 4 pence a gallon. That should make unleaded nearly 10 pence a gallon or a little over 2 pence a litre cheaper at the pumps than four star - one of the largest differentials in the EC. At the same time, I propose to increase the tax on two and three star petrol by roughly 4 pence a gallon, so that the pump price of these grades will be at least as high as that for four star. This should accelerate the phasing out of two star, which is already underway, and free storage space and pumps for unleaded petrol. I have told Nicholas Ridley about this proposal, and he welcomes it.

21. Second I propose a number of changes to the Vehicle Excise Duties, which I have agreed with Paul Channon. At present, a bus or coach has to have 66 seats before it pays as much tax as a family car. I propose to increase the rates

SECRET
B.L.O.
SECRET
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

CONFIDENTIAL
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

for this group of vehicles. I also propose to increase the rates on non-articulated lorries, to put them on a more equal footing with the tax paid by articulated lorries. And I propose to simplify VED, cutting the number of main rates by about a third.

Value added tax

22. As usual, I propose to raise the VAT registration threshold as much as I can under EC law, namely from £22,100 to £23,600.

23. The only change to the coverage of VAT I have to propose this year has already been announced - the measures to implement the ECJ judgement of last June requiring us to end the zero-rating of non-domestic construction; of supplies of electricity and gas to non-domestic consumers, and of water and sewerage services to industry; of protective clothing and headgear supplied to employers; and of news services (but not newspapers, which continue to be zero rated). As you know, I have decided to give generous transitional arrangements for non-domestic construction, and have agreed to defer until July 1990 the standard rating required for fuel, power, water and sewerage to enable these industries to cope more easily with the administrative changes involved. The loss of these zero rates derives from the 6th EC VAT Directive agreed by our predecessors in 1977.

Charities

24. The effects of the ECJ judgement on charities is a sensitive issue and I have done all I can to soften the blow, as the charities themselves have acknowledged. All fuel and

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

CONFIDENTIAL
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

power supplies and construction for their non-business activities will remain zero-rated, as will water for all their activities. But some charities may still have to pay extra VAT. I have therefore decided to introduce some additional reliefs.

25. I propose to extend exemption from VAT to fund-raising events by charities (and certain other fund-raising organisations, including political parties and trade unions); and to extend zero-rating to all advertisements placed by charities, and to sterilising equipment used by medical charities. And I propose to exempt from special car tax vehicles purchased by Motability for leasing to the disabled.

26. I also propose a change in the rules on covenanted membership subscriptions so that it is clear beyond doubt that charities such as the National Trust can offer members free or cheap entry to their properties without loss of tax relief. This will remove a long-standing anxiety.

27. I continue to believe that the best way to help charities is to encourage charitable giving. I therefore propose to double the annual amount which can be given tax free to charities under the payroll giving scheme from £240 to £480 a year.

Capital gains tax

28. I shall keep the annual exemption from CGT at £5,000 this year. Married couples will then in effect have a £10,000 exemption when independent taxation comes in next year.

29. I propose to restrict the deferral of CGT on gifts. This was originally introduced by Geoffrey Howe to prevent a double tax charge when Capital Transfer Tax was levied on

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

CONFIDENTIAL

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

lifetime gifts. Now that CTT has gone, the continued CGT exemption for gifts has become a popular form of tax avoidance. I therefore propose to restrict the exemption, but I shall keep it for gifts of business, farm and heritage assets, gifts to charities, and of course gifts between husband and wife. Gifts or sales of ordinary personal belongings are already exempt from CGT if they are worth less than £3,000. I propose to double this to £6,000.

30. Finally on CGT, I propose to block off a device for turning income into capital through deep discounted bonds.

Company taxation

31. I propose to reduce the burden of corporation tax on many companies, not by changing the main rate of 35 per cent, which is still one of the lowest in the world, but by making the benefit of the 25 per cent small companies rate available to more companies. Ever since the corporation tax reform I introduced in 1984, the small companies' rate has applied to companies with an annual profit of less than £100,000. The benefit is only gradually withdrawn, so that companies only pay the full 35 per cent rate if they have an annual profit of £500,000 or more. I propose to increase both the £100,000 and the £500,000 limits by 50 per cent, reducing the CT burden for more than half the companies which do not already benefit from the small companies rate.

32. I intend to simplify the tax rules for close companies. At present, 20 pages of complex legislation - the apportionment rules - are in force to ensure that they are not used for tax avoidance. After last year's reforms, the rules are no longer necessary, and I shall abolish them. Special provisions will be required to prevent the use of close investment companies for avoidance purposes, but these will be pretty straightforward.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

CONFIDENTIAL

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

Wider share ownership

33. I propose a number of measures to encourage the further widening of share ownership.

Personal equity plans

34. I propose to raise from £3,000 to £4,800 the limit on the overall amount which can be invested in a Personal Equity Plan each year. Within that, I propose to raise the amount which can be invested in unit trusts or investment trusts from £750 to £2,400 a year. I shall drop the rule that no more than a quarter of a PEP may be invested on unit or investment trusts, but require instead that such trusts be invested mainly in UK equities. (We may in time have to face the wrath of the Commission over this, but I see no point in anticipating it.)

35. So far, investors in privatisations and other new issues have not been able to take advantage of the tax reliefs which PEPs provide, because of the rule that only cash may be invested in a PEP. I propose to change this so that all shares obtained from a new equity issue can be placed directly in a PEP. This should not only encourage wider use of PEPs but also contribute to the success of future privatisations, in particular Water and Electricity.

36. Finally, I propose to make a number of important simplifications to the rules, to make PEPs more flexible, better directed to the needs of small and new investors and cheaper to administer.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

CONFIDENTIAL
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

Employee share schemes

37. All-employee share schemes have been a major success, growing in number from 30 in 1979 to some 1500 at present. We need to ensure that the limits governing such schemes do not hamper this growth. I therefore propose to increase the annual limit on the value of shares which can be given to an employee income-tax free; to increase the monthly limit for all-employee save-as-you-go share schemes; and to double the maximum discount from market value at which options may be granted, from 10 per cent to 20 per cent.

Employee share ownership plans (ESOPS)

38. I have been impressed by the enthusiasm for Employee Share Ownership Plans in the representations I have received about the Budget, both from some of our own backbenchers and from outsiders. These schemes involve putting shares into a trust for later transfer to employees. They are a relatively new development in the UK, but could have a useful potential for increasing employee share ownership, especially in unquoted companies. They are at present being hindered by uncertainties about the deductibility for corporation tax of employers' contributions to ESOPs. I propose to clarify the legislation to put this beyond doubt.

Profit related pay

39. Profit related pay schemes have been spreading, but more slowly than I would like. In the light of experience, I propose to abolish the restriction that PRP must equal at least 5 per cent of total pay; to raise the limit on the

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

CONFIDENTIAL
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

amount which can attract relief from £3,000 to £4,000 a year; and to relax the rules which prevent headquarters staff from using the profits of the whole company or group in calculating their PRP.

Life assurance

40. I propose to make reforms in the tax treatment of life assurance and pensions. You will recall that last June I authorised the Revenue to issue a consultative document on the taxation of life assurance. This drew attention to defects in the tax regime, which mean that the incidence of tax is uneven between companies, and the overall yield lower than it should be by any reasonable yardstick. There has been a full response from the industry and others, and the Financial Secretary and the Revenue have had consultations with the main representative bodies, including in particular the Association of British Insurers.

41. I have concluded that it is right to make a number of changes within the existing tax regime, which is special to life assurance, but not to pursue the more radical alternatives canvassed in the consultative document. More radical reform could arguably place an unnecessary burden on the industry when it is adjusting to the changes flowing from the Financial Services Act, and when it is preparing for the increased competition it may face in the 1990s in the European Community.

42. I propose, first, to separate for tax purposes the pension business of the life offices from life assurance proper. This will stop the life offices from setting pensions expenses against life business profits. The ABI has itself acknowledged that it is anomalous to allow this at present. This single measure is the source of the net yield of the life assurance package: the other measures are broadly neutral over a run of years, with a modest reduction in yield to start with.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

CONFIDENTIAL

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET L.O.

43. I propose to spread over seven years the deductibility of expenses associated with selling new life assurance policies, which the present regime allows to be deducted all at once; to reduce the tax on life assurance policyholders' funds from 35 per cent on income and 30 per cent on capital gains to a single rate of 25 per cent; and to abolish Life Assurance Policy Duty, the special stamp duty paid on Life Assurance Policies. The changes will come into effect on 1 January 1990; but, to give the life offices time to adjust, the spreading of expenses will be phased in over four years.

Unit trusts

44. I also propose to reduce the rate of tax on unit trusts to 25 per cent. This will remove a tax disadvantage which UK unit trusts face. The change will apply to authorised trusts recognised in the Community as "Undertakings for Collective Investment in Transferable Securities", for whom the EC UCITS directive comes into effect later this year.

Pensions

45. For pensions, I propose first to make an important deregulatory change. At present the tax reliefs for contributions to occupational pensions, for the fund itself, and for the lump sum, are tied to schemes which comply with the relevant Inland Revenue rules and limits. If an employer wants to pay pensions beyond the Inland Revenue limits, the whole of the tax relief is lost. I propose to end this all-or-nothing rule. Employers will be free to pay larger pension benefits, but from non-tax privileged funds.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

CONFIDENTIAL

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

46. At the same time, I propose to put a limit on the tax relief which occupational pensions can receive. This will be related to final salary of £60,000, indexed to prices. Even if it were applied immediately, only some 50,000 employees would be affected; but I propose that the measure should only apply to new entrants to existing schemes, and to new schemes.

47. I also propose to improve the tax regime for personal pensions, by increasing the proportions of salary which people of 35 and over can invest tax-free in a personal pension. Of all the pensions measures, this will be the one with the largest immediate impact, and will encourage further growth in personal pension provision. There will be a cash limit on the total contributions which can be made tax-free.

48. Public service pension schemes including the Civil Service pension scheme will have to be amended to comply with these new rules before the implementation date of 1 June. I have told colleagues most directly involved about my proposals. After the Budget, I will want to consider with them the implications of the new rules for public service pensions.

Other measures

49. I propose, at Paul Channon's request, to include in the Finance Bill provision for the sale to the public of "cherished" car registration numbers.

50. I propose to exempt from taxation as a benefit-in-kind the security equipment which a few employers now have to provide at the home of key employees at risk from terrorist or other attacks.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.F.O. SECRET

CONFIDENTIAL

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

51. I also propose, as you know, to include in the Bill provisions to restore criminal sanctions against Revenue or Customs officials who reveal information about the private affairs of individual taxpayers.

52. I intend to issue consultative documents on the tax treatment of gains and losses on foreign currency borrowing, and of interest swaps between companies and on proposals to simplify the administration of the tax scheme for sub-contractors in the construction industry.

53. Finally, I should let you know the conclusion I have reached on residence. The representations on the consultative document the Revenue published last summer have convinced me that the world wide income approach would be damaging and unworkable. I intend to have it made clear during the Budget debates that we do not intend to continue with this proposal.

Cost

54. I attach a table which summarises the revenue effects of the Budget measures.

N.L.

N.L.
7 March 1989

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

CONFIDENTIAL
BUDGET SECRET—BUDGET LIST ONLY
0331
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET
SECRET
B.L.O.

Table 1.1 The Budget measures[1]

	£ million		yield(+)/cost(−)
	1989–90		1990–91
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
National ~~I~~nsurance			
~~reform~~ employee contributions ~~reformed~~	−980	−980	−2805
Income ~~T~~ax			
personal allowances and basic rate limit indexed	−1 465	—	—
car benefit scales increased	+160	+160	+200
new basis of assessment for Schedule E	− 80	− 80	−60
Excise duties			
petrol, derv etc	—	−545	−580
duty on unleaded petrol reduced, duty increased for 2 and 3 star petrol	−40	−40	−100
vehicle excise duty	+40	−150	−170
tobacco	—	−235	−250
alcohol	—	−255	−280
Value Added Tax			
non-domestic construction etc	+315	+315	+540
Life assurance ~~businesses~~' tax regime reformed	−20	−20	+45
Corporation ~~T~~ax			
small companies' rate threshold increased	*	*	−35
Other tax changes	−80	−45	+ 5
Pensioners' earnings limit abolished[2]	—	—	—
Total	−2150	−1875	−3490

[1] *These measures and the basis of the costings shown, are described in detail in Chapter 4.*

[2] *Public expenditure cost of £~~125~~ 190 million in 1989–90 and £~~255~~ 375 million in 1990–91 will be met from the Reserve. See Chapter 5.*

* = Negligible — = Nil

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET—BUDGET LIST ONLY

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

S C

12(A-P.)

BUDGET SPEECH - FIRST SECTION

The background to this year's Budget is the unprecedented strength of the British economy, coupled with the continuing need to combat inflation, at a time when, throughout the world, it is unmistakably edging up again.

Note
PM: consult
asked passed
a to Chancellor's
Office.

Rec'd 11/3

2. I shall begin with an account of the performance of the economy in 1988 and the prospects for 1989, set in the context of the past ten years. I shall then deal with monetary policy and the public sector finances. Finally, I shall propose a number of measures to carry forward the process of tax reform.

3. As usual, the Financial Statement and Budget Report, together with a number of Press Releases filling out the details of my proposals, will be available from the Vote Office as soon as I have sat down.

ECONOMIC PERFORMANCE AND PROSPECTS

4. The Government's first ten years in office have seen a transformation both in the way in which economic

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

policy is conducted, and in the results that have been achieved.

B

5. For the first time, financial policy has been set firmly and explicitly in a medium-term context. We have been guided by the basic philosophy that the Government should set a sound medium-term financial framework and leave the private sector free to operate with confidence within it.

6. The Government came to office with two central objectives - to defeat inflation, and to breathe new life into a moribund economy - and a clear idea of how to achieve those objectives. Inflation is a disease of money; and monetary policy is its cure. The role of fiscal policy is to bring the public accounts into balance and keep them there, and thus complete the process of re-establishing sound money. And strong sustainable growth is achieved, not through any artificial stimulus, but by allowing markets to work again and restoring the enterprise culture, by removing unnecessary restrictions and controls and rolling back the frontiers of the State, by reforming trade union law and promoting all forms of capital ownership, and by reforming and reducing taxation.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

7. Our first and most urgent task was to stamp out the inflationary fires that had raged in the '70s, and wrought so much economic and social havoc. And we succeeded. Between 1974 and 1979 inflation had averaged more than 15 per cent. Over the past six years it has averaged 5 per cent.

8. Once business and industry recognised the fundamental changes that were taking place, they responded to the new economic climate with vigour and confidence. As a result, we have experienced the longest period of strong and steady growth this century. Output in the United Kingdom has grown faster than in all the other main European nations during the '80s - a marked contrast to the previous two decades, when we were bottom of the league. And this growth has been based on a dramatic and sustained improvement in productivity. For the economy as a whole our productivity growth has been second only to that of Japan among all the major nations during the '80s. In manufacturing it has exceeded even Japan's.

9. In Britain today we have more people in work than ever before in our history; they are better motivated than ever before, and their living standards have improved beyond recognition.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
D

10. But it is not just our economic performance that has been transformed: so have our prospects for the future. For over the past seven years, investment has grown more than twice as fast as consumption, creating the increased capacity necessary to meet future demand. Total business investment is now a higher proportion of national income than ever before. And its quality has improved immeasurably, too; as has the quality of British management. We have seen a dramatic and long overdue improvement in company profits. And a remarkable growth in the total number of businesses, now at the rate of more than a thousand a week.

11. Provided we stand firm in our resolve to get on top of inflation, the prospects before us are excellent. And at least on this side of the House, we do.

12. A year ago, in the aftermath of the worldwide stock market crash, it looked as if there would be some slowing down from the rapid growth of 1987. In fact that was not to be.

13. As the House knows, the state of the national income statistics leaves much to be desired. But it now appears that we had in 1988 a second successive year of

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

E

growth at 4 1/2 per cent, with unemployment falling by over half a million to well below the European average.

14. Manufacturing output grew particularly rapidly, by more than 7 per cent, to a level well above the previous peak.

15. But total spending also grew by getting on for 7 per cent, mainly because of the boom in industrial investment, in itself a welcome event, but also because of continued strong growth in consumer spending. This last was financed to an unprecedented degree by borrowing, overwhelmingly mortgage borrowing.

16. Inevitably the rapid growth of total spending led to renewed inflationary pressure. To some extent this was diverted into a sharp rise in imports, and hence in the deficit on the current account of the balance of payments. The published figures put this at £14 1/2 billion in 1988, although given the £15 billion positive balancing item - another name for errors and omissions - the true figure is almost certainly less than this. But whatever the true figure, it is undoubtedly large, and a sharp increase on the deficit recorded in 1987 after seven successive years of surplus.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

17. But given sound policies it can readily be financed. Moreover, unlike previous current account deficits we have known in this country, it reflects not excessive Government borrowing, but rather an upsurge of private investment unmatched by private savings. This is something that will in due course correct itself.

18. As the House knows, however, there has also been some pick up in recorded inflation. Excluding the distorting effect of mortgage interest payments, the RPI rose by $4^1/_2$ per cent last year, much the same as the average over the previous five years. But this underlying rate increased significantly through the year, and now stands at $5^1/_2$ per cent.

19. Moreover the pick up in inflation appears to be a worldwide trend. Taking the seven major industrial nations as a whole, inflation is now at its highest level for some three years.

20. In the UK, as in a number of other countries, it became clear that it was necessary to tighten monetary policy sharply. That meant raising short-term interest rates, which I duly did, starting last June.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

G.

21. I am of course keenly conscious of the difficulties many borrowers, particularly home owners, and now experiencing. But however unwelcome high interest rates are, they are infinitely preferable to the damage that would be done by high inflation.

22. There are now increasing signs that the determined action I have taken is having the desired effect. The housing boom that played such a large part in the events of last year has subsided. Monetary growth has slowed down appreciably. And retail sales, too, seem to have levelled off over the past four months, presaging a gradual recovery in the personal savings ratio.

23. The outlook for 1989 is for inflation to rise a little further over the next few months, from $7^1/_2$ per cent including mortgage interest payments to about 8 per cent, before falling back in the second half of the year to $5^1/_2$ per cent in the fourth quarter and perhaps $4^1/_2$ per cent in the second quarter of 1990.

24. Some slow down in real growth is inevitable as we get inflation back onto a downward path - indeed, it has almost certainly already begun to happen. Overall growth is forecast to fall from the $4^1/_2$ per cent recorded last year to $2^1/_2$ per cent this year, with

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

growth through the year at 2 per cent. Domestic demand is forecast to slow down even more markedly. But within this, investment, which is holding up well, is once again forecast to grow faster than consumption. The current account deficit is forecast to remain at the same level as last year.

25. But the question of just how "soft" or "hard" the so-called landing will be is not in the hands of Government alone. The Government's task is to reduce inflation by acting, through monetary policy, to bring down the growth of national income in money terms. The extent to which, over the short term, this is reflected in a reduction in inflation, and the extent to which it is reflected in slower output growth, is largely up to business and industry.

26. The better that industry succeeds in controlling its pay and other costs, the less painful the necessary adjustment will be, not least in terms of employment prospects.

27. But over the medium-term, it is clear from our experience over the past ten years that the policy we are pursuing will bring inflation down, and steady growth will resume. The best contribution the

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

Government can make to this is to carry forward the process of supply side reform, to help make the economy work better. That is the objective of the specific measures to which I shall turn in the second part of my speech.

Monetary policy

28. As I said at the outset, monetary policy plays and must always play, the central role in the battle against inflation. It is at the very heart of the medium-term financial strategy, the tenth edition of which I am publishing today.

29. I have described the monetary tightening that has taken place over the past nine months. This has already led to a sharp deceleration in the rate of growth of the target aggregate, narrow money, or M0.

30. For 1989-90, the target range for MO will be 1-5 per cent, as envisaged in last year' MTFS. Although it will start the year above the top of that range, its very low growth over the past six months - under 3 per cent at an annualised rate - suggests that it will fairly soon come back within the range. As in the past two years, there is no target for the growth of broad

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

money, or liquidity, but I will continue to take it into account in assessing monetary conditions.

31. The exchange rate is of particular importance in the conduct of monetary policy. A clear commitment not to accommodate increases in domestic costs by exchange rate depreciation remains a key safeguard against inflation. This has been demonstrated both by the level of interest rates and by our readiness to use the massive reserves we have accumulated. In this context, we will continue to work with our G7 partners to maintain the exchange rate stability that has been a feature of the past two years.

32. Short-term interest rates remain the essential instrument of monetary policy. I repeat what I have stated clearly on a number of previous occasions: interest rates will stay as high as is needed for as long as is needed. For there will be no letting up in our determination to get on top of inflation.

Public Sector finances

33. I now turn to fiscal policy.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

K.

34. When we first took office the public sector borrowing requirement was over 5 per cent of GDP - equivalent to £25 billion in today's terms.

35. This we steadily reduced over the years as a deliberate act of policy, until, by 1987-88, the PSBR had been eliminated altogether and we started to repay the public debt.

36. Accordingly, last year I budgeted for a further Public Sector Debt Repayment, or PSDR, of some £3 billion. In the event, it looks like turning out almost five times as large, at £14 billion, or 3 per cent of GDP. Even if there had been no privatisation proceeds at all, the public finances would still be in surplus, to the tune of some £7 billion. Government debt as a proportion of GDP is now lower than at any time since the First World War.

37. Nothing like this has ever been achieved in the past 40 years. And no other major country enjoys a comparable budget surplus. It has not been easy, even though we have been assisted this year by the exceptional buoyancy of the economy, which both boosted tax receipts and reduced public expenditure well below the planned level.

Do we need to put this credit so much - and light public expenditure in check.

BUDGET SECRET
B.L.O.
SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

38. Moreover, the substantial net repayment of public debt over the past two years has permanently reduced the burden of debt servicing, both now and for future generations. For the coming year, for example, the debt repayments of the last two years mean that net debt interest costs will be lower by some £1 3/4 billion a year. This saving is being put to good use, allowing extra spending on departmental programmes within our overall public expenditure constraints.

39. The dramatic improvement in the United Kingdom's public finances has also provided a welcome opportunity to devote more attention to the structure of the debt that remains. We will continue to seek both to minimise the cost of servicing the Government's domestic debt and to improve its quality by relying less on the more liquid borrowing instruments.

40. We have also been able to restructure part of the Government's foreign currency debt, launching an innovative and cost-effective programme of Treasury Bills denominated and payable in ecu. The first series of six monthly tenders for these bills has proved very successful, and this is an innovation we plan to continue, at around the current level.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

41. Meanwhile, I am today adding one more entry to the long list of financial controls which we have swept away during our term of office. The last surviving relic of the post-War apparatus for the direction of capital by the State is the Control of Borrowing Order, which since 1946 has involved first the Treasury and then the Bank of England in giving consents for equity and bond issues in the capital markets. As from today it will no longer be necessary for companies who wish to make capital market issues to obtain the Bank of England's consent to the timing of such issues; and we will, as soon as possible, revoke the Order itself and repeal the 1946 Act from which it stems.

42. The sterling capital market has in recent times been going through a period of considerable adjustment, as the Government has changed from being a large issuer to a large purchaser of its own debt. The abolition of the Control of Borrowing Order will remove an unnecessary and bureaucratic restriction on issuers of capital as they move into the space formerly occupied by the Government when it was a borrower.

43. This new freedom will be enhanced by a further, important, set of deregulatory measures for the sterling

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

capital market which are being promulgated today in notices issued by the Bank of England. These measures will open up the market for sterling paper of less than 5 years' maturity by extending the range of institutions which can make such issues; and they will create a unified regime for all these issues.

44. Taken together the changes I have described constitute a major liberalisation of the arrangements for London's capital markets. They will give greater flexibility to issuers and wider choice to investors.

45. In last year's Budget Speech, I set out the principle of a balanced budget as the proper objective of fiscal policy, in these terms:

> "A balanced budget is a valuable discipline for the medium term. It represents security for the present and an investment for the future. Having achieved it, I intend to stick to it. In other words, henceforth a zero PSBR will be the norm. This provides a clear and simple rule, with a good historical pedigree."

46. It is a rule that ensures that, as national income continues to rise, the ratio of public debt to national

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

income continues to fall, and with it the burden of debt interest. It ensures, too, that the State makes no claim either on the savings of the private sector or on flows of finance from overseas. To go further than this, and seek to achieve the maximum possible repayment of public debt, would not be consistent with the Government's policy, as it would mean deferring for a very long time the benefits of a reduction in the burden of taxation.

47. So I reaffirm the principle of the balanced budget. However, given the substantial surplus we now have, the path of prudence and caution must be to return to balance not overnight, but gradually, over a period of years. Thus we can expect to have a number of further years of debt repayment ahead of us.

It may come later than that, if the economy slows down

48. Moreover, given the particular uncertainties there are at the present time, I believe it would be right to budget for 1989-90 for a surplus similar to that secured in the year now ending; in other words, a further public sector debt repayment, or PSDR, of some £14 billion. This means that, in the space of three years, we shall have repaid roughly a sixth of the public debt that has accumulated over two centuries. But it also means that it will not be possible in this year's Budget to reduce

This makes it sound as if it were the only reason for not reducing tax?

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

the burden of taxation; that is to say, to reduce taxation as a share of national income.

BUDGET
SECRET
B.L.O.
SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

Copy NO 1 of 6

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

MPW/89/8
11 (A-II)

BUDGET SECRET B.L.O. SECRET

TAXPAYER CONFIDENTIALITY

Before I turn to my proposals for changes in taxation, I have one other change of a specific nature to announce.

2. As the House knows, the new official secrets legislation currently passing through Parliament is very much narrower in scope than the present Official Secrets Act. In particular, it does not cover information in the possession of either the Inland Revenue or Customs & Excise concerning the private affairs of specific taxpayers.

3. I am sure that the whole House will agree that it is essential for taxpayer confidentiality to be properly protected. I therefore propose to introduce provisions in this year's Finance Bill to ensure that it will continue to be a criminal offence for officials or former officials of either of the Revenue Departments to reveal information about the private affairs of a specific taxpayer.

4. I would only add that the need for this protection is in no sense a reflection on the probity and integrity of the members of those two Departments. Indeed, after nearly six years as Chancellor and more than eight years

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

B.

BUDGET

as a Treasury Minister, I would like to take this opportunity to pay public tribute to the outstanding service I have consistently received from the officials of both Departments.

BUSINESS TAXATION

5. I now turn to taxation. As I have done on a number of previous occasions, I propose to divide this into three broad sections: the taxation of business, the taxation of savings, and the taxation of personal income and spending.

6. First, taxes on business.

7. Ever since the corporation tax reform I introduced in 1984, the rate of corporation tax for small companies, defined for this purpose as those with annual profits of less than £100,000, has been set at the basic rate of income tax, currently 25 per cent. Large companies, defined as those with profits of £$^1/_2$ million or more, pay the main rate of corporation tax of 35 per cent, one of the lowest rates of tax on company profits in the world. Between £100,000 and £$^1/_2$ million the average rate of tax gradually rises from 25 to 35 per cent.

SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

8. I propose to keep the small companies rate in line with the basic rate of income tax for 1989-90 and to leave the main corporation tax rate unchanged . But I propose to increase the small companies' rate band substantially, by 50 per cent.

SECRET

9. Thus the small companies' rate will apply to companies with profits of under £150,000, and the 35 per cent rate will only be reached at profits of £$^{3}/_{4}$ million. These changes will reduce the corporation tax burden for more than half of all those companies that do not already enjoy the benefit of the small companies rate.

B.L.O.

10. I propose to increase the VAT threshold to £23,600, the maximum permitted under European Community law.

11. I also have to set the scales for the private use of company cars. This remains far and away the most widespread benefit in kind. When I doubled the car scales in last year's Budget, I made it clear that this still left this benefit significantly undertaxed.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET
SECRET B.L.O.
SECRET

12. Accordingly, I propose to increase the car scales by one third for 1989-90. The yield from this will be £160 million in 1989-90 and £200 million in 1990-91. There will be no change in the fuel scales.

13. Over the years I have received a number of representations from business complaining about the long-standing tax treatment of foreign exchange gains and losses. I recognise that as business becomes more global this subject becomes increasingly important. However, I have to say that I find it one of the most intractable I have encountered. Certainly, there can be no question of any change in the present system until a number of crucial and complex issues have been satisfactorily resolved. I have therefore authorised the Inland Revenue to publish today a consultative document which explores those issues and examines the scope for reform.

14. Finally, on business taxation, I have two major simplifications to propose, both of which follow from the income tax reforms I introduced last Budget.

15. One of the many undesirable features of an income tax system with several higher rates was that since a taxpayer's marginal rate could well be very different in

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

E

different years, the question of which year income related to made a great deal of difference. This was true of Schedule E where the strict rule is that income is taxed in the year to which it relates, on an accruals basis.

16. For the vast majority of employees, this basis of assessment for Schedule E poses no problem. But for about half a million people, mainly directors, who do not receive all their income in the year to which it relates, it causes complications and often needless assessments and correspondence long after the tax year is over. It is also open to manipulation.

17. I therefore propose that income tax under Schedule E should in future be assessed on a receipts basis, with the simple principle that you pay the tax when you receive the income. This will have a transitional cost of £80 million in 1989-90 and £60 million in 1990-91, but in the long term it will yield both extra revenue and a significant saving in both taxpayer's time and Inland Revenue staff.

Also open to manipulation!

18. The reduction in the top rate of income tax to 40 per cent in last year's Budget also enables me to make a major simplification of the tax treatment of the

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

f

vast bulk of the incorporated sector of small businesses: those known as close companies - generally speaking, unquoted companies that are controlled by five or fewer people.

19. The rules for the so-called apportionment of close companies' income are notoriously complex, taking up some twenty pages of impenetrable legislation. These rules are no longer needed and I propose to abolish them. I believe that family businesses in particular will welcome this substantial simplification.

20. I do, however, have to guard against the avoidance of tax on investment income by channelling it through a closely controlled investment company. Any such company which does not distribute most of its profits and other investment income will therefore be taxed at 40 per cent, equivalent to the higher rate of income tax.

TAXES ON SAVING

21. I now turn to the taxation of saving.

22. The sharp decline in the ratio of personal saving to personal income, over the past two years in

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

G

particular has led to even more discussion than usual of the merits of providing greater tax incentives for personal saving.

23. Certainly it is desirable that, over the medium-term, we generate as a nation a level of saving sufficient to finance a high level of investment. But what matters for that is not personal savings alone, but corporate savings too, which are running at historically high levels, and public sector savings, which have been boosted by the move to budget surplus.

24. Moreover, the personal saving ratio is measured in net terms, that is to say as gross saving net of borrowing, and it has fallen not because of a decline in gross saving but as a result of the sharp increase in personal borrowing. And the appropriate remedy for that is to raise the cost of borrowing, and with it the return on saving, as we have done.

25. Above all, the role of tax reform is to encourage enterprise and improve economic performance in the medium term. It is wholly inappropriate as an answer to short term or cyclical phenomena. So for the taxation of savings, the Government's policy is clear. It is to

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

H

BUDGET

strengthen and deepen popular capitalism in Britain, by encouraging in particular wider share ownership.

26. I have a number of specific tax measures to announce today to that end.

SECRET

27. Personal equity plans, or PEPs, were first announced in my 1986 Budget, and started up in January 1987. As the House knows, those who invest in these plans pay no further tax at all, either on the dividends they receive or on any capital gains they may make - indeed, there is no need for them to get involved with the Inland Revenue at all.

B.L.O.

28. Personal equity plans got off to a good start, with over a quarter of a million investors, many who had never owned shares before, subscribing almost £$^{1}/_{2}$ billion between them in 1987.

29. Since then, however, the take-up of new PEPs has slowed down, not least as a result of the changed climate in the equity market which followed the October 1987 Stock Exchange crash.

SECRET

30. So the time has come to improve and simplify PEPs and give them a new boost.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

(1)

BUDGET

31. First, I propose to raise the annual limit on the overall amount that can be invested in a PEP from £3,000 to £4,800.

32. Second, within that, I propose to raise substantially the amount that can be invested in unit trusts or investment trusts. For many small savers, these provide an excellent introduction to shareholding. At present PEP investors may only place £540 a year, or a quarter of their PEP, in unit or investment trusts. I propose to more than treble this amount, to £2,400 a year; and I propose to allow the whole of a PEP to be invested in unit or investment trusts, up to this limit. To qualify for tax relief, the unit or investment trusts will be required to invest wholly or mainly in UK equities.

[I've passed this comment to Treasury already]

SECRET B.L.O. SECRET

33. Third, at present, only cash may be paid into a PEP. I propose that investors should also be permitted to place directly into a PEP shares obtained by subscribing to new equity issues, including privatisation issues.

34. Finally, I propose to make a number of important simplifications to the PEP rules so as to make the

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

scheme more flexible, better directed to the needs of small and new investors, and cheaper to administer.

35. I am confident that the changes that I have announced today will enable personal equity plans to play an important part in stimulating the spread of ownership of British equities in the years ahead.

36. I also have a number of improvements to announce specifically designed to encourage employee share ownership.

37. It is a striking fact that the number of approved employee share schemes has risen from a mere 30 in 1979 to almost 1,600 today, involving some $1\frac{3}{4}$ million employees. At present the annual limits on the value of shares which can be given under all-employee profit-sharing schemes are £1,250 or 10 per cent of salary up to a ceiling of £5,000. I propose to raise these cash limits to £2,000 and £6,000 respectively.

38. Second, I propose to increase the monthly limit on contributions to all-employee save-as-you-earn share option schemes from £100 to £150, and at the same time to double the maximum discount from market value at

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

k

which options may be granted from 10 per cent to 20 per cent.

39. Third, a number of my Hon. Friends have been concerned that current tax law may be inhibiting the development of employee share ownership plans, otherwise known as ESOPs. These are distinguished from ordinary approved employee share schemes by the fact that they use a wider variety of finance, acquire more shares and tend to operate on a longer timescale. I propose to make it clear that companies' contributions to ESOPs qualify for corporation tax relief, provided they meet certain requirements designed to ensure that the employees acquire direct ownership of the shares within a reasonable time. I hope that this will encourage more British companies, particularly in the unquoted sector, to consider setting up ESOPs.

40. Those firms with employee share ownership schemes have no doubt that giving the workforce a direct personal interest in their profitability and success improves the company's performance. The same benefits flow from profit related pay.

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET
SECRET
B.L.O.
SECRET

41. This was one of the reasons why in my 1987 Budget, I introduced a tax relief to encourage its development. I have some improvements to make to this scheme, too.

42. First, as I have previously announced, I propose to abolish the restriction that, to qualify for the tax relief, prospective profit-related pay must equal at least 5 per cent of total pay. Second, I propose to raise the limit on the annual amount of profit-related pay which can attract relief from £3,000 to £4,000.

43. Third, I propose to enable employers to set up schemes for headquarters and other central units using the profits of the whole company or group for their profit calculations. And fourth, to help share schemes and ESOPs as well as profit related pay, I propose to change the so-called material interest rules which may at present unnecessarily exclude employees from schemes where they can already benefit from a trust set up for employees.

44. Taken together, the package of measures I have announced to encourage wider share ownership in general, and employee share ownership in particular, will help to ensure that the idea of a share-owning democracy becomes

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

M

BUDGET

ever more entrenched as a part of the British way of life.

45. Last June, the Inland Revenue issued with my authority a major consultative document on the taxation of life assurance.

46. The tax regime for life assurance is sui generis. The present system dates back to the First World War and has developed over the years in a piecemeal way, leading to a state of affairs in which the incidence of tax is extremely uneven, with some successful life offices paying no tax at all.

47. There is clearly a powerful case for reform, with a view to securing a tax regime which is more equitable both within the industry and as between life assurance and most other forms of savings.

48. , I have considered very carefully the representations the industry has made, and taken full account both of the changes to the regulation of life assurance proposed by the Securities and Investment Board under the Financial Services Act and the prospects for increased competition within the European Community after 1992. In the light of these factors, I have

SECRET
B.L.O.
SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

N

decided not to proceed with the more radical reforms canvassed in the consultative document. But I do have a number of important changes to propose, based for the most part on the general tax reform principle of seeking lower rates on a broader base.

49. First, many life offices run a pension business alongside their main life assurance business, and they are not required to keep the two businesses entirely separate for tax purposes. This enables them to set the unrelieved expenses of the pensions business against the income and gains of their life business, thus giving their life profits unduly favourable tax treatment. The life offices themselves have accepted that this treatment is anomalous and I propose to end it.

50. This change, along with some minor related changes, will come into force on 1 January 1990, and will yield some £150 million in 1990-91. The remainder of the changes I have to propose constitute a broadly balanced package which, because of the transitional provisions, will reduce the taxation of life assurance in 1990-91 by some £100 million.

51. I propose that the expenses incurred by life offices in attracting new business should continue to be

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

fully deductible for tax purposes from the income and gains of life funds, but should in future be spread over a period of seven years. To give the industry time to adjust, this change will be phased in gradually over the next four years, starting on 1 January, 1990.

52. There are certain other, more technical matters raised in the consultative document which will require further discussion with the industry, and any legislative changes on these issues will have to wait for next year's Finance Bill.

53. But I can say here and now that I propose, as from 1 January 1990, to abolish Life Assurance Policy Duty. And I also propose, from the same date, that the rate of tax payable on the policyholder's share of income and gains of life offices, which at present stands at 35 per cent on unfranked investment income and 30 per cent on realised capital gains, should be reduced to the basic rate of income tax.

54. The net effect of all these changes to the taxation of life assurance will be a cost of £20 million in 1989-90 and a yield of £45 million in 1990-91, rising somewhat in subsequent years.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

P.

BUDGET
SECRET
B.L.O.
SECRET

55. But above all it will provide a more efficient and equitable tax regime for this most important industry.

56. Later this year, UK unit trusts will be able to compete freely in Europe and will face competition from analogous Community investment schemes here. At present, trusts investing in gilt-edged securities or other bonds face a tax disadvantage. They pay corporation tax at 35 per cent on their income but can pass on a credit of only the basic rate to their investor. So I propose that from 1 January 1990, as for life assurance companies, the corporation tax rate on unit trusts that come within the new European Community rules will be equal to the basic rate of income tax. Their investors will then get full credit for all the tax the trusts pay.

57. I now turn to pensions.

58. The tax treatment accorded to pension schemes is quite rightly particularly favourable; and the extent of this privilege has to be circumscribed by Inland Revenue rules. So pension schemes only qualify for tax relief if they meet certain conditions, notably that the pension paid may not exceed two-thirds of final salary:

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

and if they fall foul of any of these rules, they lose all relief.

59. This has the perverse result that tax law effectively constrains the overall pension an employer can pay his employee. This is neither desirable nor necessary. Accordingly, I propose to make it possible for employers to provide whatever pensions package they believe necessary to recruit and reward their employees.

60. However, while it is clearly right that employers should be free to provide whatever pension they see fit, it would not be right to make the present generous tax treatment available with no upper limit at all. I therefore propose to set a limit on the pensions which may be paid from tax-approved occupational schemes, based on final salary of £60,000 a year.

61. I have deliberately set the ceiling at a level which will leave the vast majority of employees unaffected, and it will be subject to annual uprating in line with inflation. It will still be possible for a tax-approved occupational scheme to pay a pension of as much as £40,000 a year, of which up to £90,000 may be commuted for a tax-free lump sum.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

R

62. The new ceiling will apply only to pension schemes set up, on or after today, or to new members joining existing schemes after 1 June. And, as I have already said, there will now be complete freedom to provide benefits above the Inland Revenue limits, though without the tax relief.

63. The introduction of this ceiling on tax relief also enables me to simplify and improve the rules for the majority of pension scheme members, in particular to ease the conditions under which people can take early retirement.

64. I also propose to simplify very substantially the rules concerning additional voluntary contributions to pension schemes, or AVCs. In particular, the present requirements for free standing AVCs place a heavy administrative burden on employers. These requirements will be greatly reduced. Indeed, in many cases employers will not need to be involved at all.

65. Furthermore, if AVC investments perform very well, occupational pensions may at present have to be reduced to keep total benefits within the permitted limits. I propose that in future any surplus AVC funds should be returned to employees, subject to a special tax charge.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

S

This will remove the penalty on good investment performance.

66. The most important development in the pensions field in recent years has undoubtedly been the introduction and success of personal pensions. Since July last year, a million people have already taken advantage of the new flexibility and opportunities these offer. I have two proposals today to make personal pensions still more attractive.

67. First, I propose to make it easier for people in personal pension schemes to manage their own investments.

68. Second, I propose to increase substantially the annual limits, as a percentage of earnings, on contributions to personal pensions for those over the age of 35. This will be of particular value to those running their own business, who are often unable to make contributions until later on in their working life. It will also improve the position of personal pensions in relation to occupational schemes. The new limits will be subject to an overall cash ceiling based on earnings of £60,000, corresponding to the new ceiling for occupational pensions, and similarly indexed.

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

1

BUDGET

Treasury assure me these words do not preclude future "tidying-up" measures - eg raising to £60,000 figure!

69. These changes build on, and complete, the pension measures I introduced in my 1987 Budget. They represent a significant deregulation which will allow more flexibility, while setting for the first time a reasonable cash limit on the tax relief available to any individual. They should give a boost, in particular, to saving through personal pensions and through AVCs.

69a. Coupled with the changes I made in 1987, this is as far as I wish to go in amending the broad tax treatment of pensions.

Keep open a small loophole for anomalies

70. Finally, on the taxation of saving, it should not be overlooked that a far-reaching reform which I announced in last year's Budget, to come into effect in April 1990, is relevant in this context.

71. I refer to Independent Taxation. For there can be little doubt that one of the greatest disincentives to saving in the present tax system is the treatment of the savings of married women. At present a wife's income from savings has to be disclosed to her husband and taxed at his marginal rate. Independent Taxation will change all that. In particular, those married women who have little or no earnings will in future have their own personal allowance to set against their savings income. Independent Taxation may well do much to encourage the growth of personal saving in this country.

SECRET
B.L.O.
SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET B.L.O. SECRET

TAXES ON SPENDING

72. I now turn to taxes on personal income and spending.

73. As the House knows Her Majesty's Government are obliged to implement the European Court's judgement that certain of our zero rates of VAT on supplies to business, notably on non-residential construction, but also on fuel and power and on water, are not lawful. This derives from the Court's interpretation of the Community's Sixth VAT directive to which the UK agreed in 1977. The necessary changes will be introduced in this year's Finance Bill, and draft clauses have already been published.

74. In implementing the judgement I have sought to do as much as possible to minimise the burden. From 1 April VAT will be payable in respect of all non-residential construction unless carried out under a agreements entered into before the court ruling. And from 1 August landlords will have the option to tax rents, which means that in most cases no extra VAT will be paid at all.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

V.

75. These measures will reduce the burden of VAT on construction so far as the private sector is concerned to just £35 million in 1989-90 rising to £110 million in 1992-93. Without them the yield from VAT on construction in the private sector would have risen to £450 million. There will also be a yield of £250 million from construction carried out for the public sector, and the public sector programmes concerned have already been protected by compensatory adjustments where necessary.

With regard to a recent ruling of the European Court judgment

76. VAT will not be payable until July 1990 on water for industry or on fuel and power - then only on business users above a specified threshold. Private households will remain zero rated.

77. I have been particularly concerned about the impact of the European Court's ruling on charities. Unfortunately charities' business activities cannot lawfully be shielded from the effects of the ruling but I have been able to retain zero-rates for construction, water, fuel and power for all charities' non-business activities, for churches and for most residential accommodation such as old people's homes, students' hostels and hospices.

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

W

78. I have considered whether there is anything further I can sensibly do to assist charities with their VAT bills in these special circumstances. I propose to relieve charities from VAT on fund raising events, on sterilising equipment for medical use, and on classified advertising.

79. I also propose to relieve from car tax cars leased to the disabled. This is equivalent to an overall saving of about £400 on each vehicle leased to a disabled person.

80. I also propose to allow the present rules on tax relief for membership subscriptions paid by covenant to heritage and conservation charities. If the member is given the right of full entry to view the charity's property, that benefit will be ignored in determining whether relief is due. This will be of particular benefit to organisations such as the National Trust.

81. But in general, I continue to believe that the best way of helping charitable causes through the tax system is by directly encouraging the act of charitable giving. The Payroll Giving Scheme, which I introduced in my 1986 Budget, has been growing steadily. Some 3,400 schemes have now been set up, and over 100,000

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

X

BUDGET

employees are already participating, quite a few of them giving the full £240 annual limit for tax relief. I now propose to double that limit to £480, or £40 a month.

82. But for the Payroll Giving Scheme to achieve its full potential, it is clearly necessary for the charities themselves, and others involved, to mount a major information and marketing campaign to promote it. I am particularly glad that my Rt.Hon. Friend, the Viscount Whitelaw, has agreed to become Chairman of the new Payroll Giving Association, which will co-ordinate efforts in this field.

SECRET

83. I now turn to the excise duties.

B.L.O.

84. The damage to the environment in general, and to child health in particular, from lead in the atmosphere, and the contribution of ordinary leaded petrol to this problem, is increasingly widely known. The government is committed to phasing out leaded petrol altogether, and in successive Budgets I have sought to assist this. I first introduced a tax differential in favour of unleaded petrol in 1987, and increased it last year. But although sales are undoubtedly rising, unleaded petrol still accounts for only some 5 per cent of total petrol sales, even though two-thirds of the cars now on

SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

the road could use it, either without any adjustment or else with a conversion costing only some £20 or so.

85. One of the problems is ignorance of the facts. Many motorists do not realise that their cars can already use unleaded petrol. Many others are unaware how modest the conversion cost usually is. Others wrongly imagine that their car's performance would suffer were they to use unleaded fuel. Many are under the false impression that, if they do switch to unleaded petrol, their cars will no longer be able to use leaded petrol.

86. It is clearly essential that these myths are rapidly dispelled. Meanwhile, I propose to take the opportunity of this Budget to increase still further the tax differential in favour of unleaded petrol, by nearly fourpence a gallon. If this reduction is fully passed on to the customer - and I look to the oil companies to see that it is - it means that the price of unleaded petrol at the pump will generally be getting on for tenpence a gallon, or just over twopence a litre, cheaper than four star leaded petrol. This will be one of the most substantial differentials between the price of leaded and unleaded petrol within the European Community.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

7

87. But I do not intend to stop there. I also propose to raise the tax on two and three star petrol, so that the pump price of these grades will be at least as high as that of four star. This should encourage garages to phase out two star petrol, which is already down to about 6 per cent of the total market, thus enabling them to switch storage capacity to unleaded petrol - quite apart from the incentive to the remaining two-star users to switch to unleaded fuel.

88. I am confident that the duty changes I have announced, which will take effect from six o'clock this evening, will help to lead to a marked increased in the use of unleaded petrol over the next twelve months.

89. They will of course also lead to a loss of revenue of some £40 million in 1989-90. I propose to recoup this from Vehicle Excise Duty. A the present time a bus or a coach has to have 66 seats before it pays as much in Vehicle Excise Duty as a family car. I propose to rectify this anomaly by increasing the tax rates of this group of vehicles so that they cover their track costs. I also propose to increase the rates of duty for the heaviest non-articulated lorries, to put them on a more equal footing with articulated lorries. These changes

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

AA

will also simplify the system, greatly reducing the number of separate rates of Vehicle Excise Duty.

This is very brief, & I gather follows exactly the precedent when duties were last held down.

90. I have no further changes to propose this year in the rates of excise duty.

TAXATION OF INCOME

91. Nor do I propose any change this year to either the basic or higher rate of income tax.

92. Since I aligned the rates of income and capital gains tax in last year's Budget, it follows that I also propose no change this year in the capital gains tax rates. However, I do have a few changes to capital gains tax to propose.

93. With the advent of independent taxation from April 1990, married women will acquire their own capital gains tax threshold, so that a married couple will enjoy two such exemptions. In the light of this, I propose to maintain the capital gains tax threshold at £5,000 for 1989-90.

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BB

BUDGET

SECRET B.L.O. SECRET

94. Second, I propose to abolish the general holdover relief for gifts.

95. This was introduced by my predecessor in 1980, when there was still capital transfer tax on lifetime gifts, in order to avoid a form of double taxation. But the tax on lifetime giving has since been abolished, and the relief is increasingly used as a simple form of tax avoidance.

96. But while the general holdover relief will go, I propose to retain it for gifts of business, farm and heritage assets. I also propose to extend the existing relief for all gifts to charities to gifts of land to housing associations. And of course gifts between husband and wife will continue to be exempt.

97. In the case of gifts of personal belongings, these benefit from chattels relief, under which any items worth less than £3,000 on disposal are entirely exempt from capital gains tax. I propose to double the chattels exemption limit to £6,000.

98. Lastly, on capital gains tax, I propose to change the tax treatment of certain bonds so as to simplify the tax rules and prevent a loss of yield by the use of

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

ce

indexation to create losses and the conversion of income into capital gains.

99. To return to income tax, I propose to raise all the main income tax thresholds and allowances by the statutory indexation factor of 6.8 per cent, rounded up. Thus the single person's allowance will rise by £180 to £2,785, and the married man's allowance will rise by £280 to £4,375. The basic rate limit will rise by £1,400 to £20,700.

100. The single age allowance will rise by £220 to £3,400, and the married age allowance by £350 to £5,385. The higher level of age allowance will rise by £230 to £3540 for a single person, and by £360 to £5565 for a married couple.

101. I have a number of measures to help the elderly. In 1987 I introduced a new higher age allowance, for those aged 80 and over. I now propose to extend this to all those aged 75 and over. This will take an additional 15,000 elderly single people and married couples out of tax altogether. Three quarters of all those aged 75 and over will not be liable to income tax at all.

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

DD

BUDGET
SECRET
B.L.O.
SECRET

102. The income limit for the age allowance will rise by £800 to £11,400, again in line with indexation. However, I propose to reduce the rate at which the age allowance is withdrawn above this income limit. I propose that in future it should be withdrawn at the rate of £1 of allowance for each £2 of income above the limit, instead of the present rate of £2 in every £3. This means that the marginal tax rate for those in the withdrawal band will be reduced to well below 40 per cent, thus meeting a large number of representations I have received over the past year.

103. The Finance Bill will also include the provisions to establish the new tax relief for the over-60s' health insurance premiums, which I announced to the House in January, and which will take effect from April next year, at a cost of £40 million in 1990-91.

104. I have one further change to make to help pensioners. Under the earnings rule, any pensioner who decides to continue to work after reaching the statutory retirement age has his or her pension docked at a rate of 50 per cent on every £1 earned between £75 and £79 a week, rising to 100 per cent for every £1 earned over £79 a week. This rule applies until he or she has reached give years beyond the State pension age.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

EE

105. The Manifesto on which we were first elected in 1979 acknowledged that it was wrong to discourage people who wished to work beyond retirement age in this way, and pledged that we would abolish the earnings rule.

106. That is precisely what we shall do. My Rt.Hon Friend the Secretary of State for Social Services and I have agreed that the pensioners' earnings rule should be abolished from the beginning of October, the earliest practicable date. The necessary legislation will be included in the Social Security Bill currently before the House.

107. The cost to public expenditure will be £125 million in 1989-90, which will be entirely met from the Reserve. But the net cost of this measure will be significantly reduced by the income tax payable on the increased pensions.

108. Those who wish to defer taking their pension will remain entirely free to do so, and will continue to earn a higher pension in return.

109. I am sure the whole House will welcome this long overdue reform.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

110. If I were to adopt the so-called "duck test" now in vogue across the Atlantic, the pensioners' earnings rule would probably qualify as a tax, and I would now be able to claim to have abolished a sixth tax. But sound tax principles coupled with my innate modesty and natural reticence prevent me from doing so.

NATIONAL INSURANCE CONTRIBUTIONS

111. I have one further measure to propose.

112. It has long been a feature of the National Insurance system that, once people earn more than the lower earnings limit, which in 1989-90 will be £43, they have to pay National Insurance contributions at the same rate on the whole of their earnings up to the upper earnings limit. There are currently three different rates - 5 per cent and 7 per cent for those on lower pay and the standard rate of 9 per cent,

113. The two reduced rates, which I introduced for both employers and employees in my 1985 Budget, cut the cost of employing the young and unskilled, among whom unemployment was then high and rising, and cut the

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

GG

burden of national insurance contributions on the low paid. But the highly desirable reduction in the steep step at the lower earnings limit was at the expense of two small steps further up the earnings scale. This inevitably means that, at certain points on the income scale, people can still be worse off if they earn more. Their extra earnings take them from a lower rate band to a higher one, and they therefore lose more in National Insurance contributions than they gain in extra pay.

114. In agreement with my Rt Hon Friend the Secretary of State for Social Security, I now propose to build on my 1985 reform. For everyone who pays employee National Insurance contributions, I propose to reduce to only 2 per cent the rate of contributions on earnings up to and including the lower earnings limit. On earnings above that limit, there will be a single rate of 9 per cent, up to the upper earnings limit, which has already been set for 1989-90 at £325 a week.

115. This will abolish altogether the steps which at present exist at earnings, for 1989-90, of £75 and £115 a week. The step which has always existed at the lower earnings limit, where people first come into the National Insurance system, is the entry ticket to the full array of contributory benefits. As such, it is an

BUDGET SECRET
SECRET B.L.O.
SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

44

BUDGET

essential feature of the contributory principle. But my proposals will more than halve this step, to only 86 pence a week in 1989-90.

116. There will be no change in the contributions payable by employers.

SECRET

117. This reform will significantly reduce the burden of employees' National Insurance contributions across the board. For the lowest paid, that burden is now heavier than the burden of income tax. This is the most effective measure I can take to lighten it. For everyone on just under half average earnings or more, it will leave them £3 a week more of their own money.

BUDGET SECRET

118. The new system will take effect from the beginning of October, the earliest practicable date. The cost will be £1 billion in 1989-90 and £2.8 billion in 1990-91. The necessary legislation will be included in the Social Security Bill currently before the House.

119. The total additional cost of all the measures in this Budget, on an indexed basis, is under £2 billion in 1989-90 and £$3^1/_2$ billion in 1990-91.

[PERORATION]

SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

CONCLUSION

11

Mr Deputy Speaker, in this Budget I have reaffirmed the Government's commitment to the defeat of inflation through the maintenance of prudent monetary and fiscal policies. I have budgeted for a debt repayment of £14 billion - the largest ever. I have announced a major reform and reduction in employees national insurance contributions; and I have fulfilled our pledge to abolish the earnings rule for pensioners.

I commend this Budget to the House.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED