



THE DEPARTMENT OF TRANSPORT



FROM THE SECRETARY OF STATE

CONFIDENTIAL

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Rt Hon John Major MP
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My Ref:

Your Ref:

21 DEC 1989

SHIPPING AND THE 1990 BUDGET

You will be expecting my views on the strength of the case submitted to you by the General Council of British Shipping in connection with next year's budget.

After a decade of very low investment, the United Kingdom merchant fleet is now looking decidedly old. Probably for the first time this century, the average age of the British vessel - at some 13½ years - is now higher than the world average. I find it disturbing that against the background of a now buoyant market and with our competitors freely re-equipping themselves with efficient modern tonnage, our companies' investment comes nowhere near the level necessary to replace existing stock.

The problem has of course been addressed before. Some very modest measures of assistance were adopted in the Merchant Shipping Act 1988, to give some encouragement to owners to make more use of British crews. These have had some effect on the recruitment of officers; but the impact on the profit and loss account of the companies has been negligible and the new recruits in many companies remain rightly sceptical about the prospects of their employers continuing to operate ships beyond the short term. Since the last collective discussion of the issue some 18 months ago, more and more countries have taken steps to ensure that their shipowners are in a position to reinvest. The latest example is the Netherlands, where seafarers' tax and social security payments are now diverted to their employers.

We shall obviously press the Commission very hard to ensure that the state aids which member states are introducing are consistent with their Treaty obligations. However, there is such a widespread sense of the strategic importance of national fleets that this must be one area where our efforts to get state aids abolished are going to make less impact than we would wish. The recent debates in the Council of Ministers on the Commission's

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To note this Budget expenditure which seeks to build on the fiscal concession agreed at the 2 meetings you held with colleagues in summer 1988.

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proposals for "Positive Measures" for shipping have made that abundantly clear. Unless we are prepared to see British shipping continue its steady decline we would be wise to consider what further help we can give our owners while minimising the call on public funds.

The industry's main request is for 100% depreciation allowance. This would of course improve the viability of projects and stimulate reinvestment. But I would support you in being extremely reluctant to make such a conspicuous exception to the neutral tax regime which was introduced in 1984.

I feel that there is an altogether stronger case for rollover relief of balancing charges. Peter Lilley will have heard the arguments himself from the GCBS in their presentation to him on 7 December. I hope that you and he will be persuaded that the proceeds from the sale of a ship should be exempted from corporation tax provided that they are invested in a new or second-hand ship within a period of 3 years. If you found it necessary to restrict the benefit to the purchase of ships for the UK register, I would not disagree. The introduction of rollover relief for shipping could, in my view, be defended as being consistent with our general fiscal policies by reference to the peculiarly mobile nature of shipping investment and it would reflect practice that is now extremely common amongst the maritime countries.

I would also like to propose two rather more technical changes which would also be helpful to the industry. Although there have been some successes, the Business Expansion Scheme has not really caught on for shipping projects. The main reason may well be the competition from assured tenancy schemes. But many owners believe that a further important factor is the restriction of the scheme to one year charters at a time when the proportion of charters over one year is rising. I would be grateful if you would take a look at this.

Second, I believe that there is scope for improving the current Foreign Earnings Deduction Scheme. A change was made in the 1988 Finance Act so as to allow seafarers who stay in the UK for 90 days or less to recover the tax paid on their overseas earnings. If the seafarer is in the United Kingdom for over 90 days, the seafarer is fully liable for tax. It now seems clear that the "cliff edge" effect is frustrating our objective of helping maintain an adequate supply of British seafarers, important to us on defence grounds. With that aim in view, I would like to propose therefore a more graduated scheme, which provides for some relief for those seafarers who spend more than the prescribed period in the UK.

Before making these proposals to you, I considered carefully the outcome of collective discussion in June 1988. It was agreed then that if the Merchant Shipping Act measures and the adjustment in the Foreign Earnings Deduction had insufficient impact to take care of the supply of ships for defence purposes we might need to consider legislation to allow payment of a special premium to owners suitably crewed of ships in short supply. The NATO study of supply and demand was going to help us assess the position.

This was agreed
by you
relying
in June
1988.
HCC.

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Quite apart from the difficulties associated with primary legislation I am not sure that this would be the most cost-effective way of shoring up our commercial shipping resources. Nor do I believe we have previously given anything like enough weight to the contribution which British shipping makes to the balance of payments and to sustaining London as a world centre for the service industries. These considerations lead me to the conclusion that the right course is to seek early adjustments to the fiscal regime.

If you feel that any of my suggestions need further discussion before you can adopt them I shall be very glad to meet you, with other colleagues as necessary.

I am copying this letter to the Prime Minister, Douglas Hurd, Tom King, Nicholas Ridley and Sir Robin Butler.

Yours *E. S.*
hil

CECIL PARKINSON

DEFENCE

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