

PREM

15

818

PART 3 begins:-

lt / Esc cheques to PM 19-12-72

PART 2 ends:-

PM to lt / Esc cheques 1967/72
20/7/72

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CM (72) 17 th Conclusions	20.3.72
CM (72) 18 th Conclusions, Minute 1	23.3.72

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB (CABINET OFFICE) CLASSES**

Signed J R Green *AWayland*

Date 15/3/2002

pp J R Green
Prime Minister's Office Records
Hepburn House, Marsham Street

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in the Public Record Office.

- ① House of Commons Hansard, Columns 75 to 172
dated 27 March 1972
"Budget resolutions & economic situation"
- ② House of Commons Hansard, Columns 1689 to 1815
dated 23 March 1972
"Ditto"
- ③ House of Commons Hansard, Columns 1523 to 1648
dated 22 March 1972
"Ditto"
- ④ House of Commons Hansard, Columns 1343 to 1418
dated 21 March 1972
"Budget statement"
- ⑤ House of Commons Hansard, Columns 616 to 617
dated 17 February 1972
"Business of the House"

Signed

J. R. Green

Date

24. 9. 2001

J R Green

Prime Minister's Office Records

Hepburn House, Marsham Street

Subject

Econ Policy White 11/11/72
20/7/72



10, Downing Street,
Whitehall

Prime Minister's
Personal Minute
No. M 67/72

CHANCELLOR OF THE EXCHEQUER

With the passing of the third reading of the Finance Bill, the main legislation for the reform of personal taxation, company taxation and indirect taxation is virtually complete.

The working out of these measures, the carrying out of the administrative preparations and the drafting and passage of the legislation have, I know, been enormous tasks for those concerned, especially when added to the continuing work of administering the existing taxes. It is a very remarkable achievement to have accomplished this major work in so short a period of time.

I should be grateful if you would join my own congratulations and thanks with those which you yourself will be expressing to those responsible in the Inland Revenue, the Customs and Excise, Parliamentary Counsel and the Treasury.

A.

20 July 1972

In sending you these transcripts, we want to make it clear that the programme was entirely impromptu and that this is not, therefore, a text; it is a transcription made from dictaphone recordings. There are often inaccuracies of detail due to the clash of voice or a not perfectly audible word.

These transcripts, therefore, represent the general trend of the verbal discussion but should not be regarded as accurate in detail. Moreover, they do not indicate the changed flavour which expression and gesture in television can add to the spoken word.

THE BUDGET

recorded from transmission 2120 (BBC-1)

22nd March, 1972

THE RT.HON.ROY JENKINS MP: As was generally predicted, Mr.Barber produced a big give-away Budget. Of course, he's had the advantage of the balance of payments surplus for which we, both the British people and the British Government, sacrificed a good deal between 1968 and 1970. A lot of things have been made much easier by that.

Mr.Barber has inherited a built-in security on this front which none of his predecessors since the War enjoyed and he didn't himself do the building. But, when all that is said, I would not really like to have been in the position to give away as much as he did yesterday. Now that's not through any attachment to high taxes as such. Any Chancellor likes to be popular rather than unpopular and therefore prefers reducing taxes to increasing them.

But the plain fact is that you can only produce taxation reductions on yesterday's scale if you run the economy so badly that the country is near, nearer a depression than at any time since the Thirties. This may strike a lot of people as nonsense. Surely, they would say, taxations.. taxation reductions are like a dividend or a bonus. You distribute them out of an economic achievement. Yet a moment's thought shows this is not so. In themselves, taxation reductions are in no way a symbol of success, or a passport to prosperity.

Look at last year's experience. Mr.Barber then reduced taxation by six-hundred-and-eighty-million and he did so largely because unemployment was already seven-hundred-and-fifty-thousand and going up rapidly. But his measures were misdirected and inadequate, despite a couple of further belated attempts to get some life into the economy. What he has so far achieved is to make 1971 the year with the lowest increase in output since 1958 and to send unemployment up to the million mark. And it's precisely because of the failures of the past year, not because of successes, that Mr.Barber was able to appear yesterday in such a generous guise.

If his Budget last year had worked, if unemployment had fallen instead of rising catastrophically, if there had been some movement in the economy, yesterday's Budget would have had to be far more cautious. Nobody really disputes that.

Now I believe that a Chancellor should be judged more by how he runs the economy over the year as a whole than by the concessions he makes on Budget Day. The country knows it's had a bad year economically and I don't believe that yesterday's tax cuts are any adequate compensation for the soaring unemployment, the stagnant production, the declining investment, the industrial bitterness and all the wasted opportunities of the strongest balance of payments in our history.

Nothing the Government does now can blot out its blunders of the past eighteen months. Nevertheless, we all want to turn our eyes to the future. There's now some evidence that the Government no longer believes it can bludgeon everybody into its own dogmatic economic mould. And we should ask ourselves whether this Budget offers a cure to our present difficulties. At best, the answer is only very partially.

Unemployment may now come down a bit over the next year but I think it will stick stubbornly at quite unacceptably high levels. And I see a real danger that the Budget may run us into other difficulties before we have got nearly enough people back to work. That is the evil of neglecting a problem as long as this Government has neglected unemployment. It's like an illness left untreated for far too long.

Now of course if we could get a new sense of social cohesion in the country, that would help us with a lot of our problems. But I doubt if the Budget will do that. I don't claim it's as grossly unfair as was last year's Budget, but nor is it remotely as fair as the Chancellor last night claimed it was. His broad point is that it frees two-and-three-quarter-million people from paying income tax and gives a reduction of a pound a week all the way up the scale. But many of the people who are freed from tax have only had to pay tax because of the pace at which inflation has recently bounded ahead. They weren't paying tax a few years ago and they hadn't become significantly better off in real terms in the meantime. They've merely been caught by the fact that as prices and incomes rise so tax bites harder. Their position, as a result of the Budget, has merely been restored and there are a lot of cases. They will be caught by tax again even before we get to next year's Budget.

Furthermore, there is nothing at all, even with the huge out-pouring of concessions which the unemployment levels make possible, for those at work who already pay no tax. And this is where some of the worst poverty in the country is concentrated, particularly amongst the low-paid with large families.

Even the Purchase Tax reduction is angled in such a way, with nothing off the lower rates, that those whose need is the greatest are most unlikely to get any benefit from this. There aren't many motor cars or refrigerators, let alone jewelry or fur coats, bought by this group.

The pensioners, of course, get an increase but nothing like enough. Pensioners to-day are no better off than they were in the late autumn of 1969. In relation to the rest of the population, they are quite a lot worse off. For the next seven months, until their rise begins to be paid in October, their standard of living will fall because prices will continue to rise. Then they will go a bit, just a bit, ahead of 1969. But by the time of the next
BBH

increase in 1973, they will be just about back where they were in 1969. In other words, no real increase for four years. For one of the most deserving and needy groups in the country, this just isn't good enough. In the context of a Budget which distributes one-thousand-two-hundred-million pounds to others, it's meanness and it will be widely regarded as such.

We need an overall strategy to abolish poverty. This is no longer beyond the means of this country. But I don't see even the beginnings of this in this Budget. Nor do I see a strategy to get us back to full employment. What I do see is a Government which has become frightened by its own failures, which has wasted twenty-one months and is now trying to strike an uneasy and uncertain balance between its own mistaken doctrines and the needs of Britain to-day. Not until they fully abandon all those devisive, abrasive policies which Mr. Heath once used to be so proud, will we begin to get out of the messⁱⁿ to which they've led us.

BBH

In sending you these transcripts, we want to make it clear that the programme was entirely impromptu and that this is not, therefore, a text; it is a transcription made from dictaphone recordings. There are often inaccuracies of detail due to the clash of voice or a not perfectly audible word.

These transcripts, therefore, represent the general trend of the verbal discussion but should not be regarded as accurate in detail. Moreover, they do not indicate the changed flavour which expression and gesture in television can add to the spoken word.

CSB
WFB

transcribed from a tv telediphone recording

THE BUDGET

recorded from transmission 2120 (BBC-1)

21st March, 1972

RT.HON.ANTHONY BARBER MP:

CHANCELLOR OF THE EXCHEQUER: Good evening. This picture up here is of Mr. Gladstone. He was, I suppose, probably our most famous Chancellor and he had a motto -- to let the wealth of the nation, as he put it, fructify in the pockets of the people. What he really meant was don't over-tax people. And I think you will agree that he was right.

But this year there is an additional, special reason for making, what I am told, are the biggest ever reductions in taxation. And it's this. I am determined to get the economy expanding faster and this is the way. If taxes are cut, that means more spending and more spending means more orders, ^{and} so more production. And more production means more jobs.

But there's a second reason behind the strategy of this Budget. Next January, in only nine months' time, we will be in the Common Market. And make no mistake, this will give us a great opportunity to make Britain more prosperous. And so I've decided on a large number of changes to encourage British industry to modernise and to re-equip.

And, thirdly, I've made sure that the Budget, as a whole, is fair. Fair to all sections of the community.

I expect you will have seen on the news that there is to be another increase in pensions. For the past twenty years, the old age pension has been put up only once every two years. Well now we've changed that. From now on, we shall review it every year. We have, of course, promised that pensions will always keep up with prices. But this time we are making sure that they go up more than prices so that pensioners will be better off.

Next, the reductions in Purchase Tax. These cuts in Purchase Tax come on top of the very large cuts in Purchase Tax and SET which I made last summer and they are all part of our campaign to slow down the rise in prices. Already, the cost of living is rising only half as fast as it was last summer. So I think you will agree that we are making progress on that front.

And then the Income Tax. Last year, when I cut Income Tax, I gave priority to helping families with children. This year, I thought the right thing to do was to make a straight reduction of Income Tax for every taxpayer in the country. Now what it means is a big increase in the starting point for tax so that more than two-and-a-half-million people will be taken out of tax altogether. And then, for everyone above the new

BMH

starting point, that is for everyone who will still be paying tax, there will be a pound a week less tax to pay.

This is the biggest cut in Income Tax that has ever been made and I am sure you will agree that this is the right way to help this year.

And these three changes -- pensions, Purchase Tax and Income Tax -- they account for over four-fifths of the money released by this Budget for the year ahead. There are other important changes as well. There is the biggest ever extra help, or preference, for those parts of the country which for years now have suffered from higher unemployment than the rest of the country. And there is also special help for charities, and for widows from the changes in death duties.

And then, at long last, we are repaying all the old Post-war Credits. We are doing this in alphabetical order and next week we'll be starting with people whose names begin with A-C. A man called Williams complained to me the other day that I'd arranged this order just to get Barber into the first batch. Well I'm afraid it's not so because I lost my certificates ^{and} so I am at the end of the queue anyway.

Next year, as I expect you know, we are going to have a Value Added Tax, or VAT as it's become known. And when it comes in, Purchase Tax and the Selective Employment Tax will be abolished. Obviously I can't go into all the details now but I just want to say this. Many other countries now have this sort of tax and we've been to immense trouble to make sure that ours is one of the simplest. We are getting rid of the Selective Employment Tax, or SET as it's called, which put up the price of food and the new tax will not be charged on fuel, coal, gas, electricity or on railway fares or bus fares or on house building or on rents. And small traders will be exempt.

In other words, we are making sure that the new tax will be fair and we are taking special care to see that it will be fair for pensioners and for those on low incomes.

Now I expect that there'll be quite a lot of discussion about VAT and, of course, that's right. But remember that when it comes in next year, Purchase Tax and SET go out. And the net result of all these changes -- last year, this year, next year, including the new VAT -- will be to reduce the taxes on spending and so help to keep down the cost of living.

Looking even further ahead, I put before the House of Commons this afternoon an entirely new way of bringing together the tax system and the system of social benefits. The truth is that very, very few people really understand the present set-up. After all, you get tax deducted by one office and then you collect benefits from another office. There are allowances for this and allowances for that and the whole thing takes thousands and thousands of civil servants to run it all.

Well I believe that now, at last, we've found a way to simplify the whole system very considerably. A way, incidentally, which would get rid of a lot of the individual means testing and which would give more help to the people who need it most.

I would like to leave you with one further thought. I am the first to admit that a year ago when prices were rising much faster, it was not easy then for some to accept the need for moderation in pay claims. But you know to-day the situation is quite different. Over the past year, the Government have made the biggest ever cuts in those taxes which affect prices -- Purchase Tax and SET. It's a fact that since last summer, the rise in the cost of living has been halved. And now, to-day, I've announced a thousand million pound cut in Income Tax which will increase by one pound a week the take-home pay of every person who will still be paying tax.

So you see the situation is now quite different from a year ago and I believe that the overwhelming majority of the British people will now have no patience with those whose actions endanger our hopes for steadier prices and more jobs and growing prosperity. Goodnight.



COPY NO. 2 OF 8 COPIES.

Treasury Chambers, Great George Street, SW1P 3AG
01-930 1234

14th March, 1972

I have written separately about the speakers in the Budget Debate. But you will wish to know that the Chancellor and the Secretary of State for Social Services have agreed that the Secretary of State should make a Statement on Wednesday, 22nd March. I understand that the Prime Minister and the Lord President would be content.

I am sending copies of this letter to Peter Gregson (No. 10), Leonard Davies (Lord President's Office) and Robin Wendt (D.H.S.S.).

(P. E. Middleton)

A. H. Warren, Esq., C.B.E.



Treasury Chambers, Great George Street, SW1P 3AG
01-930 1234

14th March, 1972

We spoke about the speakers in this year's Budget Debate. Peter Gregson has subsequently passed on to me the Prime Minister's views. The Chancellor would like to propose the following speakers on the Government side for the Debate.

2nd Day - Wednesday 22nd March

- | | | |
|-----|-------------------------|---|
| (a) | Open for the Government | Secretary of State for Trade and Industry |
| (b) | Wind | Financial Secretary |

3rd Day - Thursday 23rd March

- | | | |
|-----|-------------------------|--|
| (a) | Open for the Government | Secretary of State for the Environment |
| (b) | Wind | Minister of State |

4th Day - Monday 27th March

- | | | |
|-----|-------------------------|-----------------------------|
| (a) | Open for the Government | Chief Secretary |
| (b) | Wind | Chancellor of the Exchequer |

I am sending a copy of this letter to Peter Gregson (No. 10), Leonard Davies (Lord President's Office), Eric Wright (D.T.I.), Robin Wendt (D.H.S.S.), and John Rowcliffe (D.O.E.).

(P. E. Middleton)

A. H. Warren, Esq., C.B.E.



Prime Minister

10

Treasury Chambers, Great George Street, SW1P 3AG
01-930 1234

10th March 1972

AM^{12/3}Dear Robert,
^{BWA}

I am told that last year the Prime Minister saw the Chancellor's Budget Speech during the last weekend before Budget Day. The Chancellor tells me that, because of President Pompidou's visit, he suggested to the Prime Minister that it would be as well to let the Prime Minister have a draft of the Speech during the previous weekend. He pointed out that the Speech could not by then be in its final form, and that he would himself be working on it over this weekend and during the following week. I understand that the Prime Minister was content with this arrangement and that, unless the Chancellor considered that there were any further changes of significance which warranted the attention of the Prime Minister, he would not need to put the Speech to the Prime Minister again.

I therefore enclose a full draft of the Speech in its present form. No doubt you will let the Chancellor have the Prime Minister's comments or alternatively, let me know whether the Prime Minister would like to see the Chancellor on Monday before the next version of the Speech is circulated.

Yours ever,
Alan Bailey

(A. M. Bailey)

R. T. Armstrong, Esq.

I have told Mr. Wright
- DTI

PO
15/3

Agreed
- top secret
[A1]

PRIME MINISTER

The Trade and Industry Secretary has asked whether he can now tell his Junior Ministers, on a "need to know" basis, about the industrial incentives package. Apparently they are already aware that certain things are going on relating to areas of work which are their responsibility, and there is some unhappiness.

PO

13 March, 1972.

BUDGET SPEECH 1972: OUTLINE

Handwritten notes:
P. sec by [unclear]
Comments: [unclear] budget [unclear] [unclear]
Speech [unclear] [unclear]
Set out.
[Signature] 12/3

I INTRODUCTION

II RECENT ECONOMIC DEVELOPMENTS

- (1) Inflation
- (2) Output and employment
- (3) Monetary developments
- (4) Government finance: provisional outturn
- (5) Savings
- (6) External developments

III THE ECONOMIC OUTLOOK

- (1) Balance of payments
- (2) Exchange control
- (3) The domestic economy
- (4) The Budget judgement

IV SOCIAL SECURITY BENEFITS

V MODERNISATION OF INDUSTRY (INCLUDING COMPANY TAXATION)

- (1) Reform of Corporation tax - choice of system
- (2) International companies
- (3) Rate
- (4) Relief for small companies etc.
- (5) Close companies
- (6) Capital gains of companies - general
- (7) Capital gains of companies - unit and investment trusts
- (8) Share option and incentive schemes
- (9) Free depreciation
- (10) Regional policy

/VI MISCELLANEOUS

VI MISCELLANEOUS

- (1) Relief for interest
- (2) Sale and leaseback, and deferred premiums
- (3) Charities (estate duty, C.G.T.)

VII INDIRECT TAXATION

- (1) Tax paid stocks
- (2) Small traders exemption
- (3) Rate structure and coverage
- (4) Main exempted and zero-rated categories
- (5) Rate
- (6) Purchase tax

VIII ESTATE DUTY

- (1) Green Paper
- (2) Changes

IX PERSONAL DIRECT TAXATION

- (1) Reform (UNITAX)
- (2) Unification
- (3) Surtax threshold
- (4) Personal allowances

X CONCLUSION

- (1) Post-Budget outlook for Government finance
- (2) Peroration

I INTRODUCTION

1.1 The Budget which I introduced last year was the first of the new Parliament, and in it I outlined a programme of taxation reform which I shall be developing further today. But this Budget is also a first - from a different point of view. It is the first Budget since Parliament took the historic decision that we should join the European Economic Communities.

1.2 In January we shall become part of a new market of 300 million people. This enlarged outlet for our goods and services, combined with the strength of our balance of payments, the present slack in the economy and the recent upturn in productivity - all these factors together provide our country with an unparalleled opportunity for a strong and sustained expansion over the coming years. And so the various proposals which I shall put to the House today are designed to ensure that we take full advantage of this unique set of circumstances to build a more prosperous Britain, and to help British industry to modernise, to re-equip and to re-organise to meet the challenge of greater international competition.

cf Feb's

1.3 But if, because of the opportunity which is opening up, we are right to set our sights high and to look with confidence beyond the immediate future, we are also right to regard with profound concern the immediate problem of a level of unemployment which has persisted, despite the whole series of unprecedented steps to counter it which have been taken over the past year.

1.4 So these are my aims in presenting this Budget.

1.5 First, that we should move into top gear as we set out on our new European venture.

1.6 Second, that we should produce an expansion which can be sustained and which will bring a permanent improvement in both employment and living standards.

1.7 Third, that we should make further progress in the field of taxation reform, so as to evolve a system which is more just, and a system which over the years and decades ahead will help to create a greater national wealth.

1.8 No taxation policy can of itself guarantee prosperity but, as we have learnt to our cost, it can most certainly hinder it. And this is why taxation reform is an essential element of our strategy for increasing our rate of economic growth; and it is economic growth that we need to bring down the deplorably high level of unemployment and to increase the real wealth of our country.

implies over budget - 9.

*what
in the '60's*

1.9 There are some who have recently been voicing a certain suspicion about the whole idea of economic growth, because they fear that what is at present regarded as progress may in fact be causing, or be about to cause, irreparable damage to our environment. They are concerned about the quality of life in this country and across the world.

1.10 I believe that most hon. Members of this House, while acknowledging this concern, will still take the view that the main threat to the quality of life in this country has come from the inadequacy of real incomes, from social problems such as unemployment and from those consequences of slow growth such as the persistence of bad schools, of old hospitals, of slums and urban squalor. The fact is that both the cause and the solution of all these problems lies in our economic performance.

1.11 I must warn the House that my statement today will be long. The House will recall that last year I announced plans for the radical reform of company taxation, of indirect taxation and of personal taxation. All these three reforms will become operative a year hence, in April 1973. Because of the needs of business planning, including computer programming, it is now more than ever desirable that people should

/know

know as far ahead as possible what are our present intentions about future tax measures. I intend *R 113* to follow *i.e. forming the* this principle of more 'open Government' in matters of taxation wherever I can, as indeed I did last year. I shall therefore be setting out not only the main details of the changes, but I have decided that it is right to take the unusual step of giving today my present ideas about the new rates for next year, even though the House and the country will recognise that these may have to be changed if circumstances alter.

[1.12 I shall also put forward further proposals for the reform of our taxation system and, in particular, a scheme which I shall in due course ask the House to consider, for an important simplification and bringing together of our systems of Pay As You Earn and Social Security.]

/II. RECENT ECONOMIC DEVELOPMENTS

II RECENT ECONOMIC DEVELOPMENTS

2.1 But I must start by referring to some of the main developments of the past year. It has been a year which has been dominated by the twin evils of inflation and unemployment.

/(1) Inflation

(1) Inflation

2.2. I would ask hon. and rt. hon. Members to cast their minds back to the time of the Budget last March - a year ago. We were then facing a problem of cost inflation which, in the minds of many, was the biggest single threat to our prosperity. Both the problem and the threat remain, but I think that my rt. hon. Friends and I can fairly claim some success.

2.3 As far as prices are concerned, the facts have been published, and they speak for themselves. Since last summer the rate of increase has been halved.

2.4 I am sure the whole House will want to pay tribute to the C.B.I. for their programme of price restraint and to all the companies and nationalised industries which have responded. Together with the cuts which I made in S.E.T. and purchase tax, that programme has made a major contribution in reducing the rate of inflation and in improving the climate for wage bargaining. [I shall have something to say about the settlement of the coal strike in a moment], but taking the past year as a whole, it is a fact the average level of pay settlements has fallen significantly. I have no doubt that, in part, this has been due to the
/slower rise

slower rise in prices. In part too, it may reflect a growing awareness of the truth - to quote one rt. hon. Gemtelman - that "one man's wage increase is the next man's price increase"; that there is no future in an irresponsible scramble for higher pay all round if the only result is higher prices all round; and that rising costs may be even more damanging to employment prospects than falling demand.

2.5 But if it be true that we have already made considerable progress in the fight against inflation it is also true that we still have a considerable way to go in narrowing the gap between the rate of increase of money incomes and of productivity. And in the end that is the only sure way that we can keep prices steady, maintain our international competitiveness and substantially improve the prospects for employment.

[Handwritten signature and checkmark on the left margin]

/(2) Output and Employment

(2) Output and Employment

2.6 There is universal agreement that the present high level of unemployment is on every ground - economic and social - one which no Government could tolerate. It is also generally agreed that, over the past year, unemployment has risen to a much greater extent than could have been expected if one had regard only to the movement of output. The upward trend in unemployment was partly the result of very slow growth in 1970, and a fall in output in the first half of 1971. But there has been an additional factor with major consequences for the level of unemployment - the so-called "shake-out" of labour which stemmed from the rapid rise in wage costs. While cost inflation is clearly one of the causes of high unemployment I have never agreed with those who look to unemployment as the cure for inflation.

2.7 And so, throughout this past year we have acted to raise the level of economic activity. The various reflationary measures which were taken resulted in a strong upswing in demand in the second half of last year; between the first and second halves of the year gross domestic product is estimated to have increased by around [2] per cent or 5 per cent at an annual rate]. It is difficult to forecast the level of output in the first half of this year, especially in view of the dislocating effects of the coal strike, but to give the House the underlying trend, I believe that, [had /it not

*Contingency
services.*

it not been for the coal strike, the growth of output
between the first halves of 1971 and 1972 would have been
in line with
broadly / the forecast which I made last July of
4-4½ per cent, and that despite the coal strike
it will in fact be of the same order as forecast].

/(3) Monetary Developments

(3) Monetary Developments

2.8 I turn now to monetary developments. A year ago I outlined a radical and far-reaching reform of credit control and banking arrangements. The details are known. Suffice it to say that that reform is now in full operation, and it has opened a new era in British banking.

2.9 Monetary policy in the past year has been expansionary, in line with our other policies for stimulating the economy. All terms control restrictions on hire purchase, credit sale and rental agreements were removed last July. Interest rates have declined and there has been a strong growth of bank lending and consumer credit.

2.10 All this has been reflected in a faster growth of money supply. In the first half of 1971 money supply rose by 4½ per cent; in the second half of the year it rose by about 8½ per cent. This acceleration in money supply was associated with the turn round in the economy. Demand for money tends to increase more than proportionately to money incomes as real incomes rise, to that at times when output is expanding, especially after a period of sluggish growth, the demand for money is likely to be strong.

2.11 It follows

2.11 It follows that, taking into account prospective price increases, the high growth of output which I intend to sustain with this Budget is likely to entail a continued growth of money supply that is also high by past standards. This will be necessary to ensure that adequate finance is available for the extra production we are seeking. If we were to hold the growth of money below that required rate, we would reduce the growth of real output itself.

2.12 This argument is now, I think, generally accepted. It certainly does not mean that monetary policy is unimportant. On the contrary, it recognises the strong effects that monetary policy can have on the economy and the need for using it correctly. But it recognises also that these effects operate through demand, so that there is no magic way by which output can be expanded by fiscal and other means and at the same time prices can be held back by monetary policy.

2.13 And so I intend to use monetary policy in the future, as I have in the past year, as an integral part of the general management of demand. Because one of the main qualities of monetary policy is its flexibility, I do not propose to lay down numerical targets for its growth or for the growth of any other monetary aggregate. The policy will be geared to the

needs of the situation, and will change as those needs change.

2.14. 1971-72, the Government's financial requirements can be met by borrowing from the public sector, and by the sale of assets, and by the sale of assets.

2.15. For 1971-72, the Government's financial requirements which I estimated...

/(4) Government Finance: Provisional
Outturn

the public sector as a whole. In the year, 1971-72, the Government will need, of course, to raise the total amount of borrowing from the public sector, and to sell assets to the public sector, and to sell assets to the public sector.

2.16. The Government's financial requirements for the year 1971-72, and for the year 1972-73, are estimated to be...

The Government's financial requirements for the year 1971-72, and for the year 1972-73, are estimated to be...

(4) Government Finance: Provisional Outturn

2.14 Next, the Government's financial accounts. I can be brief here, because these are set out in detail, in the normal way, in the Financial Statement and Budget Report.

2.15 For 1971-72, the borrowing requirement for which I estimated was some £600 million for the Central Government and some £1,200 million for the public sector as a whole. In the event, though final figures will not, of course, be available until after 31st March, the Central Government figure is expected to be about [£770 million], and that for the public sector, [£1,225 million].

2.16 One important factor behind the increase in the central government's borrowing requirement over the forecast figures lies in the measures taken by the Government in the course of the year to increase public sector spending, with the object of stimulating the economy and increasing employment. In 1971-72, the total expenditure attributable to special measures of this kind will have amounted to [£143 million].

/(5) Savings

(5) Savings

2.17 In last year's Budget I announced a number of improvements concerning national savings. I do not propose any further changes at this time.

2.18 Over the past year, national savings have gone from strength to strength. In the twelve months to the end of February, the amount of national savings outstanding, including accrued interest, increased by [] million, or about [] per cent. That is the best result ever recorded and reflects great credit on the whole national savings movement. The thousands of voluntary workers throughout the country deserve our gratitude.

*Can he point to
how the
providing the
benefit for
the Government
bring?*

/(6) External Developments

(6) External Developments

2.19 I turn next to the external developments which have taken place over the past year.

International monetary matters

2.20 For the international monetary system, 1971 was certainly a critical year. Strains had already been apparent for some time, and they were finally brought to a head by President Nixon's announcement on August 15th - a date I well remember because it was the very day I was due to start my family holiday! After a succession of meetings of the Group of Ten, the agreement which we reached in Washington in December produced a realignment of currencies and the removal of the U.S. surcharge and related measures. That realignment should in time lead to an adequate swing-round in the U.S. balance of payments, which is a necessary element in restoring stability in international payments. It is bound to take time to work through, as in the case of any exchange rate change.

2.21 But that is only one part of the problem. There are other fundamental questions which as yet remain unsolved. The House will, I know, appreciate the point that the U.S. authorities have not a sufficient stock of reserve assets to restore general convertability of

/U.S. dollars

U.S. dollars held by monetary authorities. This will clearly take time. But it certainly ought to be possible to work out acceptable arrangements to enable I.M.F. operations to be restored to a more normal basis.

2.22 This affects in particular our own remaining I.M.F. debt. This now stands at £415 million, which begins to fall due in June this year, our reserves are now ample to repay it, and as my rt. hon. Friend the Prime Minister has said, we should like by now to have done so. Indeed, I should like to go further and repurchase also the £83 million of other sterling held by the I.M.F. This would fully reconstitute our so-called I.M.F. gold tranche, giving us £292 million automatically available for drawing from the I.M.F. in case of need as part of our reserves. It is indeed a strange world when we are frustrated in our determination to wipe the slate clean of our debts. I hope a solution will soon be found.

2.23 My own belief is that a return to a system in which all the major currencies are fully convertible depends on achieving a consensus internationally about the lines on which the international monetary system should be reformed. The crisis last year demonstrated clearly enough that reform is needed. I outlined my own view of the principles on which that reform

/should be

should be based in my speech at the last I.M.F. Annual Meeting. The task now is to persuade some others that in the months ahead serious international discussions should take place in a constructive spirit.

2.24 Meanwhile in Europe I have been having discussions about the progress of the enlarged Community towards economic and monetary union, [and today in Brussels Ministers of the Ten are meeting to consider this.]

U.K. Balance of Payments

2.25 The details of the U.K. Balance of Payments last year were published only a fortnight ago. So I can be brief. We had a record current account surplus of £951 million. The volume of our exports of goods, after staying flat for nearly two years, rose strongly. We had a record surplus on visible trade of [£300] million. Our earnings on invisible account continued to rise.

2.26 Our official reserves more than doubled. At the end of 1970 the reserves were \$2,827 million. A year later, at the end of 1971 they had risen to \$6,582 million, and we also had \$2,250 million swapped forward with overseas monetary authorities.

12.27 The House

[2.27 The House will agree that, whatever may be said about our other problems, 1971 was a good year for the Balance of Payments.]

*Aslow f' kes - the
month f' from play sent!*

III THE ECONOMIC OUTLOOK

(1) Balance of Payments

3.1 But so much for the past year. I turn now to the future, starting with the prospects for the balance of payments over the next year. It is likely that world trade will grow rather faster in the year ahead than in 1971. Expansionary measures have now been introduced in a number of countries and, of course, the removal of the U.S. surcharge and related measures will also help.

3.2 I expect the current account to continue to show a satisfactory surplus, but it will not be as large as it was in 1971 which, in this respect, was clearly an exceptional year. The balance on visible trade in particular will be less favourable this year. The monthly visible trade figures are bound to show a deficit from time to time, for there will be a faster growth of imports as our domestic economy expands. It is as well to remember that 1971 was only the ninth year since the end of the eighteenth century in which we have had a surplus on visible trade. There is no reason to expect that it will now continue year in, year out. A modest deficit on visible trade need not trouble us so long as the other important component of the current account, earnings on invisibles, continues to keep up well - as I believe it will.

*be positive, put
himself first -
le. will keep up well
deposits in
the bank
higher
current*

(2) Exchange Control

3.3 I must next give the House the outcome of a review of our policies governing international investment. I decided on the following changes.

3.4 First, the financing from sterling sources of inward direct investment. As from tomorrow, with some exceptions to exclude certain financial services, permission will be given for subsidiaries of foreign companies making new direct investments in development and intermediate areas to draw finance without restriction from sterling sources; and for subsidiaries of E.E.C. companies the restrictions on finance from sterling sources will be completely withdrawn in respect of direct investments in any part of the United Kingdom.

*Flora
- think if Feb Trade Figures
done down this*

ie. 3.5
3.6
+ 3.7.

3.5 Second, outward direct investment in E.E.C. countries. This change brings forward a relaxation which had been planned for the end of this year at the latest. As from tomorrow, U.K. companies making direct investments in E.E.C. countries will be allowed, as an alternative to the usual overseas borrowing, to use official exchange or its equivalent for the first £1 million of any project in an E.E.C. country, or in one of the acceding countries.

/3.6 Finally,

3.6 Finally, there is the future of the so-called Voluntary Programme under which since 1966 countries and institutions have been asked to observe certain restraints on their investment in developed countries of the Sterling Area. It is right that I should pay tribute to those who have co-operated to maintain the Programme over the past six years. But my rt. hon. Friends and I have always found distasteful the concept of this Programme operated on a voluntary basis year after year. Accordingly, the Voluntary Programme is now abolished.

3.7 Full details of these changes are being given in a Treasury Press Notice and Bank of England Control Notices issued tonight.

3.8 I realise that other relaxations have also been suggested, but I cannot go further this year, and these particular changes have been selected with due regard both to prudence and a right sense of priorities.

(3) The Domestic Economy

3.9 I turn now to the prospects for the domestic economy.

3.10 I should at this stage stress that the analysis I am about to give of our economic prospects assumes no changes of policy. It is of course, this analysis which provides the basis for my Budget judgement and for any proposals for change.

3.11 Looking ahead over the next 12 months or so, I would expect a recovery in private investment, both in manufacturing industry and in the service sectors. On present policies, however, I do not believe that this recovery would be of the magnitude required either to meet the challenge of Europe or to provide an adequate basis for a return to full employment.

3.12 There are three main elements of demand where a slowing down seems probable; public investment, stockbuilding, and private consumption. I deal with each of these in turn.

3.13 First, public investment. As the House knows, because of the high level of unemployment, we have deliberately given a large, temporary boost to public investment: and as this boost comes to an end the rate of increase - albeit from a high level - is bound to slow down.

3.14 Next, stockbuilding. Stockbuilding was abnormally low last year. A recovery to a more normal rate is almost certain at some stage, [though it has probably been delayed by the coal strike]. While the recovery is taking place it will give an important boost to the growth of demand, but this boost will cease when stockbuilding settles down again at a new, higher, rate.

3.15 Finally, private consumption. This has grown rapidly over the past 12 months, stimulated by taxation reductions, by the abolition of hire purchase terms control and by a large uprating of social security benefits last autumn. This rapid rise in private consumption reflected a raising of consumers' expenditure from a lower to a higher level. But it is right to expect that, when this process has been completed, the rate of increase of private consumption will slow down again to a more normal rate unless steps are taken to stimulate it further. In addition account has to be taken of what is sometimes called "fiscal drag" - the fact that as personal incomes rise tax burdens tend to increase more than proportionately. It is true that a modest boost will be given to consumers' expenditure over the coming months by the repayment of post-war credits, but this again will be a temporary stimulus.

3.16 For these

3.16 For these and other reasons I should expect that, on the basis of present policies, the growth of output would slow down over the year ahead to a rate well below what we have achieved over the past year, and would go on slowing down thereafter. The implications of such a slowing down in the growth of output for the general prosperity of the nation and for the level of unemployment in particular are obvious. Such a situation would not be acceptable.

(4) The Budget Judgement

3.17 I have therefore come to the conclusion that a further boost to demand is required to keep up the necessary momentum.

3.18 In weighing up how great this boost should be, I have had to take account of a number of considerations, some of them conflicting. On the one hand there is the need to reduce the level of unemployment. On the other hand, I have to take full account of inflationary dangers, of the balance of payments outlook, and of the need to avoid a purely ephemeral spurt which before long led to another stop. It is essential that we should lay the foundations of sustained growth over a prolonged period ahead.

3.19 Taking account of these various considerations, and after weighing up the risks and uncertainties involved, I have come to the conclusion that the boost to demand will have to be sufficient, taking account of both direct and indirect effects, to raise output in the first half of next year by [between 1½ and 2] per cent. This will require a substantial reduction in taxation.

3.20 [The measures I shall be proposing are intended to ensure a growth of output at an annual rate of

[4½ - 5] per cent between the second half of last year and the first half of next.) I have chosen as my base period the second half of last year because a much firmer estimate can be made of the level of output in that period than in the current half year, especially in view of the uncertain effects of the coal strike. This growth rate of [4½ - 5] per cent is a "central forecast", and I stress that because of the many uncertainties to which, as every former Chancellor knows, such predictions are necessarily subject. This is the reason why policies must be flexible, and why the only sensible course is to be ready to act at any time of the year, as indeed I did last year.

3.21 If my present expectations are correct, output will have risen by [about 10] per cent over the two years from the first half of 1971 to the first half of 1973. The extent to which there will be a reduction in unemployment must depend on our success in slowing down inflation. If the nation insists on pricing itself out of business no power on earth can secure full employment.

3.22 I do not believe that a stimulus to demand of the order I am proposing will be inimical to the fight against inflation. On the contrary the business community has repeatedly said that the

/increase in

increase in productivity and profitability resulting from a faster growth of output is one of the most effective means of restraining price increases.

3.23 [As I have said], we now have a rare opportunity to secure a sustained and a [faster] rate of economic expansion over a considerable period of years. I will list the reasons.

3.24 First, our entry into the European Communities next January provides us with an additional opportunity for faster growth which was the experience of nearly all the existing members of the Community when they established the larger market.

3.25 Second, we are starting from a position where there are more unused resources than there were at the beginning of the last two periods of rapid expansion.

3.26 Third, I believe that the potential growth of productivity is greater than it was on either of those earlier occasions.

3.27 Fourth, there is no reason why the expansion for which I am providing should speed up the pace of inflation; and the Government is determined that this shall not happen.

3.28 Fifth,

3.28 Fifth, both the current balance of payments and our reserves position are much stronger than they were at the beginning of previous periods of expansion. Moreover I am sure that all hon. Members in this House will agree that the lesson of the international balance of payments upsets of the last few years is that it is neither necessary nor desirable to distort domestic economies to an unacceptable extent in order to maintain unrealistic exchange rates whether they are too high or too low. Most countries now recognise the acceptability of smaller and more frequent parity adjustments, sometimes in one direction, sometimes in another, in the interest of a smooth and internationally co-operative adjustment process. Certainly, in the modern world, I do not believe that there is any need for this country, or any other, to be frustrated on this score in its determination to sustain sound economic growth and to reduce unemployment. But I must repeat again here my warning about cost inflation; the adjustment process will not be a soft option if we fail to get a grip on ever-rising costs.

3.29 These are the principal reasons why I believe we can now realistically look forward to a prolonged period of sustained expansion. And indeed a prolonged period of rapid expansion is exactly what British industry so desperately needs to provide

the foundation and the confidence for ambitious and forward looking modernisation.

3.30 For the very purpose of avoiding "stop go" and specifically in order to maintain steady growth over a period of years, there will doubtless from time to time need to be measures to regulate demand; and these may be in either direction. But, the prospects for expansion and for growing prosperity over the next five years must surely be better than they have been for a very long time.

3.31 This Budget is designed to set us on that path.

/IV SOCIAL SECURITY BENEFITS: UPRATING

IV SOCIAL SECURITY BENEFITS: UPRATING

4.1 At this stage I want to deal with one matter which is not strictly speaking part of the Budget proper - social security benefits.

I thought it helpful, in the particular circumstances of last year, to refer in the Budget statement to our intentions for the year ahead, and I do so again this year for this reason.

4.2 In our Election Manifesto we promised to review retirement pensions every two years to ensure that they at least maintain their purchasing power. We have in fact done better than we promised. As the House knows, the Government recently decided that in future the main social security benefits will be uprated every year and that the next uprating will be this autumn. This, of course, is something that pensioners have been asking for for years.

4.3 My rt. hon. Friend will be making a statement about this [and related matters] [tomorrow]. But as the House found convenient last year, I will today give an outline of the Government's proposals.

14.4

4.4 Last autumn the retirement pension was increased by 20 per cent. This autumn - the first time for twenty years, that there have been increases only a year apart - the pension will be increased by a further 12½ per cent. The standard pension for a single person will therefore be increased by 75p. - from the present rate of £6 to £6.75. The standard rate for a married couple will be increased ^{by £1.20,} from £9.70 to £10.90. Other national insurance benefits and war pensions will be correspondingly improved. The basic scale rates of supplementary benefit will go up by the same cash amounts as pensions. This means that, in cash terms, these benefits will have been raised by about one-third above the level at which they stood before last year's increase. The two increases together, in conjunction with the assurance of an increase every year in future, will go further to improve the position of pensioners than any previous measures in the history of national insurance.

4.5 The cost of the improvements in national insurance benefits is estimated at about £400m. in a full year. This of course leads me to the consequent increase in contributions.

74.6

*Post Review
Copy first.*

4.6 Once again we have concluded that the fairest way of financing the increase is by moving towards the long term contributions structure described in the White Paper "Strategy for Pensions". This year, however, we intend to go further in this direction than last year by transferring some of the burden from employees onto employers. Accordingly, the employers' flat rate contributions will go up by ^{for men} 10p%. The earnings ceiling for graduated contributions will be raised from £42 to £48 a week. Only a relatively small proportion of the total cost will then need to be found in other ways. We have decided to meet it by an increase in the rate of graduated contributions on earnings between £18 and £48 a week; these will go up from 4.35 to 4.75 per cent/ for employers and employees alike. The ordinary flat rate contribution by employees will remain unchanged, although there will, of course, be flat rate increases for the self-employed and non-employed.

4.7 The Exchequer will, as in the past, contribute about 18 per cent of the total contribution income.

4.8 The pre-Budget forecasts, to which I have referred, take into account the increases in both pensions and contributions.

14.9

4.9 There is one taxation aspect I must mention. Because the Inland Revenue are so heavily committed to work in preparation for the unification of personal taxation, and they cannot this year undertake any extra P.A.Y.E. recoding work, the increase - and I stress only the increase - in National Insurance pensions and War Widows' Pensions will not be taxable until the tax year 1973/74.

/V.

V MODERNISATION OF INDUSTRY (INCLUDING COMPANY TAXATION)

5.1 [I come now to a group of proposals designed to help British industry to expand and modernise and to improve its efficiency.]

(1) Reform of Corporation Tax: Choice of System

5.2 In last year's Budget Speech I announced my intention to reform the structure of corporation tax in order to remove the present discrimination between retained and distributed profits. I explained that this discrimination distorts the capital market, tends to misallocate scarce investment resources, impedes companies that need to raise equity capital, and lessens the pressure for efficiency.

5.3 In the Green Paper on the reform of corporation tax which I published last year it was stated and explained that, in order to achieve our objective, there were only two real alternatives, a two-rate system or an imputation system which could be very similar in substance. Those two alternative systems were fully described and I invited views about the choice.

5.4 Since then there have been important consultations with industry, commerce and the professions about the alternative systems. These have been invaluable and fully justified the decision not to introduce legislation until those who would be mainly affected

/by it

by it had been consulted.

5.5 In addition, the choice set out in the Green Paper has been considered by the Select Committee under the distinguished chairmanship of my hon. Friend, the Member for Walsall South, and we now have the benefit of their views. That Select Committee, like the Green Paper itself, was a new departure, although it was one which put into practice the view often expressed by those of us on this side of the House, that major tax changes should so far as possible be preceded by full and careful public consultation. The Select Committee completed their task with thoroughness and speed and the whole House will agree that their report fully justified the innovation.

5.6 I should tell the House, frankly, that last year, when I announced the proposal to reform corporation tax, I had a preference on domestic grounds for the two-rate system.

5.7 Having said that, the fact is that the majority of those with whom we consulted clearly favoured an imputation system. So did the Select Committee, by a unanimous recommendation.

5.8 I have reconsidered the matter in the light of this advice, and have come to the conclusion that the advantages of the two-rate system are not sufficient to outweigh the arguments that have been put forward in

/favour

most people - but those who don't know what it is. Shows it can be a "black swan" - a surprise expansion, but not a "black swan".

favour of the alternative. I therefore accept and endorse the Select Committee's main conclusion that the form of corporation tax to be introduced in this country ought to follow the imputation system set out in the Green Paper, and this is what I propose. As the system is described in the Green Paper, I will not burden the House with a further explanation of it. The legislation will be in this year's Finance Bill and the new tax will come into effect as from [6th April] next year.

5.9 I should add that in the course of the year I have been keeping closely in touch with developments in the Community, where they are engaged in a programme to harmonise the structure of their company taxation. They have not yet reached a conclusion, but the choice which we have made puts us in line with both France and Germany.

/(2): International companies

(2) International Companies

5.10 I have given a great deal of consideration to the position of those companies - and they include a small number of very important ones - which derive their profits and income wholly or mainly from overseas countries where the rate of tax is as high as, or higher than, it is here. What these companies wanted was in substance a return to the arrangements, like those in force before 1965, where the excess of a company's overseas tax on its profits over the United Kingdom tax on those profits could be used to reduce the income tax on the shareholder's dividend. I made it clear in the Green Paper that this was not an alternative which the Government would favour and I am sure, with the benefit of a further year for reflection, that that decision was right.

5.11 In reaching this conclusion I am, once again, reinforced in my view by the conclusions of the Select Committee. The Select Committee did not, of course, formally consider the possibility of a return to pre-1965 arrangements; they were choosing between the two systems which the Green Paper had indicated as the real alternatives. But they gave a great deal of consideration to the problem of companies trading mainly in countries abroad with higher tax rates; indeed, they took more

/evidence on

evidence on this point than on any other. Their views were clear and again unanimous. They said, first, that "... it is hard to see why double taxation relief should be so extended as to allow a United Kingdom based company not only to pay no corporation tax, but also to pay its shareholders net dividends on which no standard rate income tax has, in fact, been paid"; and second, they said "...Your Committee on balance ... plump for the imputation system with a minimum corporation tax charge as an essential element".

5.12 In addition to conforming with the unanimous view of the Select Committee on this point, there is another compelling reason for my decision. It is this. To give the overseas companies the relief they want would cost the Exchequer something of the order of £100 million a year. To maintain the yield of corporation tax, therefore, it would have been necessary to have increased the rate of corporation tax for the generality of companies by 2.5 percentage points. The alternative would have been to have recouped the lost revenue from the general body of taxpayers.

5.13 It is right, too, to note that for most companies trading overseas, relief for overseas tax under the new system will in fact be more favourable than at present. Furthermore none will be worse off,
/not even

not even the companies whose only profits are earned in high rate countries abroad. Indeed, what these companies fear is not that they will be worse off, for they will not. What they are apprehensive about is that they will not be able to benefit as much under the new system as companies which have at least enough United Kingdom income to cover their dividends. Accordingly they fear that their access to new capital for expansion and development may be impaired.

5.14 I believe that these fears are exaggerated; I recognise however that they are very real to the companies concerned, and I recognise too that these companies play a most important part in the economic life of the nation. It is for these reasons that I have decided that although I cannot meet their case in full it would be right to give them some further relief for a transitional period. The present overspill payments will therefore be continued at their 1971-72 level for the period up to the end of 1976-77; by then we should be in a position to judge whether the companies' fears have in fact been realised.

5.15 For the purpose of this transitional relief I propose to leave the overspill rules unchanged with the single exception, logical under the new

BUDGET-SECRET

system, that as from 1972-73 increases in dividends will no longer diminish entitlement to overspill. This extension of transitional relief will cost £12 million in 1972-73 and £25 million for each of the four following years.

It is expected that the amount of the overspill will be £12 million in 1972-73 and £25 million for each of the four following years. This extension of transitional relief will cost £12 million in 1972-73 and £25 million for each of the four following years.

The amount of the overspill will be £12 million in 1972-73 and £25 million for each of the four following years. This extension of transitional relief will cost £12 million in 1972-73 and £25 million for each of the four following years.

/(3) Rate

(3) Rate

5.16 During the Budget debates my hon. Friend the Financial Secretary will be describing in greater detail the main features of the new corporation tax. I also thought that it would help the House, and those outside, if I were to publish, at the same time as the Finance Bill, a descriptive White Paper on the new corporation tax, and this will be done. There are however a number of matters on which it may be helpful for me to comment now.

5.17 First, the rate of tax. Because the tax will not become operative until April 1973, it will not begin to be paid for the most part until 1 January 1975. The normal practice therefore will be for the rate to be fixed in the 1974 Budget and it will need to be determined in the light of the circumstances at that time. This is two years ahead and for the moment I can do no more than base what I say on the 50 per cent rate which was taken for the purposes of illustration in the Green Paper but I must stress that this is purely illustrative and that the actual rate cannot be fixed at this moment of time. I can however give the rate of advance payment as this is determined by the basic rate of income tax of 30 per cent. The advance payment of corporation tax will therefore be 3/7ths of the dividend paid.

/(4) Relief for Small Companies
and Special Cases

(4) Relief for Small Companies and Special Cases

5.18 I now turn to a matter of great importance - the situation of small companies under the new corporation tax. Both the Bolton Committee and the Select Committee rightly drew attention to the position of small companies which have to rely on their retained profits for a very large part of the funds they need for expansion and development. These small companies comprise a sector which is of crucial importance to the economy, and they must have every reasonable incentive to expand and develop.

5.19 I therefore propose that all companies whose profits for corporation tax purposes do not exceed £15,000 in any year will pay tax on their income at a special rate; with the illustrative rate of 50 per cent the special rate for small companies would be 40 per cent, but I must stress again that these figures are illustrative. Notwithstanding the reduced rate of tax on profits, any dividends paid will be treated as entitling the shareholder to full imputation relief in the usual way. There will be marginal relief for companies whose profits are between £15,000 and £25,000. The full relief will be available to about 350,000 companies which is more than 90 per cent of all companies, and the marginal relief to a further 10 to 15,000. The cost will be substantial - on the basis

/of the

of the figures I have taken \$45 million to \$50 million in a full year - but well worth the encouragement which this will give to small companies.

5.20 My Hon. Friend, the Financial Secretary, will be giving details of the way in which we propose to deal with building societies and co-operative societies, and also with certain unincorporated associations and other bodies of a broadly non-profit-making kind which have objects of a public nature.

(5) Close Companies

5.21 I turn next to the taxation of Close Companies. To safeguard the revenue there must be, and indeed there have been ever since 1922, special rules applicable to this type of company. But the 1965 legislation (when the name 'Close Company' was coined) greatly multiplied the rules, and these have been a constant source of complaint. There can be no doubt that in recent years the rules which the Inland Revenue were bound to apply have been unduly harsh and unnecessarily burdensome.

5.22 The first point to remember is that the only justification for special rules for close companies is to prevent avoidance of tax; there is no other justification. Accordingly, my starting point is that we should retain legislation of this sort only to the extent that significant sums of revenue are at stake.

5.23 The House will recall that we said in last year's Green Paper on the Reform of Corporation Tax, that one of the objectives was to secure a major simplification of the close company rules.

5.24 One important simplification which the new system of corporation tax itself enables us to achieve is this: a shortfall assessment will in future be confined /to the

BUDGET-SECRET

to the income tax at higher rates and the investment income surcharge. But it is right that the simplification of the system should go well beyond this. Following the relief which I gave to trading companies last year, the starting point for shortfall will again be raised. This will be done in three ways which will be explained by my Hon. Friend.

5.25 All these reliefs will take effect from next year when the new corporation tax comes into force. To give the House some idea of the practical significance and extent of these changes, the result can be expressed in this way. Last year's reliefs took out of shortfall over half the trading companies which at that time were within its scope; next year's raising of the threshold will effectively take out about half of those which remain. So the combined effect of the two Budgets will be to relieve altogether from shortfall some 80 per cent of the trading companies that came within its scope in 1970 and previous years. This represents a very considerable easing of the work burden which for far too long has lain on the backs both of companies and their advisers and of the Inland Revenue.

5.26 In total, these changes, and others which will be in the Finance Bill, will amount to a very substantial simplification of the close company legislation. In future it will be strictly confined in scope, easier to understand ^{and} a good deal less difficult to administer.

BUDGET-SECRET

C43

(6) Capital Gains
of Companies -
General

(6) Capital Gains of Companies - General

5.27 I come now to the treatment of capital gains of companies [and I deal first with companies in general.] The Green Paper recognised that it would not be appropriate for the rate of tax on companies' capital gains to rise in line with the increase in the rate of tax on retained profits. It therefore envisaged that the overall rate of tax on gains might be reduced by the expedient, which is administratively simple, of leaving part of each gain out of account but charging the remainder at the full corporation tax rate.

5.28 This approach was endorsed by the Select Committee and I propose to follow it. The fraction of the gains to be left out of account will be fixed at the same time as the new corporation tax rate. If I were fixing it now, I should proceed on the basis that the effective rate of tax on companies' gains should be 30 per cent.

/(7) Capital Gains of Companies

(7) Capital Gains of Companies - Unit and Investment Trusts

5.29 There is next the special case of approved unit and investment trusts. Ever since 1965 the trusts have contended that they should themselves be exempt from capital gains tax. For reasons which I shall explain I do not believe that this is the appropriate solution. Having said that, I agree that the present tax treatment of unit and investment trusts is clearly both inequitable and complex. Despite the cost, it is right that the necessary changes should be made, and they will be included in this year's Finance Bill.

5.30 The guiding principle must be that the tax on capital gains should be neutral in its impact on the ability of a trust to act as a medium of investment. The present arrangements are obviously not neutral, for the 30 per cent rate of tax on trusts' gains may be higher than the rate which the person of modest means would have to pay if he invested on his own behalf. Equally, the arrangements for avoiding the double taxation of gains, first when they are realised by the trust and then again when they are reflected in the value of units or shares, are so cumbersome in practice that they may themselves deter investors.

5.31 There is

5.31 There is plainly room for change here. But it would be a departure from neutrality simply to exempt the trusts in full, for that would give them the benefit of tax free switching and would put them at an advantage as compared with other investment media, and, indeed, with the ordinary individual managing his own portfolio.

5.32 As from 6th April this year there will therefore be a new system under which gains realised by trusts will be taxable at the rate of 15 per cent. When the shareholder disposes of his ordinary shares or units he too will be taxable, but in calculating the tax he has to pay he will be given a tax credit of 15 per cent of the amount of his gain. This credit, which will not be repayable, will effectively take into account the 15 per cent charge borne by the trusts.

5.33 The House will recall that most individuals do not pay capital gains tax at the full 30 per cent rate on their gains; instead, they pay at their personal income tax rate on only half their gains up to £5,000 if this is more favourable. From April next year, for those of them who are liable only at the basic income tax rate of 30 per cent, that will mean an effective capital gains tax rate of 15 per cent. This, in the case of units or investment trust shares, will be wholly offset by the 15 per cent credit on account of tax paid by the trust. The result will

/be that

be that no individual on the basic rate of income tax will then have to pay any tax at all when he disposes of his units or investment trust shares; the trust will have settled the bill for him.

5.34 The new system will be much easier to understand and will certainly enhance the attractiveness of unit and investment trusts. The long-term cost will be about £30 million a year although in the early years it may be somewhat higher than this.

/(8) Share Option and Incentive Schemes

(8) Share Option and Incentive Schemes

5.35 [Link sentence which I will write when the speech is put together.] I want now to deal with the matter of share option and incentive schemes.

5.36 In 1966 the Finance Act charged to income tax all gains from share options given by a company to its employees or directors. That legislation, as was no doubt intended, effectively put a stop to share option schemes. But there has since grown up a variety of share incentive schemes under which gains to participants are liable only to capital gains tax.

5.37 I believe it is now recognised on both sides of the House that the 1966 legislation was altogether too drastic and that, contrary to the view then put forward by Treasury Ministers, share options have a valuable role to play in stimulating management enterprise and in helping industry to recruit and keep the kind of management talent that it needs. The Finance Bill will therefore contain provisions under which share option schemes which are approved by the Inland Revenue as meeting prescribed conditions will be exempted from the 1966 legislation. Gains from other schemes will continue to be charged to income tax, and so in future will gains from share incentive schemes which do not meet similar conditions. The conditions will be broadly similar to those which responsible bodies regard as necessary to safeguard shareholders' interests.

ought to be more specific? Norm will know what is meant + the other side will know.

(.9) Free Depreciation

5.38 The country now stands at a moment of great challenge but also of tremendous opportunity. If we are to take full advantage of the enlarged Community market which will be opening up for us in less than a year, one of our foremost tasks must be to improve our competitiveness as a trading nation.

5.39

The hard fact is that, for years now, the level of productive investment in this country has been low by comparison with that of our main trade competitors. For example, in 1970 Japan invested no less than 28 per cent of her national income. The average figure for the Six was 19 per cent. In this country it was 15 per cent.

5.40 The primary factors which determine the level of productive investment are two-fold - business confidence in a sustained growth of demand, and profitability.

5.41 A major part of our strategy must therefore be to provide the climate in which industry can have the confidence to re-equip and expand.

5.42 For very many years the leaders of British industry have called upon successive Governments to introduce

BUDGET-SECRET

nation-wide free depreciation for all investment in plant and machinery. The problem is, of course, that to do this would remove the present taxation differential between the country in general and the development areas where, the House will recall, I introduced free depreciation in October 1970.

5.43 The other request which has repeatedly been made by industry is for investment incentives which are stable and easy to understand.

5.44 With the opportunities which are opening up for this country, the time has now come to provide these incentives.

5.45 As from tomorrow, free depreciation - that is to say, a 100 per cent first-year allowance - will be introduced throughout the whole country for all investment in plant and machinery, other than passenger cars, whether the investment takes place in a development area or not.

5.46 For the sake of simplicity free depreciation will apply equally to investment in new and second hand equipment.

5.47 In other words, as from tomorrow the whole country will enjoy the taxation treatment previously reserved for the development areas. Moreover, in order to give industry the stability they seek when planning

/long term

BUDGET-SECRET

long term investments I should make it clear that my present intention is that this system of free depreciation is one that will endure at least for the remainder of the present Parliament.

5.48 For industrial buildings the rate of initial allowance for new buildings outside the assisted areas, which was due to revert to 15 per cent on 6th April this year, will be increased to 40 per cent. This means that the 40 per cent rate of initial allowance for new buildings will apply throughout the country. The cost of all these changes will be £5 million in 1972-73 and £115 million in 1973-74.

/(10) Regional policy

(10) Regional policy

5.49 It will of course be immediately apparent that by introducing countrywide free depreciation I have removed the existing differential in favour of investment in assisted areas. It is our purpose however not merely to re-establish the regional differentials, but to do so in the framework of an entirely new approach to regional policy, which gives the development areas a more clear-cut preference than any previous systems. The new system of regional incentives will be simpler, more easily understood and more certain in its application than the existing arrangements, thereby enabling businessmen to evaluate more readily the advantages to both their firms and the country of providing more job opportunities in the assisted regions.

5.50 Our existing programmes for helping the development and intermediate areas rely heavily on the powers under the Local Employment Act, in particular with regard to the building grants which are available throughout these areas on condition that the projects provide a given amount of additional employment. I now propose, as a central feature in our renewed attack on the problems of the older industrial areas, to make building grants much more widely available. In respect of new industrial buildings started from tomorrow in the assisted areas there will be a new system of regional development grants which will not be subject to this condition, and which will also be available, for example, for schemes which maintain

to make grants of various kinds - part of it.

existing employment and for straightforward modernisation. The scope of these grants will be described in greater detail tomorrow by my rt. hon. Friend the Secretary of State for Trade and Industry, but they will apply to a wide range of industries in the assisted areas without their having to go through the procedures at present required under the Local Employment Act, so speeding up and simplifying the administration of the scheme.

5.51 The rate of grant for buildings in the intermediate areas and in the development areas other than the special development areas will be 20 per cent. In the special development areas it will be 22 per cent. Moreover these grants will be on a different basis from previous grant incentives. They will not affect the recipient's entitlement to taxation relief on his investment; he will still be able to claim capital allowances on the full amount of his investment notwithstanding that part of it has been covered by grant. The separation of grants and tax allowances in this way will not only make for simpler administration, it will also make it very much easier for the businessman to see the precise margin of advantage to him if he invests in a development area. The value of the new grants will be substantially enhanced by the new tax basis. For a profitable company they are equivalent, on the old tax basis, to grants of over 30 per cent.

5.52 Geographically, the broad coverage of the

/development areas

BUDGET-SECRET

development areas will be unchanged. But there will be a major extension of the intermediate areas to embrace, broadly speaking, those parts of the North West and of Yorkshire and Humberside which are not already included, [together with those parts on the coast of North Wales which are at present unassisted]. This will absorb into the intermediate areas a large part of what are termed the derelict land clearance areas; the remaining part of these ^{derelict land clearance areas} ~~latter areas~~ will, as a temporary measure, get the same 20 per cent building grants as the intermediate areas for a period of two years, as a once-for-all fillip to industrial renovation.

5.53 Under the Local Employment Act, the development areas, though not the intermediate areas, get other forms of assistance to industry. It is necessary to restore and reinforce the differential treatment of the development areas in a way which best meets their present need both for more enterprise in existing industries and for new firms and industries capable of seizing the opportunities provided by the European market. There are opportunities in these areas for foreign firms as well as British. These are powerful reasons why our incentive system needs to be simple to understand and capable of offering advantages to newcomers as well as established firms. We have therefore decided that in the development areas alone there should be a grant scheme for plant and machinery closely related to the arrangements for building grants. The rate of grant for capital expenditure incurred /on new plant

BUDGET-SECRET

on new plant and machinery from tomorrow will be the same as for building grants, that is 22 per cent in the special development areas and 20 per cent in the rest of the development areas, and on the same new tax basis.

~~VI MISCELLANEOUS~~

5.54 The Cost of these grants/

5.54 The cost of these grants, as of capital allowances, will depend on the level of qualifying investment, and we know that actual payments can fluctuate a good deal. Subject to that, the estimated additional grant expenditure in the development and intermediate areas is approximately £200 million in the first full year. If the expenditure previously forecast for building grants under the Local Employment Acts is also included, the estimated cost of all these regional development grants will be about £250 million in the first full year. The cost of the temporary grants in the derelict land clearance areas may be up to £10 million a year.

5.55 These general schemes will be supplemented by continuing selective assistance in the areas of high unemployment on the lines of the loans and special grants hitherto provided under the Local Employment Acts. My right hon. Friend the Secretary of State for Trade and Industry will deal in greater detail, not only with the changes which I have just described, but with plans to intensify this selective regional assistance and also to strengthen the organisation and powers of the Department of Trade and Industry.

15.56

*any to be done
indication to be
given of the new
regional structure?*

5.56 The measures which I have announced provide the most powerful combination of national and regional investment incentives which we have had in this country since the war. The object is twofold. First, to stimulate investment and modernisation in productive investment throughout the economy, and so to equip industry to adapt more readily to our membership of the European Community, and, second, to make a new and intensified assault on the deep-seated problem of regional imbalance, which involves so much waste in terms of unused resources and lack of fulfilment in people's lives.

5.57 The House knows my views about the Regional Employment Premium. The previous Administration undertook that it would continue until at least September 1974 and that there would thereafter be no question of abrupt termination of the scheme. In our Manifesto we said that we would phase out REP taking proper account of existing obligations and commitments. That will be done, and REP will accordingly be phased out over a period from September 1974. The rate and method of phasing out will be announced in due course in the light of the circumstances at the time and after consultation with Industry.

—/VI

(VI) MISCELLANEOUS

(1) Relief for interest

6.1 I come now to the question of tax relief for interest.

6.2 During the Report Stage of last year's Finance Bill I explained at some length both the approach of the Government and the problems consequent on the Report of the Crowther Committee last year. [Hansard 6 July, Cols. 1200-1203]. I pointed out that the Government's commitment was part of a programme for a Parliament. I also made it clear that the burden on the administration must be a major factor and pointed out that reallowance without restriction would require 1000 extra trained staff. Nevertheless I intend to make a start this year.

6.3 For the reasons I explained last year there cannot be relief for ordinary hire purchase transactions. That, of course, has always been the position. For administrative reasons at present, and to maintain equity as between different forms of credit I propose that the first £35 of all interest paid should not qualify for tax relief except in the case of loans for house purchase. Secondly, I propose to take action to frustrate the artificial transaction of borrowing to buy dated securities with the certainty of a capital gain on realisation on or shortly before redemption. Subject to these two restrictions relief for interest will be restored as from 6 April.

(2) Sale and leaseback, and deferred premiums

6.5 As was foreshadowed in announcements made last August, the Finance Bill will also contain provisions concerning the treatment of short leaseback arrangements, and of certain forms of tax avoidance involving the use of premiums for leases and other capital payments made by instalments.

(3) Charities

(3) Charities

6.6 In our manifesto we stated that we would encourage the flow of private funds to charities, and over the past year I have been considering how best to do this.

6.7 Charities already benefit greatly from the covenant system, and I do not propose to change that.

6.8 It has repeatedly been put to me that there should be some relief from Estate Duty on bequests to charities, and I agree. Unfortunately, because of the opportunities for manipulation by a few if very large sums were to be exempted, there must be a limit.

6.9 After today property going to charities will be exempt from Estate Duty up to a maximum of £50,000.

6.10 There are certain bodies concerned with the preservation of the national heritage where in future bequests will be exempt from Estate Duty without limit. These include the National Trust, the National Gallery, and the British Museum.

6.11 There is one further and important way in which I propose to help charities. This proposal also is the outcome of representations and discussions over the past year. All gifts made to charities or to those other bodies I have just referred to will after today be exempt altogether from Capital Gains Tax. In the case of this proposal the exemption will be without limit.

6.12 I have no doubt, from what I have been told, that these two proposals will be of very considerable benefit to charitable and other organisations concerned. The cost is estimated to be £7 million in 1972-73 and £15 million in a full year.

/VII INDIRECT TAXATION

VII INDIRECT TAXATION

7.1 [I now turn to value-added tax.] The House will recall that, a year ago I announced a major reform of indirect taxation under which a value-added tax would be introduced in April 1973 and, at the same time, purchase tax and SET would be abolished. A Green Paper was published as a basis for consultation with trade and professional associations and other interested parties. That procedure has been widely welcomed and the Customs and Excise Department have had separate discussions with more than 300 organisations. This process of consultation has been invaluable in planning the details of the tax with the object of ensuring that, from the point of view of industry and commerce, it will be at least as simple to operate as in any of the eight countries which now have a V.A.T. and much simpler than in most of those countries. Our objective has not merely been to design a V.A.T., but to design the best possible form of V.A.T. There can be no doubt that the Green Paper procedure, and the consultations which have followed, have paid handsome dividends.

7.2 Last November I announced that I would publish the value-added tax legislation during the Budget Debate instead of waiting for the publication

/of the

of the Finance Bill as a whole. A draft of the relevant Clauses and Schedules will be available in the Vote Office when I sit down. This draft legislation forms an Appendix to a White Paper in which is set out an explanation of the main features of the tax. This will be a help both to the House and to those outside. This afternoon I must of necessity concentrate on those aspects of the tax which are of wide general interest. More detailed matters are included in the White Paper.

/(1) Tax paid stocks

(1) Tax paid stocks

7.3 Before I come to the tax itself, I deal with one particular aspect of the transition from purchase tax to V.A.T. which is both difficult and important - the treatment of stocks which will have borne purchase tax and which, being still unsold when V.A.T. begins, will then attract V.A.T.

7.4 If no relief were given, many retailers and others holding stocks of purchase tax paid goods would seek to protect themselves by running down their stocks. Moreover some retailers might increase their prices in order to recover both the purchase tax and V.A.T. on their goods.

7.5 I have considered a number of ways of meeting the difficulty. In fact there is no perfect solution.

7.6 It would be wholly impracticable to attempt an accurate stocktaking on 1st April of every one of the half million businesses concerned, and then seek to estimate the purchase tax they had paid. What is wanted is a formula which is simple, involving the minimum of additional work at a time when everyone will be occupied with the preparations for V.A.T., and yet giving traders a reasonable measure of relief. After consulting a number of those concerned,

/I propose

I propose to tackle the problem in two ways. First, those dealing in readily identifiable goods will be able to use sale or return arrangements, so that if the goods are still unsold when V.A.T. comes into operation there will be no liability to purchase tax. Most cars and many consumer durables are in fact already sold under these arrangements, which work well.

7.7 For other goods purchase tax will end a short time before V.A.T. is introduced, so that in preparation for it retailers will have an opportunity to build up stocks which have not borne purchase tax.

7.8 Details of these proposals are given in the White Paper, and there will be further consultations with trade interests. This scheme will have the advantage of benefiting the cash flow of traders. Similar problems will arise in respect of stocks of goods subject to the revenue duties if those duties are reduced to avoid increases in the total level of taxation of the goods concerned when V.A.T. comes into operation. The extent to which I can make such reductions must take account of economic circumstances nearer the time. I propose, however, to take a power, to be used only before the introduction of V.A.T.,

(2) Small traders exemption

7.9 Before I turn to the rate structure of the V.A.T., there is one general exemption I should mention. Most countries which operate a V.A.T. provide some means of excluding small businesses. Having examined the methods, I have come to the conclusion that the best way is to provide for a general exemption governed by turnover. In determining the limit, there are two considerations: the loss of revenue, and the need to ensure equity as between small and larger businesses in competition with each other. In those countries where turnover is the criterion, the highest limit for exemption is £1,360. Bearing in mind, however, the need to keep the administration of the new tax simple, I have decided that there will be a general exemption for all businesses whose taxable turnover (including zero-rated items) does not exceed £5,000 per annum.

7.10 This will exclude from the tax about 1/2 million traders.

(3) Rate structure and coverage

imported] cars of 10 per cent of the wholesale value which will come into force at the same time as the V.A.T. Together they will yield considerably less than the present 30 per cent purchase tax on cars, and this should be reflected in car prices.

7.15 In order to enable the motor industry to plan for the future with greater certainty than in the past there will not be a regulator power covering the new car tax. The Finance Bill will, however, include a regulator power to change the V.A.T. rate between Budgets for purposes of economic management, and this will of course apply to V.A.T. generally, including cars.

/(4) Main exempted and zero-rated goods

annum will in fact be subject to tax. The vast majority of charitable activities will therefore be outside the tax, and the overall effect on their costs of the changes in indirect taxation, taking into account the abolition of purchase tax and S.E.T., is likely to be very small. When account is taken of the proposals I have already put to the House on the direct tax side, it is clear that charities will be substantial net beneficiaries from this Budget.

7.21 I come next to the main areas where relief will be given by zero-rating. First food.

7.22 In our Election Manifesto we promised that V.A.T. "would not apply to food, except for those few items already subject to purchase tax". This undertaking will be honoured. Food, other than those foods now subject to purchase tax will be zero-rated. Those items now liable to purchase tax - [confectionery, ice cream, petfoods, potato crisps, salted nuts, soft drinks] - are estimated to yield about £150 million in the coming financial year, and if they were to be relieved altogether there would have to be a commensurate increase in the rate of V.A.T. They will therefore be charged at the standard rate. The overall effect of these proposals, together with the abolition of S.E.T., will be a reduction in the burden of tax on food.

7.23 In the last Budget I said that newspapers, periodicals and books would be relieved of the tax. These too will be zero-rated. In the case of newspapers, /zero-rating

zero-rating will apply not only to sales but also to advertising. This is right because there are special circumstances attaching to newspaper advertising, in particular the large volume of advertising by private persons. The relief will not apply to other advertising media.

7.24 Advertising on television, for example, will be undertaken almost exclusively by registered traders who will be able to reclaim the tax on this advertising under the ordinary accounting procedures of the tax.

7.25 In our Election Manifesto, we said that under a value-added tax "special arrangements would be made for housing". The details are set out in the White Paper, but in broad terms what they amount to is that all new construction, whether of houses or other buildings, will be zero-rated, while other transactions in land and buildings will be exempt. This means that new housing will be wholly relieved from V.A.T. What is more it will also be relieved from the S.E.T. which was a significant addition to housing costs. In addition all rents will be exempt and there will be full relief for local authority rates.

(5) Rate

7.28 I now turn to the question of the rate at which V.A.T. will be charged when it is introduced a year hence. As with all future rates of taxation, a final decision can only be taken in the light of the economic situation at the time.

7.29 But I am sure that it is right, in order to help industry and commerce with its forward planning, that I should state now the rate which I have in mind. Indeed I think it is right to go further and to provide for that rate in this year's Finance Bill. In order to allow for the needs of economic management at the time when the tax comes into operation, the legislation will also include a once for all power to substitute by Treasury Order, before 1st April 1973, a rate within a range of 2½ percentage points on either side of the prescribed rate. In other countries with a V.A.T. there is a wide range of standard rates, from the lowest figure of 10 per cent in Luxemburg up to the highest, 23 per cent, in France. The rate prescribed in the Finance Bill will be 10 per cent. Even taking into account the special arrangements for cars, the yield will be less than the current yield of purchase tax and S.E.T.

17.30

7.30 To sum up. The particular value-added tax designed for the United Kingdom will be at least as simple to operate as in any of the countries which now have a V.A.T., and much simpler than in most of those countries. What is more, no country in the world has a lower standard rate than the one I propose to prescribe.

7.31 Over the past years there has been much talk about the relative effects of the change to V.A.T. on different levels of family income. In particular it has been suggested that the change from purchase tax with its high rates on so-called luxury goods and low rates on so-called essentials to a single rate of V.A.T. might bear more heavily on the poor than on the rich. Yet in practice these definitions of luxuries and essentials devised in the main 30 years ago have little relevance today. It makes no sense that, for example, television sets, electric, gas or paraffin heaters are taxed at 30 per cent while items such as Persian carpets or the latest Paris fashions should be taxed at a mere 11 per cent. And I am sure hon. Members opposite will be hard put to explain why, to take two pertinent examples, ^{boats} ~~yachts~~ should be exempt from purchase tax while pipes are taxed at 45 per cent!

17.32

7.32 The V.A.T. I have outlined has been deliberately designed with the interests of low income families in mind. If I had decided to relieve only food and housing then, given the importance of these items in the budgets of lower income families and the fact that S.E.T. enters into the cost of both, it would have been open to question whether the change would have been regressive. But I have gone much further - I have also zero-rated fares and domestic fuel and light. The decision on fuel is almost as important in this respect as the decision on food - fuel like food takes up a significantly larger proportion of the budgets of low income families, including of course pensioners, than of those who are better off. There is therefore no reason to fear that the change-over to V.A.T. will be regressive.

/(6) Purchase Tax

VIII ESTATE DUTY(1) Green Paper

8.1 I turn now to estate duty. As the House knows, a number of threads run consistently through the taxation reforms on which we are engaged - the need to restore incentives, the need to encourage savings, and the need to create conditions in which men and women can, by their efforts, contribute effectively not only to their own well being but to the prosperity of the country. Last year, I announced major reforms of personal income tax, of corporation tax, and of the whole system of indirect taxation.

8.2 On the first we legislated last year and, as I have already said, the second and third will be covered in this year's Finance Bill. The House will be relieved to know that I do not propose that this year's Bill should also provide for the complete reform of the system of taxation of capital on death.

8.3 But the time has now come when we should begin to consider whether the estate duty, which has been with us for about 80 years, is in fact the right means of taxing capital on death. Other countries have evolved systems which are fundamentally different from ours. Is it right that, in general, as under the existing system, the amount of duty should be calculated by reference to the value of the whole of the

/deceased's

deceased's estate, without regard to its distribution? May there not be a case for calculating the duty by reference to those who inherit the property rather than by reference to the deceased? Is there not also an argument for scales of duty which vary according to the relationship of an inheritor to the deceased? Is it right that the same rates of duty should be payable in respect of a bequest to a son or a daughter as to a stranger? In other words, while the system of estate duty undoubtedly has considerable advantages, we should consider whether an inheritance tax might not be fairer.

8.4 It would be quite wrong to take such a fundamental decision without the fullest public discussion. Over the past year we have been making a thorough review of the complex issues which are involved and of the implications of the replacement of estate duty by an inheritance tax. The outcome of that review is today being published in a comprehensive Green Paper. It deliberately reaches no conclusion. All I ask is that the whole subject should be considered afresh without preconceived ideas.

/(2) Changes

(2) Changes

8.5 Because full public discussion of a possible reform is bound to take some time, it would be wrong to leave matters where they are. The burden of estate duty has been made much heavier over the years by the fall in the value of money. The present estate duty scale, which broadly speaking dates from 1949, and which was regarded as pretty severe when imposed by Sir Stafford Cripps, has become more and more severe in its incidence as the years have gone by.

8.6 I have already told the House of my proposals for relief from estate duty on property going to Charities.

8.7 There is one particular aspect of estate duty which has been raised on a number of occasions during the past year. It has been suggested that the matrimonial home should be exempt from estate duty. I have considered this proposal carefully, but I cannot agree, because to provide this relief would be very unfair as between the widow whose husband owned his house and the widow whose husband chose to /rent it.

rent it. But I have no doubt that there should be special relief for the widow, and that the fairest way to achieve this is to make the relief general. I have therefore decided that, in future, any property going to a widow, up to a sum of £15,000 will be left out of account altogether for estate duty purposes. This relief will apply equally to property left by a wife to her husband.

8.8 Secondly, I propose to raise again the threshold below which no estate duty is payable. It will be increased from £12,500 to £15,000.

8.9 Taking these two reliefs together, the effect for example will be that where the estate is left wholly to the widow no duty will be paid at all unless the estate exceeds £30,000 and thereafter the estate duty will fall only on the excess over that sum.

8.10 Thirdly, I propose to take action to ease the burden of the duty which has been increasing because of the fall in the value of money since the 1949 scale was fixed. So far as the smallest estates are concerned, the policy of both Governments in progressively increasing the exemption limit has protected these estates, and this form of relief has to some extent extended to estates immediately above the exemption limit. I
/have carried

have carried this process a step further this afternoon. So far as estates above this range are concerned I would have liked in principle to have gone all the way back to the 1949 scale re-expressed in real terms - that is, adjusted to take account of the fall in the value of money. I cannot go as far as this but there will be a new scale, which appears in the Financial Statement, which while giving a real measure of relief remains generally more severe in real terms than the 1949 scale. This new scale reaches a top rate of 75% on property over £500,000. [Had I continued the scale to a top rate of 80% at, say, £1m, it would have added only £500,000 to the yield.]

/8.11

8.11 The relief for the surviving widow (or widower) will cost £60m. in a full year and £30m. in 1972-73: the increase in the threshold and the reduction in the rates will cost £68m. in a full year and £34m. in 1972-73. The relief for charities will cost £15m. in a full year and £7m. in 1972-73. These are big figures but more than two-thirds of the total cost represents the relief for the widow, for charities and the increase in the threshold. The reduction in rates accounts for less than a third of the cost. While it represents a real measure of relief, as I have already said it leaves the scale generally higher in real terms than it was in 1949 and by international standards our death duty charge is still exceptionally heavy.

8.12 These changes will relieve from duty 40 per cent of estates which would otherwise have been liable, and with the changes I made last year this means that altogether 50 per cent of estate which would otherwise have been liable to duty will have been wholly relieved - all of them at the lower end of the scale.

8.13 All these proposals will take effect in relation to deaths occurring after today.

IX PERSONAL DIRECT TAXATION

(1) Unitax (we must get a better name or description)

9.1 Last year I announced that we were carrying out a study into ways of simplifying the whole structure of the PAYE system, in particular the possibility of introducing a non-cumulative system. As we promised, we have also during the past year been considering the implications of a negative income tax. The time has come when we should reach a decision, one way or the other.

9.2 The future of PAYE is, of course, mainly a question of the mechanics of tax collection. A negative income tax raises much wider questions of the whole approach to social payments and the relief of poverty. Yet it soon became apparent that in practice the two studies were closely linked.

9.3 The present PAYE system is well-established; it is fair and it is respected. The unification of income tax and surtax and the ending of the complicated earned income relief will make it easier to understand and to operate. Yet certain well-known disadvantages will still remain. The process of annual coding is complex and time-consuming, and it is difficult for the man in the street to understand. Even after unification the PAYE system will require the employment of some 35,000 in the Inland Revenue and perhaps as many again in industry.

19.4 AB

9.4 As the House knows, while we have been searching for a simpler system I decided that the Inland Revenue computerisation programme should be suspended. I am well aware of the disruption and disappointment that that decision caused. Yet I am sure that it would have been a great mistake to go on with a vast new mechanisation programme only to have to make radical changes, possibly before it was completed.

9.5 In Britain we have two systems existing side by side - a taxation system which embodies a set of reliefs and allowances based on one set of principles, and a social security system which embodies a different set of benefits and allowances based on a different set of principles. Each has been amended and added to again and again over the years. It is obvious that immense difficulties are involved in trying to bring these two separate systems together in a simpler and more general system, and inevitably if no group is to be worse off such a change must involve a considerable cost.

9.6 But there can be few in this House who have not at some time or other been attracted to the idea of some form of negative income tax. The theoretical attraction of such a scheme, as hon. Members will know, is that there should be a single assessment of income which would suffice either for calculating the tax due if the income is above a certain level or for calculating the social benefit to be paid if it is below that level. Such a
/scheme

scheme would provide a fairer and more accurate method of directing help to many people in need and it would tidy up the present borderline between taxation and social benefits. It would provide a smoother graduation from the area of benefit to that of taxation, and so it would avoid some of the worst features of what has become known as "poverty surtax", with all that that implies by way of disincentive to earn more.

9.7 One of the difficulties of making progress hitherto has been that no really detailed scheme, which took account of all the complications of our two systems of taxation and social security, and which could reasonably be regarded as practicable and acceptable, has been put forward as a basis for discussion.

19.8 Last year

9.8 Last year a comprehensive and detailed scheme was worked out by Mr. Cockfield, my Special Adviser on Taxation. It was a new system of taxation and benefit combining many of the features both of a form of negative income tax and of a radical simplification of P.A.Y.E. After considering this, my Rt. Hon. Friend the Secretary of State for Social Services and I decided to set up a ~~(high-powered)~~ working group of senior officials - some working full time on this particular project - to examine the new scheme. Their studies have confirmed our own belief that this new system is both practicable and desirable.

9.9 Because this is a development of such immense importance, and a development which is, I believe, in principle acceptable to Hon. Members in all parts of the House, it seems to me to be eminently suitable for examination by an all party Select Committee of this House. I therefore propose to publish, later in the year, a Green Paper setting out the scheme in detail. I hope that the House will in due course agree that it should be referred to a Select Committee for study and report.

9.10 It is essential that there should be plenty of time for full public discussion but I would expect

/that,

BUDGET-SECRET

that, if such a scheme found general acceptability, we should be able to legislate during the course of this Parliament. The preparatory work before such a massive change could actually come into operation would, of course, take longer.

/9.11 I must

BUDGET-SECRET

than tax allowances for the purpose.

9.11 I must ask the House to await the publication of the Green Paper later in the year but hon. and rt. hon. Members may be interested on the following salient features of the scheme.

9.12 It will cover about 90 per cent of the population.

9.13 For these people all the main personal tax allowances - the single, married and child allowances - will be abolished and replaced by a simple system of credits payable whether or not the recipient is a taxpayer. Credits will normally be set off against tax payable but where the credit is greater than the tax the difference will be paid as an addition to the wage or other income.

9.14 Family allowances and all the complications of the claw-back will likewise be superseded by a child credit.

9.15 In almost all cases credits will also supersede the family income supplement.

9.16 The national insurance scheme, reconstructed as proposed in the White Paper "Strategy for Pensions", will continue, as will the supplementary benefit scheme. But the number of people who need to draw supplementary benefit will be substantially reduced.

9.17 The P.A.Y.E. system will be replaced by a system embodying a simple non-cumulative tax deduction

BUDGET-SECRET

at the basic rate of 30 per cent, with supplementary deductions for the small proportion of taxpayers liable at the higher rates of tax.

9.18 At present there are 450 PAYE codes which have to be operated by nearly a million employers. All this will disappear completely. The task of the employer will be made easier, and the system will be far simpler for the taxpayer to understand. For the great majority of taxpayers there will be no year-end assessment.

9.19 The scheme as well as applying generally to those who are in employment and come within the national insurance scheme, will also cover retirement and other national insurance pensioners, and those who receive short-term national insurance benefits. The credits will continue to be paid during unemployment and sickness and as a corollary the corresponding benefits will be brought within the tax net as was originally provided when the present National Insurance Scheme was introduced by the post-war Labour Government. As the House will recall, their subsequent exclusion from tax rested solely on administrative grounds which will disappear under the new system.

9.20 Finally, the scheme will save some 10,000 to 15,000 civil servants.

9.21 If this scheme commends itself to the House, it will provide a substantial and comprehensive

BUDGET-SECRET

/benefit

benefit to lower paid workers and to a very large number of retirement pensioners. It will provide this benefit without individual means-testing, but the benefit will in essence be selective because its value will fall progressively as income increases.

9.22 [Negative income tax is a misnomer for a scheme of this kind because the positive tax element is just as important as the negative tax element. As the new system has to be called something, I suggest UNITAX,] because it unites positive and negative tax and because it is the first step in uniting the hitherto separate functions of Government in collecting tax and paying out benefits.

9.23 This new scheme represents the most radical reform, improvement and simplification of the P.A.Y.E. and social service systems for a quarter of a century. Not only that, but also it will mean a considerable improvement in the position of very many people in the more hard-pressed sections of the community. I commend it to the House.

/(2) Unified Tax

(2) Unified Tax

9.25 [Link sentences which I will insert]

The new unified system of direct personal taxation, for which we legislated last year, becomes operative in April next year. The Finance Act 1971 provisionally fixed the basic rate of tax and the level of personal allowances which would apply under the new system. I explained, however, why I could not then - two years ahead - settle the higher rates of tax and the details of the surcharge on investment incomes. I was nevertheless pressed, from both sides, of the House to give some indication before the Budget of 1973. I agree that in such an important change as we are making the people who will be affected should know broadly where they stand. Moreover many large concerns these days use computers to calculate their employees' pay and tax. If the higher rates of tax were not to be announced until this time next year, they would be faced with some difficult problems in amending their computer programmes. All the rates of tax which will operate under the unified system will therefore be provisionally fixed this year.

9.26 The House will recall that the present complicated system of surtax will be abolished and /will be

BUDGET-SECRET

will be replaced by the higher rates of income tax. The schedule of these rates is set out in the Resolution which will be circulated shortly. But I can summarise the proposals in this way. On the first £5,000 of taxable income - that is after account has been taken of personal allowances - tax will be charged at the basic rate of 30 per cent. The rate for the slice of taxable income between £5,000 and £6,000 will be 40 per cent and the rates for successive slices above that amount will rise in steps of 5 per cent until a maximum rate of 75 per cent is reached at the level of £20,000. This will provide a much simpler, smoother and more easily understood scale.

9.27 I now turn to the investment income surcharge which the House will recall is to be imposed on the larger investment incomes. I have made it abundantly clear that I regard the present form of discrimination against investment income as unacceptable. Indeed among the advanced countries of the world, the United Kingdom and France are the only 2 which draw such a distinction to any significant degree. One of the foundations of the unified tax system is that only the larger investment incomes should attract the surcharge: in other words, that the first slice of investment

/income should

BUDGET-SECRET

income should be charged at the same rates as earned income. To fix a low starting point would undermine this principle and it would erode the manpower saving which we shall make.

9.28 Therefore, I have decided that the surcharge will be imposed on the excess of investment income over £2,000. As well as benefiting retired people living on income from past savings, this will also be of considerable help to people such as divorced and separated wives who depend on what the income tax rules treat as investment income. The House will be interested to know that it is estimated that no less than 30 per cent of the tax reductions arising from the new unified system will go to the 11 per cent of taxpayers who have retired. Furthermore, the fact that from next year the first £2,000 of investment income is to be treated exactly the same as earned income will be an important encouragement to the personal saving we will need to finance our growing investment programme.

9.29 The rate of the surcharge will be 15 per cent. This will of course be in addition to other tax, so that a taxpayer whose income is within the basic rate band will pay in all 45 per cent on any investment income which is liable to surcharge; that is on any investment income over

£2,000. For those with very large investment incomes the top rate will be 90 per cent. These are higher nominal rates than apply at present, but when account is taken of the fact that no surcharge is payable on the first £2,000 the effective rates are lower.

9.30 The net cost of these changes will be [£275 million] in a full year.

/(3) Surtax threshold

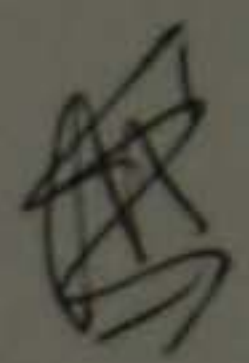
(3) Surtax Threshold

9.31 To meet the very difficult staffing position in the Surtax Office before unification takes over, I propose to adopt precisely the same device as the rt. hon. Member for Stechford adopted in his last Budget in almost identical circumstances. For 1971-72 the surtax starting point will be raised by £500, but when income exceeds the new limit, surtax will continue to be charged at the same rates as at present on the excess over £2,000. The result will be that, at a cost of £14 million for the full year, 130,000 taxpayers who are just within the surtax net will be taken out of charge for this year, over a third of whom have not paid surtax before. I should perhaps add that, but for this change, the cost of collection of the £14 million would be £14½ million. The details of this change will be in the Financial Statement and Budget Report.

*This is clear
but look 9.36 + 9.37
get the point
make the
point.*

(4) Personal allowances

9.32 The various changes that I have so far announced would raise output in/by the first half of next year by [$\frac{1}{2}$] per cent. But the House will recall that my Budget judgment was that output should be raised by that time/till that period by [around $1\frac{1}{2}$] per cent. Last year I reduced the standard rate of income tax and made a start on raising tax thresholds by increasing all the child allowances and so raising the thresholds for families with children. This year I believe a broader approach to the problem of the threshold is called for.



9.33 I come, therefore, to my final proposal.

9.34 There will therefore be no change in the standard rate. Instead there will be increases in both the single person's allowance and the married allowance. If effect is to be given to these changes quickly and without an impossible work burden, the increases must this year be of the same amount. Otherwise it would be necessary to recode a very large number of taxpayers and there is simply not the manpower available to do this.

It is highly probable the majority of the Inland Revenue would do this.

9.35 Increasing these personal allowances is undoubtedly the best means of helping taxpayers

/generally

generally right across the board, for it helps every taxpayer right up the scale, but gives no more to the surtaxpayer than to the standard rate taxpayer. The British people have been taxed too heavily for too long, and we on these benches believe that men and women do respond to the incentive of lower taxation.

9.36 And so, at a cost of £960 million in 1972-73 and £1,200 million in a full year the single person's allowance and the married allowance will each be raised by £135. The House will not be surprised to know that these are the largest increases which have been made in these allowances. The single person's allowance will therefore be raised from £325 to £460 and the married allowance from £465 to £600. Corresponding increases will be made in the amount of the allowances which will operate in the unified system.

9.37 This will mean that the tax thresholds will be raised very considerably. For example, for the single man the threshold will go up by £17⁴ a year or £3.3⁴ a week to £11.37. For the married man without children it will go up by the same amount, from £11.50 to £14.84. If one considers the family man with children the change is even more impressive.

/Before last

2 part
containing

BUDGET-SECRET

Before last year's Budget a married man with 2 young children started paying tax when his earned income reached £16.15 a week. As a result of last year's increase in child allowances and this increase in the married allowance, his tax threshold will be up by £5.31, so that he will in future pay no tax on his earned income until it reaches £21.46 a week. Another way of expressing these changes is that while all those below the new thresholds will be totally exempt from tax, every other taxpayer in the land - and there are million of them - will be £1 a week better off. [In the case of the million married couples where the earnings of husband and wife are each over the threshold, they will be £2 a week better off.] And I should mention that, altogether, about 2½ million people who would have paid tax this coming year will be freed of liability altogether by the changes I am making this year.

9.38 The Inland Revenue have arranged for the new tax tables to be prepared more quickly than on previous occasions, and the reductions should be reflected in the first pay packet after 4th May.

[Lead in to level of pay settlements]

61 Tax 2/2/48 Confuses.

X CONCLUSIONS

(1) Post-Budget Outlook for Government Finance

10.1 For 1972/73 the central Government's borrowing requirement, after taking account of the Budgetary measures, is forecast to be [] and that of the public sector []. This borrowing requirement, I should emphasise, does not imply a current account deficit; on the contrary, both the central government and the public sector as a whole are forecast to run a substantial current surplus. This surplus will finance a large part of the investment programmes of the public sector. But it will not cover the full amount of those programmes and of the public sector's lending to the rest of the economy. Nor should it: it would be highly deflationary to finance these capital outlays entirely out of revenue. In present circumstances it is not inappropriate for the public sector to borrow heavily. Indeed, the rise in the borrowing requirement in large part stems from the fiscal and other measures taken to stimulate the economy.

/(2) Peroration

BUDGET - SECRET

(2) Peroration

[Still to be drafted by Chancellor.]

TOP SECRET

8

MR. BAILEY

H.M. TREASURY

I enclose a note of yesterday evening's meeting at Chequers, which records the decisions taken on the main outstanding points for the Budget.

I am not sending copies of this minute to anyone else.

RTA

6 March 1972

TOP SECRET

B U D G E T - **TOP SECRET**

9

NOTE FOR THE RECORDREGIONAL INVESTMENT GRANTS

NOTE OF A MEETING HELD AT 10 DOWNING STREET ON WEDNESDAY
8 MARCH 1972 AT 10.30 a.m.

PRESENT

Prime Minister
Chancellor of the Exchequer
Secretary of State for Trade & Industry
Sir Douglas Allen
Sir William Armstrong
Sir William Niell
Mr. R.T. Armstrong

The Prime Minister said that, following the decision to give grants of £35m to Upper Clyde Shipbuilders, the proposal to adopt a scheme of regional investment grants would be unwelcome to some sections of Government backbench opinion. He had had a brief discussion on this with the Chancellor and the Secretary of State, and had concluded that it would be worth while to consider whether, even at this late stage, it would be advisable to go for a scheme of tax allowances rather than grants; or, if not, how the grant scheme could be presented so as to minimise adverse criticism.

The Chancellor said that the proposals for regional grants would require separate legislation from the Finance Bill. The passage of this legislation through the House of Commons would undoubtedly present problems for the Government, given the statements which had been made only a year ago about the withdrawal of grants. On the other hand expert advice was that grants would be more effective than tax allowances for the purpose.

B U D G E T - **TOP SECRET**

- 2 -

The Secretary of State agreed that grants would be a more effective means of encouraging regional development, but shared the apprehensions of his colleagues about the Parliamentary difficulties. If it were decided to go for tax allowances, it might be possible to adopt suggestions made by the Chamber of Shipping and others, that companies should be able to sell their entitlement to such allowances.

In discussion there was a general agreement that, if the decision was in principle in favour of grants, it would be better to be straightforward in the matter than to adopt some such device as saleable tax allowances. It was pointed out that, if the decision went in favour of tax allowances, the existing system of local authority grants would have to be retained instead of being scrapped. The package as a whole would be more complicated. Any scheme of tax allowances introduced at this short notice would have to be based on the previous scheme; there would not be time to take out the anomalies which had caused criticism.

The Secretary of State said that he had had a meeting the previous day with the Chamber of Shipping. The shipping industry was undoubtedly in considerable difficulty, and it would in his view be hard to introduce regional grants and not extend them to shipowners. In discussion it was felt that this proposition needed to be very carefully considered, since such a concession could be very expensive. It might be best not to extend grants to shipowners in the first instance, but to be ready to react if pressure developed

B U D G E T -

TOP SECRET

- 3 -

after the proposals were published. The Government should take a strong line with the shipping industry, making it clear that they could not look for new Government help unless they were prepared to co-operate with the Government.

Summing up the discussion, the Prime Minister said that the balance of argument was in favour of sticking to the proposals for regional grants. It would, however, be very important to develop and stick to the strongest arguments for this decision. Two strong arguments were better than ten arguments, some of which were not very strong. The parallel with Europe could be used as one argument; another possible argument was that, if free depreciation was being introduced generally, grants provided the simplest way of giving additional help in the regions. It could be emphasised that what was proposed was in large measure a reconstruction and simplification of an existing system of grants, though of course there would be some extension of coverage in the process. The Chancellor of the Exchequer and the Secretary of State should consult with each other and with Sir William Armstrong and Sir William Nield on the presentation of the proposals. It would be desirable to eliminate as far as possible the discretionary element in the grants system. The Secretary of State should consider whether the coverage and list of exceptions should be exactly the same for grants as for free depreciation. The Chancellor of the Exchequer and the Secretary of State should consider further whether grants should be extended to ship-owners. This could if necessary be kept as a concession

BUDGET - **TOP SECRET**

to be made during the passage of the legislation.

The meeting took note with approval of the Prime Minister's summing up.

REA

8 March 1972

DISTRIBUTION:- The Private Secretaries to ~~the~~
Chancellor of the Exchequer
Secretary of State for Trade and
Industry
✓ Sir William Armstrong

NOTE FOR THE RECORDBudget

The Chancellor of the Exchequer, accompanied by Sir Douglas Allen and Sir Donald MacDougall, came to see the Prime Minister at Chequers on Sunday, 5 March 1972 at 6 p.m. Mr. Armstrong was present.

The Prime Minister said that he approached the Budget with the following questions in his mind:-

- (a) was there enough in the proposals to get the economy going?
- (b) would people consider the balance of the proposals fair?
- (c) what would be the effect of the proposals on inflation?

On the overall amount of the Budget, the Chancellor of the Exchequer said that up to a short time ago the Treasury had been thinking in terms of a boost of something between £400 million and £700 million. More recently they had been concentrating their attention at the top of the range. The most relevant considerations in his mind were the need to maximise the effect on unemployment, and thereby increase the Government's freedom of manoeuvre on other policies.

Sir Donald MacDougall said that he thought that present proposals were about right for steady growth. But recent calculations suggested that they would only bring the level of wholly unemployed, seasonally adjusted,

down from 875,000 to 840,000 during the year. This would mean that total unemployment would still be around one million next winter. It might be that this calculation was based on pessimistic assumptions; other economists, starting from a similar basis, thought that the rate of decline of unemployment would be rather greater. Nonetheless, there was a case for giving a larger stimulus to demand now, if the primary object of the policy was to be reasonably sure of a substantial fall in unemployment by next winter.

The latest indicators were rather depressing. Manufacturing industry investment was down in the last quarter of 1971. The figure of industrial production for December was gloomy. Exports had been lower both in January and February. Consumer sales were unbuoyant. He understood that the National Institute for Economic and Social Research, in their forthcoming review, would recommend a much larger boost than that now proposed. They would speak of a revenue effect of "well over £2,000m."; his understanding was that the figure thrown out by their computer was £2,500 million (these were figures for a full year).

The existing Budget proposals would add about $1\frac{1}{2}$ per cent to gross domestic product in the first half of next year. They would imply a rate of growth of $4\frac{1}{2}$ to 5 per cent.

The Chancellor of the Exchequer referred to the need to keep something in hand for the Budget of April 1973. Sir Donald MacDougall said that to offset fiscal drag at

present levels of wage and price increases would require a boost of about £400 million each year. The prospect for prices next year was an uncomfortable one: the introduction of V.A.T., the new housing rents, and nationalised industry price increases, plus increases in the price of imported food, could take the increase up to as much as 8 per cent.

Going through the points remaining for discussion, the Prime Minister and the Chancellor of the Exchequer agreed that:-

- (i) the stamp duty on house purchase should not be altered;
- (ii) the proposed investment surcharge should be set at 15 per cent, not 10 per cent;
- (iii) the proposals for a surtax threshold operation should not be proceeded with;
- (iv) the proposals for additional infrastructure expenditure should not be proceeded with;
- (v) the following exchange control measures should be proceeded with:-
 - (a) the abolition of the voluntary programme;
 - (b) the proposals now before the Chancellor on E.E.C. outward direct investment, E.E.C. inward direct investment, inward investment in assisted areas, and foreign currency borrowing;
- (vi) the proposals to increase the limit for emigrants, to reduce the 25 per cent surrender figure, and to extend the concession of outward

direct investment to direct investment in less developed non-sterling countries should not be proceeded with.

Turning to the fuel oil duty, the Chancellor of the Exchequer said that to abolish the fuel oil duty now would help to limit price increases in industry and in electricity. It might be taken to demonstrate that the Government was not powerless in the face of the threats of the mineworkers. On the other hand, it would tend to increase the amount of subsidy required for the National Coal Board and might be thought at this time to be vindictive. In discussion it was suggested that a decision on fuel oil duty might be premature in advance of the review of energy policy. It had to be remembered that the C.P.R.S. were taking the view that, notwithstanding the recent increases in miners' pay, it would not be right to phase coal out more quickly, because of the threat of rises in oil prices.

The Prime Minister and the Chancellor of the Exchequer agreed that the fuel oil duty should not be changed in this Budget. It could of course be reconsidered for next year.

It remained the Prime Minister's view that some further stimulus would be justifiable in the circumstances. A number of possibilities were considered, including possibilities for limiting price rises by operating on indirect taxation (e.g. the lower rates of purchase tax, the duties on beer and spirits and the duty on tobacco. In the end the Prime Minister and the Chancellor decided that the right course would be to increase the personal

TOP SECRET

- 5 -

allowances for income tax by a figure large enough to produce the result of reducing weekly tax deductions for those not taken out of liability by a sum not less than 100p. It was assumed that this would require an increase of about £135 in the present allowances.

The Chancellor of the Exchequer said that he hoped to let the Prime Minister have an up to date draft of the Budget Speech for consideration on Friday, 10 March.

RIA

6 March 1972

TOP SECRET

"3.32 Fourthly both the current balance of payments and our reserves position are very much stronger than they were at the beginning of previous periods of expansion. Moreover I am sure that all Hon. Members in this House will agree that the lesson of the international balance of payments upsets of the last few years is that it is neither necessary nor desirable to distort domestic economies to ~~any~~ ^{unnecessary} great extent in order to maintain unrealistic exchange rates, whether they are too high or too low. All countries now recognise the acceptability of smaller and more frequent parity adjustments, sometimes in one direction, sometimes in another, in the interests of a smooth and internationally co-operative adjustment process. Certainly, in the modern world, I do not believe that there is any need for this country, or any other, to be frustrated on this score in its determination to sustain sound economic growth and to reduce unemployment."

DRAFT MINUTE TO THE PRIME MINISTER

EXCHANGE CONTROL ETC

As you know I am considering some changes in exchange control policy for announcement in the Budget.

2. Considerations which bear on our decisions in this area include:

- i) We want to conserve our reserves, which though enormously increased in the last year, are still none too large in relation to our short-term liabilities and the possibility that our balance of payments could turn less favourable a year or two ahead. Nevertheless, partly because of ~~this possibility~~, it may be helpful to bring forward to 1972 rather than 1973 or later some of the initial costs of changes we shall be bound to make in due course under our Treaty arrangements with EEC.
- ii) It is sensible to operate exchange control counter-cyclically, tightening when the reserves position is weak, relaxing when it is strong. This points to some relaxation now of policies introduced during past crises, the continuation of which when our position is clearly much stronger attracts political and public criticism.
- iii) In particular, now that the crisis conditions which originally justified it are so plainly past, we can no longer count on the willing cooperation on which

depends the Voluntary Programme concerning investment in Australia, New Zealand, South Africa and the Irish Republic. The Programme is tending to be disregarded. It is thus becoming ineffective, and to try to maintain it further against growing disregard would not only be of little benefit to the reserves but could become highly damaging to the authority of exchange control generally. If we drop the Voluntary Programme, as I think we must, this is another reason for making also some move in relation to EEC.

iv) We want to stimulate industrial investment in the UK, and inward investment from overseas is a useful way of doing this, especially in assisted areas.

3. In the light of these considerations I am thinking of the following changes to be announced and come into force at Budget time:

- i) EEC outward direct investment: allow official exchange (as an alternative to foreign borrowing) for the first £1 million of any project in an EEC (including candidate) country. This brings forward a move planned for January 1973, frees from restriction a large number of applications, and will be welcomed by the CBI and smaller firms.
- ii) EEC inward direct investment: lift restrictions on access to sterling finance by UK subsidiaries of EEC parent companies. Again, this brings forward a relaxation planned for January 1973.

- iii) Inward investment in assisted areas. In addition to (ii), a similar relaxation for inward investment from any source involving new development in assisted areas.
- iv) Emigrants: raise from £5,000 to £20,000 the amount per family which may be transferred from sterling assets at the time of emigration from the UK to any non-sterling country. £5,000 has been the figure for many years and is now unreasonably low. Raising it is a first step towards an EEC obligation to free emigrants' transfers, to which we are committed by mid-1975, and removes some awkward complications over people emigrating to take up employment in EEC countries: at present they can only take £5,000.
- v) Foreign currency borrowing: allow again foreign currency borrowing by UK companies for domestic expenditure for terms of one year or over, instead of the 5-year minimum introduced in January 1971, when we were first being troubled by excessive foreign exchange inflows. Unlike the rest of the package, this brings a small benefit to the reserves, and may also help some domestic investment.
- vi) Voluntary Programme - abolish. There is really no sensible alternative when cooperation is crumbling and the justification for a renewed request to firms is gone.
- vii) "25% scheme": reduce from 25% to 10% the proportion of the foreign exchange proceeds of sales of

foreign securities which must be exchanged for sterling at the official rate. You are aware of the dislike of the City and many of our supporters in Parliament for this scheme. Arguments against it are often exaggerated, and I want to retain the framework of the scheme, since in a period of reserve difficulty we might well want to revert to 25%. But at present some easement of the scheme is appropriate.

4. [Of these items, I regard the proposed change in the 25% scheme as the least compelling. But I am in favour of doing it.] The total net cost of these measures to the reserves is estimated at a little less than £150 million in the first year and £100 million in the second, and less thereafter. Details are in the table annexed. I think this is acceptable, even against the aftermath of the miners' strike.

5. [The Secretary of State for Trade & Industry strongly supports this package of measures.] So does the Foreign & Commonwealth Office.

[6. These Departments have suggested one additional item: to extend the proposed EEC concession at 3(1~~2~~) on outward direct investment also to direct investment in less-developed non-sterling countries. This would add little or nothing to the amount of investment undertaken, but might shift perhaps £20 million a year of the financing from foreign borrowing to a cost to our reserves. It would fit with the idea of encouraging the

private investment component of aid transfers, and be helpful politically at the forthcoming UNCTAD Conference. In my view it is not of the same priority as the other changes suggested above, and has a disadvantage in making our policy not one of discriminating in favour of EEC but of discriminating against developed non-sterling countries, including the US. Nevertheless on political grounds if you would like to add it to the list, I should not seek to oppose it.]

7. I should be glad to know whether you approve of these proposals, or would like to discuss [; and particularly your view of that in paragraph 6]. We ought to settle the matter quite quickly now.

[A.P.L.B.]

Enc:

NET EFFECTS OF CHANGES MADE IN 1972 BUDGET

(- = Reserves Loss)

Description	<u>£ million</u>				
	<u>1972/3</u>	<u>1973/4</u>	<u>1974/5</u>	<u>1975/6</u>	<u>1976/7</u>
1. VOLUNTARY PROGRAMME					
Abolition	- 40	- 20	+15	+20	+20
2. E.E.C. OUTWARD DIRECT					
Stage I	- 15	-	-	-	-
3. EMIGRANTS					
£20,000 Limit	- 30	- 20	+ 5	+35	+20
4. INWARD DIRECT					
(a) E.E.C. only	- 5	-	-	-	-
(b) Rest of World (Details to be worked out)	- 10	- 10	-10	-10	-10
5. FOREIGN CURRENCY BORROWING					
1-Year Limit	+ 20	+ 10	-	-	-
6. 25% SURRENDER					
Reduction to 10%	- 50	- 50	-50	-50	-50
TOTAL	-130	- 90	-40	- 5	-20
7. LESS-DEVELOPED COUNTRIES					
(As for 2 above)	- 20	- 20	-20	-20	-20
TOTAL	-150	-110	-60	-25	-40

TOP SECRET

Copy no. 2 of 2 copies

5

3 March 1972

Budget

... I enclose a note which I made following the Chancellor's meeting with the Prime Minister on 1 March.

I am giving the Prime Minister a copy of this note for his further talk with the Chancellor on 5 March.

... I am also enclosing with this letter a copy of the note which I am putting to the Prime Minister to cover the tables which we discussed this afternoon.

RTA

A. M. Bailey, Esq.,
H.M. Treasury.

TOP SECRET

GPO, LondonPRIME MINISTERBudget

I attach a set of tables setting out and illustrating the effects of the Chancellor's Budget proposals. I should make three points:-

- (a) There is no reference in this to the fuel oil duty.
- (b) The tables of revenue and demand effects are not as they will appear in the financial statement, since the pensions uprating and the support group proposals will not appear in the financial statement (though they will of course be described in the Budget speech).
- (c) The table of demand effects shows the demand effect of the pensions uprating as nil in 1974/75 and subsequently. This is not because there will be no demand effect in those years but because it is impossible to calculate. By that time, of course, there will have been another uprating.

You asked for an indication of the distribution of the proposals as between the personal sector and the corporate sector. It is impossible to do this in precise terms, at any rate in terms of demand effects, since while the initial effect of the proposals affecting companies will be on the expenditure of companies, much of the final effect will end up in personal demand and

TOP SECRET

- 2 -

expenditure (the current expenditure of companies is not a component of final expenditure). With this proviso, the attached figures indicate the relevant orders of magnitude.

RTA

3 March 1972

BUDGET PROPOSALS 1972

	£ million			
	1972-73	1973-74	1974-75	1975-76
<u>REVENUE EFFECTS</u>				
Personal sector	1,020	1,325	1,350	1,350
Corporate sector	350	1,275	650-750	900-1,100
Total (rounded)	1,350	2,600	2,000-2,100	2,250-2,450
<u>DEMAND EFFECTS</u>				
Personal sector	700	680	900	925
Corporate sector	65	245	225-275	300-425
Total (rounded)	750	925	1,125-1,175	1,225-1,350

CHANCELLOR OF THE EXCHEQUER'S BUDGET PROPOSALS

- | | | |
|-----|---|---|
| 1. | Value added Tax | RTA |
| | 1. repeal of SET and Purchase Tax | |
| | 2. explanatory White Paper with draft legislation appended to be published on Budget day. | |
| 2. | Corporation Tax | RTA |
| | 1. White Paper to be published with the Bill but not on Budget day. | |
| 3. | Personal tax | RTA |
| | 1. personal allowances to be increased by £100 | See note A |
| | 2. Surtax threshold | Chancellor to consider at weekend |
| | 3. unification rates | See note B |
| | 4. investment surcharge to start at £2,000 | See note C |
| 4. | Purchase Tax | |
| | 1. Cut 45% and 30% rates to 25% | |
| 5. | Estate duty | RTA |
| | 1. relief for surviving spouse. £15,000 | |
| | 2. new scale (including raising starting point) | See note D |
| | 3. Green Paper on Budget day | |
| 6. | Charities | RTA (under Estate duty and minor changes) |
| | 1. Estate duty relief for bequests up to £50,000 | |
| | 2. capital gains tax exemption | |
| 7. | Stamp duty | RTA (but now dropped) |
| 8. | Reallowance of interest | RTA |
| | 1. First £35 disallowed | |
| | 2. Business interest allowable in full | |
| | 3. Loans for house purchase and improvement allowable in full | |
| 9. | Other changes | RTA |
| 10. | Support Group proposals | See note H |
| | 1. White Paper to be published on second day of Budget debate - not on Budget day | |

/11 Pensions uprating

- | | | |
|-----|------------------------------|--|
| 11. | Pensions uprating | See note E |
| 12. | Exchange control | Chancellor to minute
Prime Minister or
discuss on Sunday |
| 13. | Negative Income Tax | RTA |
| | 1. Mention in speech | |
| | 2. Green Paper later in year | |
| 14. | Overall effect | |
| | 1. Revenue effects | See note F |
| | 2. Demand effects | See note G |

BUDGET - SECRET

EFFECTS OF A £100 TAX ALLOWANCE INCREASE

1. Taxpayers taken out of liability: (000's)

Single	600	
Married	375	
Working wives	850	
	<u>1,825</u>	(say 1½ million)

2. For those not taken out of liability weekly tax deductions would be reduced by 74p.

3. Tax thresholds (income all earned) would go up as follows:-

	<u>ANNUAL(+129)</u>	<u>Weekly(+2.48)</u>
Single	418 - 547	8.04 - 10.52
Married	598 - 727	11.50 - 13.98
M + 1 [†]	798 - 927	15.35 - 17.83
M + 2 ^{†*}	896 - 1025	17.23 - 19.71
M + 3 ^{†*}	989 - 1118	19.02 - 21.50
M + 4 ^{†*}	1083 - 1212	20.83 - 23.31

[†]under 11

*after taking account of FAM and clawback

Everyone above the new tax thresholds would receive 74p a week.

4. Married women with earnings above the new thresholds would also receive 74p.

5. Those with earnings between the old and new thresholds would benefit to the extent of being relieved of tax entirely. (This would necessarily be a benefit of less than 74p. a week).

2nd March 1972

BUDGET - SECRET

Scale for Unified Tax

<u>Income</u> (after personal allowances)	<u>Rate</u>
0 - £5,000	30% (i.e. the basic rate)
£5,000 - £6,000	40%
£6,000 - £7,000	45%
£7,000 - £8,000	50%
£8,000 - £10,000	55%
£10,000 - £12,000	60%
£12,000 - £15,000	65%
£15,000 - £20,000	70%
£20,000 and over	75%

This scale fits the Chancellor's intention as announced last year that the highest marginal rate of tax on earned income should not exceed 75 per cent reached at a level of £20,000 (after personal allowances) as compared with a top rate on earned income of 75.4 per cent applicable since the changes made in last year's Finance Act.

BUDGET - SECRET

These tables illustrate the effect of a 10 per cent and a 15 per cent surcharge, starting at £2,000. The figures are based on the unified scale shown in note B, but they assume an increase in the single and married allowance of only £40, whereas the actual increase will be £100.

SINGLE PERSONS - INCOME ALL FROM INVESTMENTS

Income	Charge	Proposed charge	Proposed charge	Proposed charge	B E N E F I T	71/72-72/72	72/72-73/72	71/72-73/72	71/72-73/74 (15/6)
	1971-72	1972-73	1973-74	1974-75 (15/6)					
500	37	26	9		6	11	17	28	
600	92	79	39		13	40	53		
700	145	130	69		15	61	76		
800	184	169	99		15	70	85		
900	223	207	129		16	78	94		
1,000	262	246	159		16	87	103		
1,100	300	285	189		15	96	111		
1,200	339	324	219		15	105	120		
1,300	378	362	249		16	113	129		
1,400	417	401	279		16	122	138		
1,500	455	440	309		15	131	146		
1,600	494	479	339		15	140	155		
1,700	533	517	369		16	148	163		
1,800	572	556	399		16	157	173		
1,900	610	595	429		15	166	181		
2,000	649	634	459		15	175	190		
2,500	843	827	659	684	16	168	184	159	
3,000	1,149	1,133	859	909	16	274	290	240	
4,000	1,712	1,696	1,259	1359	16	437	453	353	
5,000	2,324	2,309	1,659	1809	15	650	665	515	
6,000	2,987	2,971	2,112	2312	16	859	875	675	
8,000	4,412	4,396	3,215	3515	16	1,181	1,197	897	
10,000	5,937	5,921	4,491	4891	16	1,430	1,446	1046	
15,000	10,149	10,134	8,094	8744	15	2,040	2,055	1405	
20,000	14,587	14,571	12,071	12,971	16	2,500	2,516	1816	
30,000	23,462	23,446	20,547	21,947	16	2,879	2,895	1515	
50,000	41,212	41,196	37,547	37,947	16	3,649	3,665	1265	
	85,527	85,511	80,047	81,947	16	5,524	5,540	640	

single persons - income 70 to 20000, 10% from investments.
 90% earned, 10% from investments

Income	Charge 1971-72	Proposed charge 1972-73	Proposed charge 1973-74	Proposed charge 1974-75 (15%)	B 71/72-72/73	N 72/73-73/74	E 71/72-73/74	F 71/72-73/74
0	0	0	0		0	0	0	
500	29	14	9		15	5	20	
600	60	45	39		15	6	21	
700	91	76	69		15	7	22	
800	122	107	99		15	8	23	
900	153	138	129		15	9	24	
1,000	184	169	159		15	10	25	
1,100	215	200	189		15	11	26	
1,200	246	231	219		15	12	27	
1,300	277	262	249		15	13	28	
1,400	308	293	279		15	14	29	
1,500	339	324	309		15	15	30	
1,600	370	355	339		15	16	31	
1,700	401	386	369		15	17	32	
1,800	432	417	399		15	18	33	
1,900	463	448	429		15	19	34	
2,000	494	479	459		15	20	35	
2,500	649	634	609		15	25	40	
3,000	804	789	759		15	30	45	
4,000	1,114	1,099	1,059		15	40	55	
5,000	1,438	1,422	1,359		16	63	79	
6,000	1,873	1,857	1,712		16	145	161	
8,000	2,873	2,857	2,615		16	242	258	
10,000	4,019	4,003	3,691		16	312	328	
15,000	7,269	7,253	6,794		16	459	475	
20,000	10,933	10,917	10,271		16	646	662	
30,000	18,610	18,594	17,847	17,847	16	747	763	713
50,000	33,964	33,948	33,047	33,197	16	901	917	787
100,000	72,348	72,332	71,047	71,447	16	1,285	1,301	901

Married couples - income all from investments.

Income	Course	Proposed	Proposed	Proposed	B E	N E I	I T		71/72 - 73/74 (15%)
	1971-72	change 1972-73	change 1973-74	change 1974-75 (15%)			71/72 - 72/73	72/73 - 73/74	
500	6	-	-	-	6	-	14	-	-
600	114	-	-	-	114	-	52	-	-
700	52	37	-	-	15	37	76	-	-
800	91	76	15	-	15	61	85	-	-
900	130	114	45	-	16	69	93	-	-
	169	153	75	-	16	78	-	-	-
1,000	207	192	105	-	15	87	102	-	-
1,100	246	231	135	-	15	96	111	-	-
1,200	285	269	165	-	16	104	120	-	-
1,300	324	308	195	-	16	113	129	-	-
1,400	362	347	225	-	15	122	137	-	-
1,500	401	386	255	-	15	131	146	-	-
1,600	440	424	285	-	16	139	154	-	-
1,700	479	463	315	-	16	148	163	-	-
1,800	517	502	345	-	15	157	172	-	-
1,900	556	541	375	-	15	166	181	-	-
2,000	595	579	405	-	16	174	190	-	-
2,100	789	773	605	630	16	148	164	159	-
3,000	1,077	1,062	805	855	15	257	272	222	-
4,000	1,633	1,617	1,205	1305	16	412	428	328	-
5,000	2,238	2,223	1,605	1755	15	618	633	483	-
6,000	2,894	2,878	2,040	2240	16	838	854	654	-
7,000	4,312	4,296	3,125	3425	16	1,171	1,187	857	-
10,000	5,830	5,814	4,292	4792	16	1,422	1,438	1038	-
12,000	10,028	10,013	7,977	8627	15	2,036	2,051	1401	-
20,000	11,146	11,131	11,945	12,845	15	2,502	2,517	1617	-
25,000	21,337	21,322	20,412	21,512	15	2,910	2,925	1825	-
30,000	41,087	41,072	37,412	37,812	15	3,660	3,675	1975	-
			74,912	74,912	15	5,535	5,550	250	-

Married couples - income 90% earned 10% from investments.

Income	Charge	Proposed	Proposed	Proposed	B E	N E I	I T	71/72 - 73/74 (10%)
	1971-72	change	change	change				
600	6	-	-	-	6	-	6	
700	37	21	15		16	6	22	
800	68	52	45		16	7	23	
900	99	83	75		16	8	24	
1,000	130	114	105		16	9	25	
1,100	161	145	135		16	10	26	
1,200	192	176	165		16	11	27	
1,300	223	207	195		16	12	28	
1,400	254	238	225		16	13	29	
1,500	285	269	255		16	14	30	
1,600	316	300	285		16	15	31	
1,700	347	331	315		16	16	32	
1,800	378	362	345		16	17	33	
1,900	409	393	375		16	18	34	
2,000	440	424	405		16	19	35	
2,500	595	579	555		16	24	40	
3,000	750	734	705		16	29	45	
4,000	1,060	1,044	1,005		16	39	55	
5,000	1,384	1,368	1,305		16	63	79	
6,000	1,801	1,786	1,640		15	146	161	
7,000	2,287	2,271	2,125		16	246	262	
8,000	2,919	2,903	2,792		16	311	327	
9,000	3,655	3,639	3,527		16	462	478	
10,000	4,491	4,475	4,363		16	651	667	
15,000	7,155	7,139	6,977		16	758	774	
20,000	10,812	10,796	10,634		16	912	928	
25,000	14,469	14,453	14,291	14,275	16	1066	1082	1098
30,000	18,126	18,110	17,948	17,932	16	1220	1236	1252
35,000	21,783	21,767	21,605	21,589	16	1374	1390	1406
40,000	25,440	25,424	25,262	25,246	16	1528	1544	1560
45,000	29,097	29,081	28,919	28,903	16	1682	1698	1714
50,000	32,754	32,738	32,576	32,560	16	1836	1852	1868

* Married couples with two children not over 11 - Income all from investments.

Income.	Charge 1971-72	Proposed Charge 1972-73	Proposed Charge 1973-74	Proposed Charge 1974-75	B E 71/72-72/73	N E 72/73-73/74	F I T 71/72-72/73	71/72-72/73
0	0	0	0	0	0	0	0	0
100	26	10	-	-	16	10	26	
200	65	49	-	-	16	49	65	
300	103	88	3	-	15	88	100	
400	142	127	33	-	15	94	109	
500	181	165	63	-	16	102	118	
600	220	204	93	-	16	111	127	
700	258	243	123	-	15	120	135	
800	297	282	153	-	15	129	144	
900	336	320	183	-	16	137	153	
1000	375	359	213	-	16	146	162	
1100	413	398	243	-	15	155	170	
1200	452	437	273	-	15	164	179	
1300	491	475	303	-	16	172	188	
1400	530	514	333	529	16	181	197	157
1500	569	553	363	753	15	190	195	145
1600	608	592	393	977	16	200	204	272
1700	647	631	423	1201	16	210	218	372
1800	686	670	453	1425	16	220	226	472
1900	725	709	483	1649	16	230	234	572
2000	764	748	513	1873	15	240	240	672
2100	803	787	543	2097	15	250	249	772
2200	842	826	573	2321	15	260	258	872
2300	881	865	603	2545	16	270	276	972
2400	920	904	633	2769	15	280	284	1072
2500	959	943	663	2993	15	290	292	1172
2600	998	982	693	3217	15	300	306	1272
2700	1037	1021	723	3441	15	310	312	1372
2800	1076	1060	753	3665	15	320	324	1472
2900	1115	1099	783	3889	16	330	336	1572
3000	1154	1138	813	4113	15	340	348	1672
3100	1193	1177	843	4337	15	350	354	1772
3200	1232	1216	873	4561	15	360	366	1872
3300	1271	1255	903	4785	15	370	372	1972
3400	1310	1294	933	5009	15	380	384	2072
3500	1349	1333	963	5233	15	390	396	2172
3600	1388	1372	993	5457	15	400	402	2272
3700	1427	1411	1023	5681	15	410	414	2372
3800	1466	1450	1053	5905	15	420	426	2472
3900	1505	1489	1083	6129	15	430	438	2572
4000	1544	1528	1113	6353	15	440	444	2672
4100	1583	1567	1143	6577	15	450	456	2772
4200	1622	1606	1173	6801	15	460	462	2872
4300	1661	1645	1203	7025	15	470	474	2972
4400	1700	1684	1233	7249	15	480	486	3072
4500	1739	1723	1263	7473	15	490	498	3172
4600	1778	1762	1293	7697	15	500	510	3272
4700	1817	1801	1323	7921	15	510	522	3372
4800	1856	1840	1353	8145	15	520	534	3472
4900	1895	1879	1383	8369	15	530	546	3572
5000	1934	1918	1413	8593	15	540	558	3672
5100	1973	1957	1443	8817	15	550	570	3772
5200	2012	1996	1473	9041	15	560	582	3872
5300	2051	2035	1503	9265	15	570	594	3972
5400	2090	2074	1533	9489	15	580	606	4072
5500	2129	2113	1563	9713	15	590	618	4172
5600	2168	2152	1593	9937	15	600	630	4272
5700	2207	2191	1623	10161	15	610	642	4372
5800	2246	2230	1653	10385	15	620	654	4472
5900	2285	2269	1683	10609	15	630	666	4572
6000	2324	2308	1713	10833	15	640	678	4672
6100	2363	2347	1743	11057	15	650	690	4772
6200	2402	2386	1773	11281	15	660	702	4872
6300	2441	2425	1803	11505	15	670	714	4972
6400	2480	2464	1833	11729	15	680	726	5072
6500	2519	2503	1863	11953	15	690	738	5172
6600	2558	2542	1893	12177	15	700	750	5272
6700	2597	2581	1923	12401	15	710	762	5372
6800	2636	2620	1953	12625	15	720	774	5472
6900	2675	2659	1983	12849	15	730	786	5572
7000	2714	2698	2013	13073	15	740	798	5672
7100	2753	2737	2043	13297	15	750	810	5772
7200	2792	2776	2073	13521	15	760	822	5872
7300	2831	2815	2103	13745	15	770	834	5972
7400	2870	2854	2133	13969	15	780	846	6072
7500	2909	2893	2163	14193	15	790	858	6172
7600	2948	2932	2193	14417	15	800	870	6272
7700	2987	2971	2223	14641	15	810	882	6372
7800	3026	3010	2253	14865	15	820	894	6472
7900	3065	3049	2283	15089	15	830	906	6572
8000	3104	3088	2313	15313	15	840	918	6672
8100	3143	3127	2343	15537	15	850	930	6772
8200	3182	3166	2373	15761	15	860	942	6872
8300	3221	3205	2403	15985	15	870	954	6972
8400	3260	3244	2433	16209	15	880	966	7072
8500	3299	3283	2463	16433	15	890	978	7172
8600	3338	3322	2493	16657	15	900	990	7272
8700	3377	3361	2523	16881	15	910	1002	7372
8800	3416	3400	2553	17105	15	920	1014	7472
8900	3455	3439	2583	17329	15	930	1026	7572
9000	3494	3478	2613	17553	15	940	1038	7672
9100	3533	3517	2643	17777	15	950	1050	7772
9200	3572	3556	2673	18001	15	960	1062	7872
9300	3611	3595	2703	18225	15	970	1074	7972
9400	3650	3634	2733	18449	15	980	1086	8072
9500	3689	3673	2763	18673	15	990	1098	8172
9600	3728	3712	2793	18897	15	1000	1110	8272
9700	3767	3751	2823	19121	15	1010	1122	8372
9800	3806	3790	2853	19345	15	1020	1134	8472
9900	3845	3829	2883	19569	15	1030	1146	8572
10000	3884	3868	2913	19793	15	1040	1158	8672

Married couples with two children not over 11 - Income 90% earned 10% from investments.

Income	Charge 1971-72	Proposed charge 1972-73	Proposed charge 1973-74	Income charge 1973-74 (15%)	B E 71/72-72/73	N E F 72/72-73/74	I T 71/72-73/74	7 1/2 - 7 3/4 (15%)
0	0	0	0		0	0	0	
1,000	26	10	3		16	7	23	
1,100	57	41	33		16	8	24	
1,200	88	72	63		16	9	25	
1,300	119	103	93		16	10	26	
1,400	150	134	123		16	11	27	
1,500	181	165	153		16	12	28	
1,600	212	196	183		16	13	29	
1,700	243	227	213		16	14	30	
1,800	274	258	243		16	15	31	
1,900	305	289	273		16	16	32	
2,000	336	320	303		16	17	33	
2,500	491	475	453		16	22	38	
3,000	646	630	603		16	27	43	
4,000	956	940	903		16	37	53	
5,000	1,260	1,264	1,203		16	61	77	
6,000	1,615	1,599	1,504		16	95	111	
8,000	2,614	2,598	2,355		16	243	259	
10,000	3,719	3,703	3,405		16	298	314	
15,000	6,919	6,903	6,456		16	447	463	
20,000	10,561	10,545	9,907		16	638	654	
30,000	18,227	18,211	17,457	17,507	16	754	770	720
50,000	33,581	33,565	32,657	32,807	16	908	924	774
100,000	71,966	71,949	70,657	71,057	16	1,292	1308	908



THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

2 March 1972

RATES OF ESTATE DUTY

Slice of net capital value	Existing	Proposed
£'000	%	%
12½ - 15	25	Nil
15 - 17½	25	25
17½ - 20	30	25
20 - 30	30	30
30 - 40	45	35
40 - 50	60	40
50 - 60	60	45
60 - 80	60	50
80 - 100	65	55
100 - 150	65	60
150 - 200	70	65
200 - 300	70	70
300 - 500	75	70
500 - 750	80	75
750 - 2045	85	75
over 2045	80	75

S E C R E T

DRAFT TABLE FOR FINANCIAL STATEMENT

ESTATE DUTY

Amount of duty payable and effective rate of duty on specimen estates.

The table shows the amount of estate duty payable and the effective rates of duty payable on estates of various sizes with the existing rates of duty and with the proposed rates. For the proposed rates examples are given where there is no surviving spouse and where the surviving spouse is the sold legatee. It is assumed that no reduced rate or other reliefs or allowances are due.

Net Capital Value of Total Estate	Estate Duty payable with existing rates		Estate Duty payable with proposed rates			
			No surviving spouse		Whole estate left to surviving spouse	
	Amount of Duty	Effective Rate	Amount of Duty	Effective Rate	Amount of Duty	Effective Rate
(£)	(£)	(%)	(£)	(%)	(£)	(%)
12,500	nil	0	nil	0	nil	0
15,000	625	4.2	nil	0	nil	0
17,500	1,250	7.1	625	3.6	nil	0
20,000	2,000	10.0	1,250	6.2	nil	0
25,000	3,500	14.0	2,750	11.0	nil	0
30,000	5,000	16.7	4,250	14.2	nil	0
35,000	7,250	20.7	6,000	17.1	1,250	3.6
40,000	9,500	23.7	7,750	19.4	2,750	6.9
45,000	12,500	27.8	9,750	21.7	4,250	9.4
50,000	15,500	31.0	11,750	23.5	6,000	12.0
60,000	21,500	35.8	16,250	27.1	9,750	16.3
70,000	27,500	39.3	21,250	30.4	14,000	20.0
80,000	33,500	41.9	26,250	32.8	18,750	23.4
90,000	40,000	44.4	31,750	35.3	23,750	26.4
100,000	46,500	46.5	37,250	37.3	29,000	29.0
150,000	79,000	52.7	67,250	44.8	58,250	38.8
200,000	114,000	57.0	99,750	49.9	90,000	45.0
300,000	184,000	61.3	169,750	56.6	159,250	53.1
500,000	334,000	66.8	309,750	62.0	299,250	59.9
750,000	534,000	71.2	497,250	66.3	486,000	64.8
1,000,000	746,500	74.6	684,750	68.5	673,500	67.4

SECRET

1972 Uprating of BenefitsTo take effect in early October 1972

<u>Cash increase</u>	<u>Present</u>	<u>Proposed</u>	<u>Addition</u>
Single pension	£6	£6.75	75p
Married pension	£9.70	£10.90	£1.20p

Percentage addition: 12½% (cf price increase, forecast
at 6½%)

Cost: £400m. in a full year

- of which: £60m. Exchequer (on standard 18% basis)
- £220m. employers' contribution
- £115m. employees' contribution
- (demand effect +£96m.)

Contributions:

Employees: Raise earnings ceiling to £48.

Raise graduated contribution for those earning £18 to £48 a week from 4.35% to 4.75%.

Additional contributions:

- for those earning	£18 a week	Nil
" "	" £25 a week	3p
" "	" £30 a week	5p
" "	" £40 a week	9p
" "	" £42 a week	12p
" "	" £48 a week	38p
	(and over)	<u> </u>

Employers: Raise employers' share of flat rate by 10p.

(Share of graduated contribution also goes up in proportion).

2/3/72

BUDGET - SECRET

TABLE 1

REVENUE EFFECTS

In year costs at 1972-73 prices^(a)

£ million

		1972-73	1973-74	1974-75	1975-76
1. Tax threshold, increase married and single personal allowance by £100	P	730	890	870	850
2. Unified personal tax	P	-	190	280	300
3. Corporation tax reform	C	75	65	50-150	150-350
4. Estate Duty	P				
a. Relief for surviving spouse		30	55	60	65
b. New scale		35	70	75	80
c. Relief for charitable donations		5	10	15	15
5. Capital Gains Tax Unit and Investment Trusts	P	0	20	40	30
6. Free depreciation with effect from 22 March 1972	C	5	100	250	400
7. Remainder of support group proposals for industrial restructuring (b)	C	215	370	405	415
8. Pensions uprating - extra gap between benefit cost and contribution yield	P	70	80	-	-
9. Cut top PT rates	P	140	-	-	-
10. Minor measures	C+P	20	20	20	20
11. The switch to VAT	C	+ 50	+ 730(c)	- 65	- 90
12. TOTAL (rounded)		1,350	2,600	2,000/2,100	2,250/2,450

NOTES: (a) positive figures are therefore costs to the revenue or expenditure and negative figures revenue gains

(b) for a breakdown of these costs see Appendix

(c) this 'hump' in the revenue effect of VAT is due chiefly to the unwinding of the SET 'forced loan', the lag before VAT receipts flow into the revenue and compensation for tax-paid stocks.

2/3/72

BUDGET - SECRET

TABLE 2

DEMAND EFFECTS

£ million(a)

	1972-73	1973-74	1974-75	1975-76
1. Tax threshold, increase married and single personal allowance by £100 ^p	485	630	650	635
2. Unified personal tax ^p	-	145	215	225
3. Corporation tax reform ^{C+P}	- 25	+ 15	60-120	100-220
4. Estate Duty ^p				
a. Relief for surviving spouse	Neg	Neg	5	10
b. New scale	Neg	Neg	5	15
c. Relief for charitable donations	Neg	Neg	Neg	Neg
5. Capital Gains Tax Unit and Investment Trusts ^p	Neg	Neg	Neg	Neg
6. Free depreciation with effect from 22 March 1972 ^C	Neg	50	95	140
7. Remainder of support group proposals for industrial restructuring ^C	75	180	190	190
8. Pensions uprating - extra demand effect ^p	90	-	-	-
9. Cut top PT rates ^p	130	-	-	-
10. Minor measures ^{C+P}	10	10	10	10
11. The switch to VAT ^p	-	- 105	-110	-110
12. TOTAL (rounded)	750	925	1,125/1,175	1,225/1,350

NOTES: (a) The figures are at constant 1972/73 prices. They show the direct effect that each of the measures would be having on demand by the fourth quarter of each of the financial years.

(b) 'Neg' = negligible

2/3/72

BUDGET - SECRET

APPENDIX

COST ESTIMATES OF SUPPORT GROUP PROPOSALS (other than
free depreciation)

£ million at constant (1972-73) prices

	<u>1972-73</u>	<u>1973-74</u>	<u>1974-75</u>	<u>1975-76</u>
1. <u>Industrial training and mobility</u>				
(a) Expansion	10	25	35	40
(b) Transfer from levy finance to Exchequer	5	35	35	35
(c) Mobility package	5	5	5	5
2. <u>Investment Incentives</u>				
(a) Regional development grants at 20% and 22% on plant and machinery and buildings in SDAs, DAs and building grants in extended IAs	100	200	210	220
(b) 40% initial allowances "nationally for industrial buildings	-	10	25	30
(c) Unconditional building grants in "derelict land" areas (apart from those to become IAs) for 2 years only	5	10	5	-
3. <u>Housing improvement grants in extended IAs (temporary)</u>	5	5	-	-
4. <u>Selective assistance to industry (regional and national)</u>	20	40	60	65
5. <u>Shipbuilding</u>	65	40	30	20
Total cost (with regional element in brackets)	215 (185)	370 (280)	405 (295)	415 (305)

3A

Original on Economic Policy
(Strategy) p 4

Less Policy, p 6

SECRET

[Handwritten signature]
2

2 March 1972

When the Chancellor of the Exchequer came to see the Prime Minister yesterday evening, he referred to the letter which I sent you on 25 February about the "message" to be conveyed to industry about future parity changes.

The Chancellor said that he had this matter much in mind in connection with his Budget speech.

Sgd. R.T.A.

A. M. Bailey, Esq.,
H.M. Treasury.

SECRET

NOTE FOR THE RECORD

Budget

The Chancellor of the Exchequer came to see the Prime Minister at 10 Downing Street on Wednesday 1 March 1972 at 9 p.m.

The Chancellor said that, since he last discussed the Budget with the Prime Minister at Chequers on 10 January, he had made the following modifications to his proposals:

- (a) For technical reasons the single and married persons' allowances would have on this occasion to be increased by the same amount. He was now proposing to increase both allowances by £100. This would raise tax thresholds, taking some 1¼ million people out of liability, and reduce tax liability for other tax payers by 74p a week at all levels of income.
- (b) In view of the relatively small effect that his existing proposals seemed likely to have on unemployment, and the prospect that the rate of growth would slow down in 1973 and later, the Chancellor was thinking in terms of reducing the two top rates of purchase tax (at present 45% and 30%) to 25%. This would cost £175m in revenue, and the demand effect would be of the order of £130m. The effect would be to reduce the retail price index by 0.4%. The disadvantage of making this reduction now was that the introduction of VAT at 10%

in 1973 would raise the cost of living by more than had hitherto been expected. But the Chancellor thought that that was a price worth paying.

- (c) The Chancellor proposed to raise the starting point for estate duty to £15,000, and to allow an extra £15,000 relief for surviving spouses. The top rate in the proposed new scale of estate duty would be 75%.
- (d) The Chancellor proposed in his budget speech to foreshadow the publication of a Green Paper on negative income tax. Some of his advisers were keen that he should produce a White Paper rather than a Green Paper; but the issues at stake were very large, and the proposals could not be implemented until after an election. It would in his view be a mistake to go into the next election committed to a White Paper. He therefore preferred to go for a Green Paper at this stage. It might be possible to volunteer to give the Green Paper to a Select Committee of the House of Commons to examine.

With the pensions uprating and the support group proposals for industrial restructuring, the package would be equivalent to a cut of £1,435m in taxation; the corresponding demand effect would be of the order of £785m. This was in line with the recommendations of the forecasters, who were suggesting that a stimulus to demand somewhere in the region of £400m - £700m would be appropriate. Even with this

stimulus, the seasonally adjusted figure of wholly unemployed was estimated only to fall by 50,000, from 870,000 to 820,000, between now and this time next year. That was, however, a highly mechanistic calculation, which might well not take full account of the effects of an improvement in confidence. There was a risk that a stimulus of this size would lead to balance of payments problems by the end of 1973: but his advisers did not demur at this package, provided that Ministers were prepared to accept that risk. It would enable him to indicate in his budget speech an expectation of a growth rate approaching 5% a year.

A number of points remain for decision:

- (i) Ministers had still to decide whether to proceed with proposals for additional infrastructure expenditure. He would not be in favour of doing so; he doubted whether Ministers would get much credit for a further batch of proposals of this kind, on top of what was already proposed.
- (ii) He was minded not to proceed with proposals for changing the stamp duty on house purchase.
- (iii) It would be necessary to decide whether the investment surcharge should be set at a level of 10% or 15%. Given the difficulty of any subsequent change in the figure which was adopted, there was much to be said for

going for a figure of 10%. But this produced very large bonuses on top income levels, and it might be preferable to go for a 15% level, which would produce decreasing bonuses at income levels above £20,000.

- (iv) The Inland Revenue had put before him proposals for a surtax threshold operation like that undertaken by Mr. Jenkins, by virtue of which surtax would not be collected in 1972/73 from those with a liability of less than £100. This would have the great advantage of taking a substantial number of people out of surtax next year, many of whom would have come into surtax for the first time. The proposal would cost £14m but would produce a substantial staff saving.
- (v) The Prime Minister had asked the Chancellor to consider abolishing the fuel oil duty. There were respectable arguments for doing so, because it would reduce industrial costs. The revenue cost would be £145m and the demand effect about £40m. The Government would, however, run the risk of accusations of vindictiveness following the miners' strike if they abolished the fuel oil duty at this moment.

(vi) The Treasury and the Bank of England were urging a package of exchange control measures, comprising relaxations for controls on investment in Europe and the abandoning of the "voluntary programme" in the sterling area.

In discussion the Prime Minister made the following points:

- (a) While there were obvious attractions about fixing the level of investment surcharge at 10%, substantial bonuses would be given even if it was fixed at 15%, and there would be a propaganda advantage about 15%, in the sense that the benefits would taper off at higher income levels. It might be best to set the level of investment surcharge at 15% and adopt the surtax threshold proposals which would keep a considerable number of small surtax payers out of liability.
- (b) Admittedly it would not be easy to justify the retention of the "voluntary programme", which might well therefore break down of its own accord if retained. But, given that it would become necessary to relax on exchange controls with Europe, it was doubtful whether our balance of payments would stand freedom of capital movements in the sterling area as well. If we foresaw the possibility of introducing exchange controls in the sterling area, it seemed psychologically unwise to

abandon the "voluntary programme" restriction at this stage. If it was decided to go ahead on this, he would have to mention the decision to President Pompidou when he came to Chequers.

- (c) The economic forecasts showed a levelling off in investment expenditure of nationalised industries after 1973. The Prime Minister had been told that future investment decisions might well be seriously influenced by the difference between power costs in this country and in Europe. He had been told that, for large consumers, electric power was 30% cheaper on the Continent than in this country. There were two reasons for this: differences in tariff structures, which in this country favoured the domestic consumer as against the large industrial consumer; and the high proportion of out-of-date plant in this country. It would probably be advisable to reconsider the tariff structure in this country. It would certainly be desirable to accelerate the replacement of out-of-date plant. This was a point which he would be following up separately.

It was left that the Chancellor of the Exchequer would think further about the points remaining for decision. He would settle for an investment surcharge of 15%, unless he reported further to the Prime Minister. It was left to

TOP SECRET

- 7 -

the Chancellor to take a decision about the surtax
threshold.

RIA

3 March 1972

TOP SECRET

Original on Economic Policy
(Shackley) 7/4

[Handwritten signature]

25 February 1972

The Prime Minister has the impression that a good many industrialists are still doubtful about the prospects for growth, because they believe that, if balance of payments difficulties recur, the Government will devalue rather than devalue.

In recent speeches the Prime Minister has tried to convey the thought that nothing must be allowed to stand in the way of steady and sustained growth, though he has tended to use that as an argument to buttress the other arguments for controlling inflation, rather than directly to refer to the balance of payments. But he thinks that there may be a case for beginning to get into public utterances by the Chancellor and other Ministers who discuss these subjects the more sophisticated message that in the new monetary world parity changes should be minor affairs, of a few percentage points at a time, sometimes in one direction and sometimes in another; so that exchange rate changes will not be the sort of traumatic shock to the system that they were in 1949 and 1967.

It should be possible to work out something on these lines, which would not have the effect of frightening hot money. If it did frighten some, we are for the present in a situation where we could stand that up to a point with equanimity.

Sgd. R.T.A.

A.M. Bailey, Esq.,
H.M. Treasury.

~~CONFIDENTIAL~~ Economic Policy 1/12

25 February 1972

Thank you for your letter of 22 February about the arrangements for informing The Queen about the Budget.

The Prime Minister is entirely content with what is proposed.

Sir Michael Adeane mentioned this to me when I saw him today, and I told him that the Prime Minister was content.

Sgd. R.T.A.

P.E. Middleton, Esq.,
H.M. Treasury.

CONFIDENTIAL

CONFIDENTIAL

Anne Minister

2



From 10/2/72
This arrangement
seems reasonable

REA

Treasury Chambers, Great George Street, SW1P 3AG
01-930 1234

22nd February, 1972

Dear Robert,

Approved
JA 24/2

As the Queen will be abroad on Budget Day, the Chancellor will not be able to inform her personally at the normal Budget audience of the contents of the Budget. I discussed this with Sir Martin Charteris before he left and have, subsequently, spoken to Sir Michael Adeane. We are agreed that the most satisfactory procedure would be to make similar arrangements to those that we made in 1970 when the Queen was in Australia. This would mean sending the Chancellor's usual note in a sealed package by Queen's Messenger Bag and making provision to make any last minute changes by telegram.

Things are a little difficult this year because the Queen will be crossing the Indian Ocean at the time in question. There is, however, a Queen's Messenger Bag leaving London at 2 p.m. on Friday, 10th March. This will be delivered to H.M.Y. Britannia at Mahe on 19th or 20th March. This is a little bit early but the Budget proposals will be substantially in their final form by the 10th. If there are any changes, for example as a result of the Budget Cabinet on Monday, 20th March Her Majesty could be informed by Top Secret telegram by reference to the note which the Chancellor will have sent out.

/The

CONFIDENTIAL

CONFIDENTIAL



The Chancellor is satisfied that this arrangement conforms to both the notes on security and the constitutional proprieties, but you will no doubt wish to inform the Prime Minister of what is proposed.

Yours ever,

Peter Middleton

P.E. MIDDLETON
Private Secretary

R.T. Armstrong, Esq.,

CONFIDENTIAL



Economic Policy
pt 2
CWR
16/2

Treasury Chambers, Great George Street, SW1P 3AG
01-930 1234

16th February 1972

The Chancellor would be grateful if the Lord President would announce the date of the Budget in his Business Statement tomorrow, 17th February. I attach some notes which may be of use to the Lord President in this connection.

The date has the Prime Minister's approval.

I am sending a copy of this letter to Christopher Roberts at No. 10.

(C.J.A. Chivers)

P.L.P. Davies, Esq.

AK 16/2

You probably saw references in the press to the budgetary representations made by the C.B.I. I attach a copy of the press release which they issued. Their main proposals were:-

- (i) A cut of $2\frac{1}{2}\%$ in corporation tax;
- (ii) "Depreciation at choice", and also investment allowances additional to asset cost for investment in new assets, these allowances to be at double the national rate in the development areas.
- (iii) Various tax changes to help small businesses, for example, relief from the standard rate for the retained profits of unquoted companies.
- (iv) Repeal of the provisions for the disallowance of interest.
- (v) Various relaxations in estate duty and capital gains tax.
- (vi) Unspecified measures to assist those with low incomes (as a help in dealing with inflation) at a budgetary cost of £80 million and a consumption cost of £100 million.

PLD

PS to see Mr Greyson

Confederation of British Industry



21 Tothill Street London SW1H 9LP Telephone 01-930 6711 Telex 21332

NOT TO BE PUBLISHED OR
QUOTED BEFORE 12.00 HOURS
ON 14 FEB 1972

E.400B.72.

BUDGET REPRESENTATIONS 1972 GENERAL REPRESENTATIONS

	<u>Page</u>
<u>SUMMARY OF GENERAL REPRESENTATIONS</u>	i
<u>INTRODUCTION</u>	
<u>Inflation</u>	1
<u>Low incomes</u>	2
<u>Investment and employment</u>	3
<u>Small firms</u>	
General	4
Remissions in estate duty	5
<u>European Economic Community</u>	6
<u>PROPOSALS FOR THE BUDGET 1972</u>	
<u>Rate of corporation tax</u>	7
<u>Investment incentives</u>	
General	8
Acceleration of relief for capital allowances	9
Capital allowances for commercial buildings	9
Expenditure on pollution abatement	10
<u>Foreign tax relief to promote development</u>	12
<u>Problems of small firms</u>	
Reform of corporation tax	13
Shortfall	13
Disallowance of interest	14
Retirement provisions	14
Estate duty reliefs	15
<u>Stock options and share incentive schemes</u>	
Stock options	16
Share incentive schemes	16

Disallowance of interest

17

Capital taxation

Capital gains tax

18

Estate duty

19

A programme for reform

20

SUBMISSIONS ON GOVERNMENT PROPOSALSReform of corporation tax

Introduction

22

Essential modifications to proposed systems

22

Capital gains

23

Intra-group dividends

23

Distribution relief

24

Conclusion

24

Personal income tax

Administrative simplification

25

Discrimination against investment income

25

The rate schedule

26

Sale and leaseback transactions

27

Value added tax

29

Rating

Introduction

31

Super-rating

31

Rating of plant and machinery

32

APPENDICES

I Cost of Budget Representations

34

II Reform of corporation tax

37

SUMMARY OF GENERAL REPRESENTATIONS

INTRODUCTION

Inflation and unemployment

As we put these representations in final form in the middle of January, the dominant economic problem is still inflation not only for industry but also for those with low incomes whose living standards are consequently deteriorating. The CBI price initiative has apparently been effective in restraining the rise in prices; to help offset the pressure it has imposed on profit margins, industrial costs should be reduced by halving the rebatable heavy oil duty and net-of-tax profits increased by a cut of $2\frac{1}{2}$ percentage points in the rate of corporation tax. A cut in corporation tax would also serve to offset the increase in the real tax burden caused by the levying of tax on the illusory profits due to inflation; similar arguments apply to the individual shareholder.

Our proposals allow for some £80m of tax remissions or other assistance to those with low incomes. When account is taken of secondary effects, the addition to demand would be about £100m. Our second main theme is the need to encourage investment and thus increase employment. In addition to the cut of $2\frac{1}{2}$ percentage points in corporation tax, we propose a number of specific investment incentives.

Small firms

Thirdly, a number of our proposals are designed to reduce the tax burden on small firms. We are glad to note that the report of the Bolton Committee of Inquiry on Small Firms contains many of the detailed recommendations made to it by the CBI Taxation Committee. We stress that estate duty is the tax most inimical to the smaller business and urge remissions in the rates of the duty in forthcoming Budgets.

European Economic Community

Our representations also contain our comments on a number of Government proposals for structural and other changes in the tax system. Here and elsewhere, we have borne in mind the desirability of reducing the present large divergences between the United Kingdom system and the systems in force within the member countries of the European Economic Community.

PROPOSALS FOR THE BUDGET 1972

Rate of corporation tax

We propose a cut in the rate of corporation tax of $2\frac{1}{2}$ percentage points as a measure of compensation for the damage done by inflation to corporate profitability.

Investment incentives

Depreciation at choice should be available to all taxpayers. Tax allowances

additional to asset cost, similar to those in existence before January 1966, should be re-introduced for investment in new assets; the rate of these allowances in the development areas should be twice that applicable to other areas. Businesses should be permitted, subject to certain conditions, to reclaim tax on capital allowances at the time the expenditure is incurred on the presentation of evidence of payment for the assets certified by the auditors. Capital allowances should be made available for commercial buildings: in the development areas this proposal should be implemented as soon as possible; an undertaking should be given that allowances for buildings in other areas would be introduced over a period of years in accordance with a predetermined plan. Specific grants should be made available for all capital expenditure on plant and pipelines for the treatment and discharge of effluent and for expenditure on abatement of pollution including the restoration and landscaping of the countryside; in the meantime all such expenditure should be eligible for tax relief through the capital allowances system.

Foreign tax relief to promote development

Unilateral relief should be extended to enable the foreign tax spared under pioneer relief schemes to be credited against UK taxation in the absence of a double taxation agreement.

Problems of small firms

Relief from the standard rate of the proposed system of corporation tax should be given for the retained profits of unquoted companies. We criticise the in terrorem nature of the shortfall provisions and recommend that the legislation should be clarified pending its repeal. The disallowance of interest provisions give rise to insuperable difficulties for many small businesses, and should be repealed. The limit of £10,000 for the exemption of chargeable gains on retirement should be increased to £20,000. The absolute limit of £1,500 on the amount of eligible premiums for retirement annuity schemes should be removed. We make specific proposals to alleviate the harmful effect of the estate duty provisions on family companies.

Stock options and share incentive schemes

The gains deemed to arise on the exercise of stock options should not be taxed until the shares are realised, and the gains arising on realisation of the shares should be subject to capital gains tax and not to Schedule E. Share incentive schemes should be treated in the same way as stock option schemes.

Disallowance of interest

The provisions for the disallowance of interest as a deduction for tax purposes should be repealed.

Capital taxation

Capital gains tax and corporation tax on chargeable gains should not be levied on assets held for more than 7 years; all deemed disposals should fall out of charge to capital gains tax, and gains arising on the disposal of capital assets used exclusively for the purpose of a trade should be excluded from charge. The exemption limit of estate duty should be raised. Consanguinity abatements (reductions in the rates of duty charged on transfers to

near relatives) should be introduced as soon as possible. Surviving spouse relief should be granted on the first death instead of the second. The 80 per cent maximum rate of estate duty compares with maximum rates of 20 per cent or less levied in the countries of the present European Economic Community on transfers to lineal descendants: there should be a commitment to a programme of reduction in the rates of estate duty to a maximum of 50 per cent by the 1974 Budget at the latest, with proportionate reductions throughout the scale, and the maximum rate should be cut to 60 per cent in the next Budget.

SUBMISSIONS ON GOVERNMENT PROPOSALS

Reform of corporation tax

We have welcomed the proposals in the Green Paper "Reform of Corporation Tax" which remove the discrimination against distributions for the generality of companies. We prefer the imputation system to the two-rate system and are gratified that the Select Committee on Corporation Tax has supported our preference. We propose two essential modifications to the imputation system in the Green Paper: firstly, we propose an exemption method for companies with mainly overseas income: and secondly, we urge that the retained profits of unquoted companies should be taxed at the same rate as under the present system. The rate of tax on the chargeable gains of companies should be 20 per cent. We welcome the Select Committee's recommendation that the payment of intra-group dividends should continue without deduction of tax, and we urge that parent companies should have complete freedom to allocate distribution relief anywhere within the group; distribution relief should relate to distributions paid within 6 months after the end of the accounting period and not solely to those made within the relevant accounting period chargeable to tax. Adequate consideration of other matters of detail and of the transitional problems that would arise would be aided by the publication before the Finance Bill 1972 of the detailed provisions of the chosen system.

Personal income tax

We welcome the substantial proposals made by the Chancellor for the replacement of income tax and surtax by a unified personal income tax system. We are critical, however, of the published proposals because they preserve most of the present differences between the definition of income for purposes of income tax as compared with surtax. In the new unified tax system there should be no discrimination against investment income. The provisional maximum marginal rate of 75 per cent under the unified tax system is too high and should be cut to 60 per cent as soon as possible, with a long term objective of a rate of not more than 50 per cent.

Sale and leaseback transactions

We recommend that sale and leaseback transactions should not be the subject of fiscal penalties.

Rating

We have welcomed certain proposals in the Green Paper on the Future Shape of Local Government Finance but we reject the concept of super-rating. We make recommendations about the amendment of Class 4 of the Plant and Machinery Order by the deletion of plant used in the course of a productive process and of plant used to mitigate environmental problems.

Cost of Representations

We show in an appendix to our General Representations a calculation of their likely cost over the next two years. A number of our main recommendations would take effect even later; for example the provisions for unquoted companies and companies with mainly overseas income under the proposed system of corporation tax would first affect payments in 1974-75 (on the assumption that the new corporation tax system becomes effective from 1973-74). As in previous years, we distinguish between the Budgetary cost of a tax reduction (the reduction in revenue to the Exchequer) and the consumption cost (the consequent increased call on resources for consumption).

In total, the Budgetary cost of our main recommendations for 1972-73 would be rather less than £300m, rising to something over £600m in the following year, including a once-for-all element that would not be repeated in future years. In the first year, the largest items would be heavy oil duty (£70m), corporation tax (£55m), and low income relief (£80m). Improved investment incentives would first affect Exchequer receipts in 1973-74 (about £250m) to which might be added a substantial once-for-all cost from our proposal to allow accelerated benefit from capital allowances; in this year the corporation tax cut would approximately double in cost, the cut in estate duty would cost about £100m, and the capital gains tax remissions might cost £40m. The consumption cost for each year would be smaller: between £100m and £200m, of which more than half represents assistance to low incomes. These totals are well within any likely estimate of the disproportionate increase in tax yield due to the combination of income growth and graduated tax schedules. If further stimulus to consumption is required to reduce unemployment and encourage investment decisions then the regulator is available outside the Budgetary presentation.

Technical Representations

We propose several technical changes in the direct taxation system, and suggest detailed provisions for the value added tax.

GENERAL REPRESENTATIONS

INTRODUCTION

INFLATION

Inflation is again this year the dominant economic problem. Although efforts to bring it under control had some success in 1971, the inflationary expectations caused by the experience of the last few years will themselves make a return to price stability more difficult to achieve.

The CBI price initiative was an attempt to find a new way of breaking into the inflationary cycle. Both the internal evidence of our members and the external evidence of the price indices confirm that the rise in prices slowed down when the initiative was introduced. The price initiative, coupled with a stiffer resistance to unreasonable wage claims on the part of private and public-sector employers, has made a direct contribution to the control of cost inflation.

These efforts must continue. But they should be accompanied by some fiscal recognition of the realities of inflation. The injustices of inflation are compounded by the refusal of the tax system to recognise its existence, directly or indirectly; and taxation increases the losses of those who lose from inflation. In particular:

- (a) the taxation of business profits is artificially increased by the use of historic-cost depreciation;
- (b) there is a rise in the proportion of capital employed represented by working capital and thus not covered by capital allowances;
- (c) graduated tax schedules become more onerous, especially in the range where tax rates are rising fastest;
- (d) when the gross return on capital is negative after allowance for the fall in the value of money, capital is further eroded by income tax and surtax;
- (e) when the appreciation of an asset is insufficient to offset the fall in the value of money, the loss is increased by capital gains tax.

The increase in the requirement of working capital is the most immediate consequence of inflation for corporate finance, since it affects cash flow as well as ultimate profitability. The whole of a firm's profits, or more, may be absorbed by the increase in nominal working capital required to keep the firm's financial structure unchanged after allowance for inflation; and this situation will persist until the rate of inflation abates.

It is beginning to be recognised that historic-cost accounting can be dangerously misleading at a time of rapid inflation. A tax system that ignores the existence of inflation can be similarly misleading; its real incidence as between taxpayers can be widely different from its nominal incidence if inflation is rapid, because those who lose most from inflation lose still more from the tax system.

The effect of inflation on the tax system is particularly serious in the United Kingdom. Taxes on saving rise higher here than in any other country in Western Europe, and the proportion of national income taken by industrial investment is among the lowest; even by conventional measures, industrial profitability has been falling for a decade and profits over a wide range of industry barely cover the upkeep of the assets employed; and cost inflation in this country has recently been higher than anywhere else in the developed world.

Under the present system, inflation bears hardest on savers, investors and those at the bottom of the income scale. We do not think it right that inflation should increase the real incidence of taxation as it does at present; this effect is diminished if the tax system is made generally less burdensome on saving, and a change in this direction is desirable in its own right.

Our proposals for cuts in taxation on saving are not put in terms of a mechanical adjustment for inflation but of a general reduction in the burden of tax which will lessen the fiscal consequences of inflation itself. Similarly for corporate taxation. We recommend a cut of $2\frac{1}{2}$ percentage points in corporation tax both as a stimulus to investment and as an offset to the increases caused by inflation in tax yield and nominal profits relatively to real profits. We also recommend a cut of one half in the rebatable heavy oil duty as an offset to the present inflationary increases in industrial costs. When we come to decide what policy should follow the CBI prices initiative on its termination in July, a continued moderation of price increases is bound to be assisted if the Government has played its part in offsetting by tax reductions the loss of short-term profitability caused by price restraint.

LOW INCOMES

We welcome the improvements instituted in the Family Income Supplement, the introduction of an annual pensions review and other recent measures for the relief of poverty. We make no specific proposals to this end in our present Representations; but, recognising that this is a continuing need, we have allowed a consumption cost of £100m for this purpose. Thus, our specific proposals amount to £100m less than the amount of tax remission that we consider suitable in present circumstances. The corresponding Budgetary magnitude would be approximately £80m. The cost of our recommendations is given in Appendix I.

INVESTMENT AND EMPLOYMENT

Next to the restraint of inflation, the most pressing need is to increase investment and reduce unemployment. We link the two because efforts to reduce unemployment should in our view be largely directed towards increasing expenditure on investment. The measures of last July were concentrated on encouraging consumer spending, as the quickest means of increasing the level of activity in general; and present evidence suggests that about enough has already been done to ensure adequate growth of consumption demand. Thus the increase in consumption implied by our Representations is modest. Later figures may suggest a need for further encouragement to this type of spending, which need not wait on the 1973 Budget. The position now is that the capital goods industries have remained underemployed especially in the heaviest sectors; and the industries concerned are largely located in the regions of highest unemployment. Moreover, the needs of the present situation are the same as those of the longer term: our recent levels of industrial investment and the age of our equipment compare poorly with those of our main European competitors. In addition to the proposed cut of 2½ percentage points in corporation tax, which is itself an investment incentive, we mention below under "Investment Incentives" specific proposals for raising the level of industrial investment by increasing both the financial means for investment and the eventual return.

PROBLEMS OF SMALL FIRMS

General

"The current regime of high taxation operates differentially against the small firm sector in two respects. First, high taxes on capital (especially death duties) undermine incentives in small firms, which are frequently family businesses, more seriously than in large; and second, high taxation of profits and rapid inflation have combined to make financing of expansion more difficult unless recourse is had to external finance on a scale which the small businessman is unwilling to accept and often unable to achieve".

"What is needed is a taxation policy which will restore initiative, encourage entrepreneurial activity and improve the liquidity position of small businesses. We believe that continued reduction in taxation of personal incomes and of estates would be most likely to achieve this result".

"These matters would affect all equally and not small businesses preferentially We are not proposing radical discrimination in favour of small firms".

These passages from the Bolton Report accord closely with our own views. The fiscal disadvantages which small firms suffer are inherent in a tax system that taxes income, risk-taking and saving as heavily as they are taxed in the United Kingdom. Certain limited ameliorations are possible within the confines of the present system, and we mention a number of these below; but the right remedy is, not a series of special concessions for small firms, but rather a lightening of the general load of personal taxation, which is relatively more of a disadvantage for small firms than for large.

The Bolton Committee eschewed comparisons with tax systems abroad on the ground that "it is extremely difficult to compare international tax levels, and meaningless to do so without taking account, for example, of the related social security contributions, differences in the cost of living and other elements of the system". These reservations apply principally to the lower end of the scale. At and near the top of the scale no qualifications could affect the conclusion that rates of personal taxation are much higher in the United Kingdom than in any other country in Europe when all the personal taxes levied in the various countries are taken into account - income tax, capital gains tax, estate duty, succession duty, wealth tax; and this sharp contrast is an indication of how much more heavily small firms are taxed here than in other European countries.

Our recommendations for cuts in estate duty and other personal taxes are intended to lessen the fiscal disadvantages of small firms as well as benefiting the economy more generally.

Remissions in estate duty

In our evidence to the Bolton Committee of Inquiry on Small Firms, we stressed that the estate duty was the tax most inimical to the smaller business. We urged that the rates of estate duty should be reduced throughout the scale and that consanguinity abatements should be introduced, for devolutions to direct descendants in particular, in order to prevent the break-up or absorption of family businesses. The raising of the exemption limit to £12,500 in the last Budget was an encouraging amelioration of the burden of estate duty, and it would be welcome if a similar adjustment were made in the forthcoming Budget in view of continued inflation. But substantial remissions in the duty remain overdue: the schedule of rates has remained in essence the same since July 1949 although the reason for the severity of the rates has ceased to exist for almost a generation. We recommend therefore that the rates should be reduced in forthcoming Budgets; the maximum rate should be reduced initially by a quarter from 80 per cent to 60 per cent, with proportionate reductions throughout the scale, and to 50 per cent by the 1974 Budget. In our representations about estate duty below, we describe a programme for remissions in estate duty, and for the introduction of consanguinity abatements which would bring the duty more in line with the succession duties in the European Economic Community.

EUROPEAN ECONOMIC COMMUNITY

Although it has been a serious possibility for some years that the United Kingdom would become a member of the European Economic Community, these are our first Budget Representations since the successful conclusion of negotiations and approval of the terms by Parliament.

The difference between the United Kingdom tax system and the European norm is much greater than the differences between the systems of the present members of the Community. Some of these differences between the United Kingdom and other countries have persisted for decades and it is now becoming increasingly important that they should be reduced.

The United Kingdom form of indirect taxation has been to levy relatively high rates of tax on a restricted range of commodities and to leave about half of consumers' expenditure untaxed (except by selective employment tax). The introduction of value added tax will move us towards the general European system of relatively low, broadly based indirect taxes, and we welcome this change. We note that a value added tax replacing purchase tax and selective employment tax only, as proposed in the Green Paper, would give one of the lowest value added tax structures in Europe and that harmonisation of value added tax rates would provide scope for a switch from direct to indirect taxation, in accordance with our long-standing policy.

The reform of corporation tax outlined in the Green Paper is also more in line with European practice than the present system, and we welcome a move away from the unrelieved double taxation of dividends.

The major remaining difference between the United Kingdom tax system and the systems of the Six lies in the taxation of personal income and capital. Rates of tax rise much higher here than anywhere else in Europe. The reduction in the maximum rate of tax on earned income to 75 per cent has brought it appreciably nearer to the European norm of 60 per cent; but the rates of tax on investment income, estates and capital gains still rise much higher in total than in any other European country, even when allowance is made for wealth tax in the countries where it is levied.

Very high rates of tax are oppressive and self-defeating; the reforms of indirect and company taxation should be complemented by a reduction in the maximum rates of tax on personal income and capital to approximately the average levels in Western Europe.

PROPOSALS FOR THE BUDGET 1972

RATE OF CORPORATION TAX

When the last Administration announced its intention to introduce a corporation tax, the rate of corporation tax which in combination with the withholding tax on dividends would yield the same revenue as the previous system of income tax and profits tax was initially given as 35 per cent. Now, after two cuts in the rate of corporation tax since the present Administration came to power, the rate of corporation tax is 40 per cent. This illustrates how the burden of corporate taxation has increased since 1965, while the gross-of-tax return on capital has declined; and although the rate of corporation tax, considered by itself, is not high by international standards, the withholding tax on dividends is exceptionally high.

Profits net of statutory depreciation allowances have been falling since 1960 not only as a proportion of national income, but also absolutely, since they have risen less than half as fast as prices. Moreover, even this understates the gravity of the situation, since historic-cost depreciation allowances are inadequate to cover replacement costs in inflationary conditions; when this is taken into account, the absolute fall in profits has been even faster.

The combination of low gross profitability and rapid inflation has produced a situation in which the real returns of a large range of firms are inadequate to pay for the upkeep of the assets employed. This situation has persisted up till the present: some three quarters of the nominal rise in profits in the first half of 1971 over the second half of 1970 was due to stock appreciation, and thus fictitious; and the remainder was inadequate to offset the fall in the value of money.

If this state of affairs is allowed to continue, industrial decline and large-scale unemployment are unavoidable. We propose no mechanical adjustment for inflation in the present Representations, since this question is under intensive study elsewhere. However, a cut in the rate of corporation tax would offer some compensation for the damage done by inflation to corporate profitability. A cut of $2\frac{1}{2}$ percentage points is the least the situation demands; it would also reduce the rate required to produce the same revenue after the reform of corporation tax proposed in the Green Paper.

INVESTMENT INCENTIVES

General

We continue to emphasise the need for increased investment in new productive assets. This need is all the greater in view of our entry into the European Economic Community, whose members have enjoyed a higher rate of capital expenditure and growth of national income in the post-war period. Improved investment incentives would not only help to put industry into a position where it can expand by the use of up-to-date plant and machinery in order to meet competition from Europe; it would equally have beneficial consequences for the level of economic activity in the development areas. The present under-utilisation of resources would facilitate such a programme, without creating any unnecessary inflationary pressure and with relatively small cost to the balance of payments.

We have recommended that the existing system of capital allowances should be improved by making depreciation at choice available to all taxpayers. The incentive effect of this concession would be considerable in the present circumstances of the economy, but would ultimately be costless to the Exchequer as its main result would be a short deferment of the payment of tax. This proposal would also serve to offset the inadequacy in inflationary conditions of historic-cost depreciation allowances to which we have referred earlier; and it would provide a permanent investment incentive at a once-for-all cost. We have also recommended that allowances additional to asset cost should be re-introduced for investment in new assets, similar to those in existence before January 1966. The rate of these allowances in the development areas should be twice that applicable in other areas.

We put on record our view that the introduction of allowances additional to asset cost at the time of the last Budget would have helped to reduce the level of unemployment in the winter of 1971-72. The present economic conjuncture would be a particularly suitable occasion for incurring the once-for-all cost involved in a move towards depreciation at choice; this cost is already partly met by the temporary increase in first year allowances to 80 per cent.

Acceleration of relief for capital allowances

Under the present capital allowances code, the allowances due for capital expenditure in an accounting year are deductible from profits adjusted for tax purposes in arriving at the tax assessment for that year. In the illustrative case of a calendar year accounting period, the allowances for expenditure in the year 1972 would generally reduce the amount of tax payable on 1st January 1974. In the event of the allowances exceeding the adjusted profits or increasing the adjusted loss, the unrelieved deficit could be carried forward for deduction from the profits of a subsequent accounting year, or carried back for relief against the profits of the preceding year only in which case the unrelieved loss would generally reduce the tax payable on 1st January 1973; in practice, however, the accounts for 1972 would not have been agreed until after the tax due on 1st January 1973 had been paid, and relief would then be given by repayment of tax. At the earliest, therefore, the allowances would not accrue to the benefit of the taxpayer's cash flow until a year on average after the expenditure in respect of which they are due had been incurred, and in the more usual case until some eighteen months after expenditure.

It would be more advantageous if the benefit of capital allowances were made available to the taxpayer in cash at the time the expenditure was incurred, by permitting a business to reclaim tax on the allowances applicable to the expenditure on the presentation of evidence of payment for the assets certified by the auditors. This acceleration of relief should be subject to the condition that the business had paid tax prior to that date of an amount sufficient to cover the repayment of tax on the capital allowances; the fund of tax could consist of the corporation tax liabilities of the three years preceding that in which the expenditure was incurred. This safeguard would prevent a loss of tax to the Exchequer in the event of the business becoming insolvent.

The proposal described above would be a simple but effective means of enabling businesses to improve liquidity when there is an outflow of cash for investment.

Capital allowances for commercial buildings

Capital allowances are not available for commercial buildings. There is no logical justification for permitting the depreciation of these buildings to continue to be ineligible for tax relief, and this fiscal penalty is particularly anomalous when applied to a commercial building inside a factory complex.

The need for capital allowances for commercial buildings in development areas is more important because of the greater depreciation in value that can affect buildings in these areas compared with those in the non-development areas. We have accordingly welcomed the recognition of the need for more incentives in the development areas evidenced by the extension of the period for which increased initial allowances are available for industrial buildings and of the loss relief provisions permitting a carry-back for two years of first-year allowances on assets in the development areas.

These improved incentives for industrial buildings and plant in the development areas should be supplemented by the introduction of capital allowances for commercial buildings in the development areas as soon as possible; in addition we propose in the Technical Representations that all newly-built warehouses should henceforth be eligible for capital allowances. We recognise that it is impracticable for all commercial buildings to become eligible for capital allowances at the same time and accordingly urge that an undertaking should be given that capital allowances would become available for all commercial buildings in other areas in accordance with a predetermined plan so as to provide certainty of relief for these buildings and to spread the cost of this measure over a period of years.

Expenditure on pollution abatement

European Conservation Year underlined the great importance attaching to pollution in the eyes of the public. The CBI has since its inception recognised the responsibilities of industry towards conservation of the environment and has been concerned at the steadily mounting costs imposed upon industry to meet the social and amenity requirements of the community which are constantly increasing.

There is no doubt that the community will continue to demand more and more effort to achieve improvements. The growing demands for water in the country will partially be met by increasing re-use of water and this in itself involves a greater degree of purity from liquid effluents. Equally, requirements of air purity continue to rise. It is an established fact that the more stringent the degree of purity required the more sharply the marginal costs of treatment increase; the unit costs of removing final traces of an impurity are greater than the unit costs of removing the bulk of the impurity. If the United Kingdom were a closed economy this would perhaps not be a major source of anxiety; but it is not. Industry is under keen competition both at home and abroad. The need to hold a sensible balance between the dictates of amenity and competitiveness is very real. The demands made by the community on industry are thus already high: there are clear signs they will increase further.

The community depends uniquely on industry and its viability for much of its wealth. It should be prepared to share in industry's contribution to the preservation of the environment at least to the extent of offering special treatment by way of investment incentives to help meet the cost of plant for treatment and discharge of industrial effluents. These incentives should not discriminate between development areas and others.

In giving evidence to Mrs. Jeger's Working Party on Sewage Disposal in 1969 and in stressing the need for increased financial incentives to improve the quality of effluents, the CBI recommended that a special Government grant should be payable both to industries and local authorities; it was suggested that this grant should be similar to those at present available in respect of rural water and sewerage schemes where the maximum state and municipal grants are 70 per cent in aggregate. CBI has accordingly recommended that specific grants of this nature should be made available for all capital expenditure on plant and pipelines for the treatment and discharge of effluent, and for expenditure on abatement of pollution including the restoration and landscaping of the countryside; in the meantime all such expenditure should be eligible for tax relief through the capital allowances system.

FOREIGN TAX RELIEF TO PROMOTE DEVELOPMENT

In the White Paper "British Private Investment in Developing Countries", it is stated that "the Government intend to consider with the Commonwealth Development Corporation (which is largely financed from the overseas aid programme) what action could be taken to enable British firms to increase their investment in developing countries in association with the Corporation".

At present, many developing countries allow exemption or reduction of taxation imposed in their territories on the profits and dividends arising from the industries which have been newly established there. Section 17, Finance Act, 1961, recognised the benefit of this relief for a United Kingdom company, by providing that the amount of foreign tax which had been spared under a scheme to promote development would be regarded as having been borne by the United Kingdom company investing in the developing country. The benefit of this relief, however, is afforded only to investment in developing countries with whom the relevant legislation incorporating a tax-sparing clause in the double taxation agreement has been enacted. There are only eight countries for whom this relief is available to the United Kingdom investor; in the majority of others pioneer reliefs granted by developing countries are being frustrated.

We have recommended previously as a transitional measure, that unilateral relief should be extended to enable the foreign tax spared under pioneer relief schemes to be credited against United Kingdom taxation in the absence of a double taxation agreement. We repeat our representation of previous years, pending a more permanent form of relief to which it is hoped that the Government, during their consideration of the future structure of United Kingdom corporation tax, will give consideration while bearing in mind the interests of developing countries which wish to encourage British investment.

PROBLEMS OF SMALL FIRMS

Corporation tax

In our evidence to the Select Committee on Corporation Tax we described the overwhelming need for small and unquoted companies to satisfy their requirements for working capital out of retained profits in view of the fact that they are denied access to the capital market. We have accordingly welcomed the conclusions of the Bolton Committee which has reported that the small company sector distributes a smaller proportion of its profits than other companies and that it would not be to its benefit if the general rates of corporation tax were to be increased as a result of a change in the system. We repeat our recommendation that relief from the standard rate of corporation tax should be given for the retained profits of unquoted companies; this recommendation is described in more detail in our proposals for the reform of corporation tax.

Shortfall

We have criticised the in terrorem nature of the shortfall provisions introduced in 1965 which has caused many companies to make distributions of funds which were needed for the maintenance and development of their business. The existence of the shortfall provisions arises from the fact that the rate of corporate tax on retained profits is lower than the higher rates of personal taxation on distributions to shareholders. One of the advantages of our recommendation that the maximum rate of personal taxation should be reduced until it reaches the level of 50 per cent is that there would no longer be any need for the shortfall provisions, the repeal of which would greatly simplify tax legislation.

In February 1969 the CBI produced an explanatory memorandum "Close Companies and Shortfall" (jointly with the Association of British Chambers of Commerce) which was circulated by the Inland Revenue to Inspectors of Taxes as an indication of our views. We recommended that prospective shortfall assessments should be restricted to trading companies which have accumulated cash and liquid resources in excess of their requirements, or those which have used income to repay initial business loans; in the normal case, if a company has no cash or investments, and finances its trading operations by the use of borrowed money such as overdrafts, and if this situation is likely to continue, there should be no possibility of a shortfall assessment. We recommend accordingly that the opportunity presented by the reform of the corporation tax system should be used to restrict the ambit of the shortfall provisions for trading companies in preparation for the eventual repeal of these provisions when the maximum rates of personal taxation are further reduced.

Disallowance of interest

In our main representation about the disallowance of interest we re-affirm our recommendation that the provisions for the disallowance of interest should be repealed; the Bolton Committee has made a similar recommendation.

In its intermediate recommendations on the taxation of small firms to the Minister for Industry before the last Finance Bill the Bolton Committee drew attention to the unfortunate consequences for close companies occasioned by the conditions of sub-section 3(a) and 3(b) of Section 58 of the Taxes Act, formerly Section 20(3) (a) and (b), Finance Act 1969, which restrict relief for loans applied in acquiring an interest in a close company. In our representations for The Budget 1970 we described the insuperable difficulties to which the legislation disallowing interest as a deduction for tax purposes gave rise in many small businesses and recommended that, pending its repeal, the legislation should be re-appraised without further delay to ensure that business transactions of this nature were not penalised; we urge that failing the repeal of the legislation, provisions should be introduced in the next Budget to prevent any disallowance of interest arising on loans obtained for the purpose of acquiring shares in an unincorporated business or a close company.

Retirement provisions

We have represented that the limit of £10,000 for the exemption of chargeable gains on retirement is too low and that it should be increased to £20,000. The Bolton Committee has endorsed this proposal in its final report. Earlier, it made the interim recommendation to the Minister for Industry before the last Budget, of which we approve, that as a measure of transitional relief until the provisions of retirement schemes for self-employed persons are improved the limit for the exemption of chargeable gains on retirement should be increased to £15,000 as soon as possible.

We support the view of the Bolton Committee that the provisions of Section 20, Finance Act 1971, do not go far enough to equate the tax reliefs available for retirement schemes for proprietors of non-incorporated businesses and controlling directors of close companies with those of insurance-based pension schemes for non-controlling directors and employed persons: it reported that many businessmen find it impossible to put by substantial sums towards a pension in the early years of the business when all available cash reserves must be directed into productive investment, and that by the time payment into a pension fund becomes possible the flat-rate ceiling on contributions renders the creation of a worthwhile annuity impossible. We have also criticised the limits imposed on the amount of premiums that may be eligible for relief and have welcomed the acceptance of part of our recommendation that the previous percentage limitation should be increased from 10 to 15 per cent of taxable income. We repeat however our main recommendation that there should be no absolute limit on the amount of eligible premiums and urge that the present limit of £1,500 be removed.

Estate duty

The CBI made representations to the Bolton Committee about the comparison of estate duty rates in the United Kingdom with those in other countries to which we refer below in our recommendations about capital taxation. The Bolton Committee decided that it was not within its remit to report on a general reduction in the rates of duty; however, the Committee was seriously concerned about the threat that family companies might be weakened by the necessity to dispose of part of their assets in order to meet the payment of estate duty (a threat already in evidence during the lifetime of the proprietor, for example because it impedes the recruitment of managerial staff). The Committee accordingly supported in whole or in part three recommendations made by CBE: firstly, that relief of 45 per cent allowed to agricultural property and industrial hereditaments should be extended to all assets other than cash of trading businesses, partnerships and unquoted companies; secondly, that the extra-statutory concession that loans made by a close company to a participator for the purpose of paying estate duty on the shares of that company may not be treated as distributions should be made as widely known as possible; and thirdly, that costs incurred in agreeing the valuation of any assets for estate duty purposes should be deductible as debts due on death.

STOCK OPTIONS AND SHARE INCENTIVE SCHEMES

Stock options

We repeat our recommendation that the practice of granting stock options should be encouraged. It arose from the need to provide an incentive to senior executives which was related to the growth of the business and was derived from their efforts. The value of this incentive was eroded substantially by the provisions of the Finance Act 1966 which subjected the notional gain on the exercise of the option to personal income tax and the further gain on the realisation of the shares to a charge to capital gains tax. We urge that the gain which is deemed to accrue from the exercise of an option should not be taxed until the shares themselves are realised, and that the gain on the disposal of the shares should be assessed to capital gains tax and not to personal income tax.

Share incentive schemes

Since the demise of stock option schemes, the pressure to provide similar arrangements for executives has given rise to various kinds of share incentive schemes. The existing taxation treatment of these schemes is not as harsh as that imposed on stock option schemes; we recommend that both should be treated in the same way in the manner outlined above, namely that the realised gain on the disposal of the shares themselves should be subject to capital gains tax.

DISALLOWANCE OF INTEREST

At the Report stage of the Finance Bill, the Chancellor restated his intention to repeal the changes introduced by the Finance Act 1969 disallowing interest payable on loans as a deduction from income, and referred to the Crowther Report on Consumer Credit which recommended that all consumer credit transactions should be treated as involving the lending and borrowing of money and that all forms of such transactions should be subject to the same body of legal rules; the effect of the Crowther recommendations in respect of relief for hire purchase interest presented problems of implementation and as a result it had not been possible to legislate in 1971 in the manner intended.

We accept the principle that all credit transactions should be treated in the same manner as far as possible; but we believe that the administrative difficulties of securing tax relief on all hire purchase transactions may be too great to justify the effort involved. Accordingly we reject the argument that the repeal of the legislation disallowing interest as a deduction for tax purposes should be postponed pending the solution to the problems created by hire purchase transactions.

Following the enactment of the provisions of the Finance Act 1969 we drew attention to several instances in which a disallowance of interest could occur even though the interest payment related to business transactions. The restriction of one year imposed on the allowability of interest on monies borrowed to pay estate duty on interests in trading businesses, partnerships or unquoted companies unless the underlying shares are valued under Section 55, Finance Act 1940, is particularly inadequate as the raising of finance when an estate consists mainly of shares in small companies can seldom be achieved within this period of time; the time limit should be increased to three years. We also criticised the selective manner in which relief was to be made available and recommended that the legislation should be repealed in its entirety. We have accordingly welcomed the report of the Bolton Committee of Inquiry on Small Firms which, in regard to the effect of these provisions on small and close companies, supported the nature of our recommendation in urging that the restrictions on the allowability of interest related to these businesses should be repealed.

We urge that the next Finance Bill should permit all payments of interest to be allowable deductions for tax purposes, and that the allowability of hire purchase interest should be considered for implementation at a later date.

CAPITAL TAXATION

Income tax on investment income, estate duty and capital gains tax are all forms of taxation on saving. Each of these taxes rises to the highest rate in Western Europe, even when the wealth taxes levied in certain countries are taken into account. The aggregate burden of these taxes is far heavier at the top of the scale than in any other European country. Such fiscal penalties on saving serve no valid social or economic purpose, and the rates of these taxes should be reduced to the levels found elsewhere in Europe.

Capital gains tax

Two main themes of our present Representations, Europe and inflation, argue for a reform and reduction of capital gains tax. The countries of the Six have no general capital gains tax; and the United Kingdom tax is especially onerous and unfair when it aggravates the difficulties of preserving capital from erosion through falling money values. Moreover capital gains tax is a third tax on saving in addition to estate duty and the tax on investment income, each of which rises to appreciably higher rates than in any European country.

The Minority Report of the Royal Commission on the Taxation of Profits and Income said:

"We wish to emphasise that - ignoring the exceptional periods following in the wake of great wars or great economic depressions - capital gains are not, to any important extent, the consequence of either rising prices or falling interest rates".

The experience of recent decades does not support this judgment. Over the period since before the War, far the greater part of the rise in asset values has been due to currency depreciation, nor is there any reason to believe that this pattern will change. The greater part of the profit base on which capital gains tax is levied is illusory.

It is sometimes argued that capital gains tax ought to be levied, as at present, on nominal gains, not real gains, because income tax is levied on the inflationary increase in incomes. This analogy is false. The real value of earned incomes is merely diminished, not annihilated, by inflation. Since inflation affects not only investment income but also the parent capital, however, investment income, even gross of tax, may be substantially negative in the sense that the yield is insufficient to maintain the value of the principal: losses of this kind are compounded, first by the tax on investment income and then by capital gains tax.

We have not argued for an arithmetical allowance for inflation in the calculation of the charge to capital gains tax, since this would further complicate a tax one of whose principal failings is its complexity. Instead, we urge that assets held for more than seven years should fall out of charge to the tax on capital gains in the hands of individuals, and to corporation tax on chargeable gains in the hands of companies. This would provide the long-term investor with the possibility of compensating for inflationary losses without incurring a tax charge; it would also simplify the administration of the tax and the record keeping necessary at present both for the Government and the taxpayer. A simplification of this kind would be especially helpful at present in view of the load imposed on taxpayers and their advisers by the many tax changes recently introduced or currently under consideration.

The abolition of the short-term capital gains tax in the last Budget has reduced one cause of the "locking-in" effect restricting the movement of securities from one investor to another. All capital gains taxes levied on realisations cause some "locking-in" effect; in our judgment the increase in "locking-in" towards the end of the seven-year period would be more than offset by the removal of the "locking-in" effect after the seven-year period was over, but the ending of liability to capital gains tax could be phased out over several years if this were thought preferable.

We have two other structural proposals to put forward.

First, the good work of the last Budget should be taken to its logical conclusion by eradicating the concept of deemed disposals from the statute book.

Second, the progressive simplification of the tax should be continued by removing from charge gains arising from the disposal of capital assets used exclusively for the purpose of the trade as applied formerly under the provisions of Section 11, Finance Act 1962. Such a dispensation would not be costly and would remove the need for the rollover relief provisions.

Estate duty

The present structure of estate duty is directly derived from the Budget of July 1940, when it was justified by the Chancellor of the Exchequer as "a necessary contribution to our war effort".

The rates of duty in the United Kingdom rise to a maximum of 80 per cent on the whole estate; there is no abatement for transfers within the family, so that a transfer to a lineal descendant attracts the full rate of tax. In Europe there is generally a consanguinity abatement for transfers to lineal descendants; the average top rate of tax on such transfers in the Six, Denmark, Finland, Norway, Sweden, Austria, Eire, Portugal and Spain is about 25 per cent, as compared with 80 per cent in the United Kingdom.

Italy is the only country in the present European Economic Community where the maximum rate of tax on transfers to lineal descendants exceeds 20 per cent. When we turn from tax rates to revenue yield, the contrast between the United Kingdom and other countries is no less striking. The yield per head of death duties in the United Kingdom is more than double the yield of inheritance taxes in Belgium, more than three times the yield in the Netherlands, more than four times the yield in France and Italy and more than ten times the yield in Germany.

The very high rates of duty intensify problems inherent in the present basis of the tax such as the delays in determining liability and the risk that the saleable value of the assets may fall substantially below the dutiable value. Again, it is difficult or impossible to insure against estate duty at its present high rates.

More generally, what distinguishes the United Kingdom estate duty schedule from the schedules of similar taxes elsewhere in Europe is that the maximum rate is exceptionally high, not that the exemption limit is exceptionally low; the exemption limit has risen from £100 in 1946 to £12,500 now. While the rise in the exemption limit in the last Budget was welcome and should be repeated this year, it left untouched the main problem of the higher rates of duty, which have become increasingly onerous through the effect of inflation on a graduated schedule.

We regard a reduction of the rates of estate duty as far more urgent than a change in its structure. A reduction in the rates is administratively simple and should not be delayed while consideration is given to possible changes in the form of the tax. Moreover, in view of the huge disproportion between the rates and yield of estate duty in the United Kingdom and comparable taxes abroad, reform of the tax should not start from the assumption that its yield must be maintained; the reduction of the burden is itself one of the most desirable reforms. The structural reforms that we recommend for detailed examination are consanguinity abatements and the granting of surviving spouse relief on the death of the first spouse instead of the second; we are interested in thorough-going reforms and would regard increases in the exempted slice of the tax as no more than a temporary expedient for these purposes. We should like to see thorough-going reforms on these lines brought in as soon as possible; if their introduction is not possible this year, the rates of duty should still be cut.

We were glad to note the remark in the last Budget Speech.

"I have been very anxious to find some way of mitigating the burden of estate duty. It is widely regarded as severe and represents a real disincentive to saving".

The realisation of this policy requires a drastic reduction in the rates of duty. The maximum rate should be reduced from the present 80 per cent to 50 per cent by the 1974 Budget, at the latest, with proportionate reductions throughout the scale; this would still leave scope for further reductions later, through consanguinity abatements or in other ways. We discuss the timing of these reductions in estate duty in the next section ("A programme of reform").

A programme of reform

The overtaxation of investment income and its parent capital in the United Kingdom has persisted for decades. Either the need for reform has not been recognised or proposals for reform have been frustrated by political, economic or administrative constraints.

One such constraint exists at present: the economic situation will in our judgment limit the scope for tax cuts this year. It is all the more regrettable that tax reductions of some £1400m over the last year have done so little to reduce the rates of tax on saving. Relatively to spending, saving is even more heavily taxed than it was before.

One of the obstacles to the reduction of taxes on saving may be public ignorance of how heavy the present burden is in this country relatively to countries abroad. We therefore suggest that the Budget Speech should contain a clear recognition of this truth and a commitment to reduce United Kingdom taxes on saving towards the European average over a period of time. This commitment should be in the most specific terms possible. Although Chancellors of the Exchequer are in general rightly reluctant to limit their future room for manoeuvre, this consideration is of little relevance here. Taxes on saving are of little or no value for economic regulation or the restraint of inflation, so that commitments in this area do little or nothing to limit the room for manoeuvre elsewhere. And a programme of reform, announced in advance as a movement towards the general European pattern of tax rates, would accustom the public both to the idea of reductions in the taxation of capital and to their justification.

As an earnest of a serious intention to realise in practice the ideas already acknowledged in principle that saving deserves to be encouraged and that taxes on saving are too high, we urge that the commitment to a programme of tax reduction should be emphasised by starting the process in the next Budget. For this purpose we propose a cut in the maximum rate of estate duty by a quarter (from 80 per cent to 60 per cent), with proportionate reductions throughout the scale.

SUBMISSIONS ON GOVERNMENT PROPOSALS

REFORM OF CORPORATION TAX

Introduction

The Green Paper "Reform of Corporation Tax" (Cmnd.4630) has described two proposed methods of taxing corporate profits as alternatives to the existing two-tier system; we support the Green Paper proposals to the extent that they remove the discrimination against distributed profits for the generality of companies. The Green Paper is unsatisfactory, however, in its treatment of companies whose income is derived mainly from overseas, and of companies with a low level of distributions which is a characteristic of the unquoted company; we make representations below about these two sectors.

Of the two systems of taxing corporate profits described in the Green Paper, we have stated our preference for the imputation system subject to certain essential modifications. The main reasons for our preference are that the imputation system accords more closely in principle to the system proposed by the CBI since 1968 and that it does not suffer from the weakness of the two-rate system in the re-negotiation of double taxation treaties.

The Select Committee on Corporation Tax did not regard it as within its terms of reference to consider the re-introduction of the pre-1965 system which we have been advocating, and accordingly limited itself to a choice between the two-rate system which the Inland Revenue prefer and the imputation system which was favoured by most witnesses including CBI; we are gratified that the Committee has recommended the imputation system.

Essential modifications to proposed systems

In our evidence to the Select Committee* we described the problems to which the systems proposed in the Green Paper would give rise for companies whose income is derived predominantly from overseas and for unquoted companies.

We propose for companies with mainly overseas income a restoration of the pre-1965 principle whereby the tax on distributed profits from overseas investment is not higher than the corresponding tax on domestic profits except in so far as the tax paid overseas is higher than the UK basic rate; this would achieve equality of treatment between companies with mixed overseas and domestic income and companies with overseas income only. In the interest of simplicity we have recommended that this result be achieved by enabling companies to elect for a nil net UK rate on their distributions; these distributions would thus be exempted from taxation at the basic rate of income tax but would be ineligible for repayment of tax to shareholders.

*Report from the Select Committee on Corporation Tax: pages 144-160, and 284-289.

We propose that unquoted trading companies (comprising those companies whose shares are not quoted on a recognised stock exchange in the United Kingdom) should be subject to tax on retained profits at the rate of 40 per cent instead of the notional rate of 50 per cent; the taxation of distributed profits and the tax deductible from distributions would remain the same as the Green Paper describes. For unquoted companies the total rate would therefore be 40 per cent on retentions (instead of 50 per cent for quoted companies), and 30 per cent and 20 per cent on distributions (being the same rates as on distributions and retentions by quoted companies).

Our recommendations for companies with mainly overseas income and for unquoted companies are set out in more detail in Appendix II.

Capital gains

We have welcomed the recognition in the Green Paper that capital gains should not be taxed as heavily as income. The Select Committee has supported this view and has recommended that consideration should be given to the system in Canada where half corporate capital gains are exempt from tax. We recommend that if the rate of corporation tax is 50 per cent, the exempt proportion should be 60 per cent; this would result in an effective corporation tax rate on chargeable gains of 20 per cent. The rate of 20 per cent combined with a capital gains tax rate of 30 per cent on individual shareholders corresponds with the effective rate of tax on distributed profits, which consists of a general rate of corporate tax on profits on 50 per cent minus distribution relief of 30 per cent with a further income tax charge of 30 per cent on dividends received by individual shareholders. We also recommend that there should be unrestricted set-off of capital losses against trading profits in terms of tax payable.

Intra-group dividends

We have criticised the contention in the Green Paper that it would be an essential feature of the two-rate system that the present arrangements for paying intra-group dividends without deduction of income tax should be withdrawn, and that the same would apply under the imputation system. The Select Committee has noted our objections that the withdrawal of grouping for dividends could occasion a cash loss when subsidiaries deriving their profits wholly from overseas paid dividends to holding companies, or when the taxable income of group companies was wholly or partly covered by excess capital allowances or by group relief for losses; it could also occasion a loss of liquidity between the transfer of intra-group dividends and the payment of distributions to shareholders. We have warmly welcomed the recommendation of the Select Committee that the present system of paying intra-group dividends without deduction of tax should be retained; we emphasise again that it is essential for parent companies to be able to allocate distribution relief among the members of the group in order to avoid a loss which might arise from

alternative methods of allocation, such as those which might require distribution relief to be allocated either in proportion to the dividends received from subsidiaries, or to the parent company's income in priority to that of the subsidiaries.

Distribution relief

We repeat our representation to the Select Committee that distribution relief should not be related solely to distributions made within the relevant accounting period chargeable to tax but also to those paid within the six months after the end of the accounting period which would accordingly be treated as distributions for that period; this treatment follows that of gross relevant distributions under the profits tax legislation. If the procedure in the Green Paper is adopted there will be many cases where, because of fluctuating profits, excess distribution relief has to be carried back one year or carried forward, even though the company is not distributing a sum which exceeds the taxable profits of the period. Indeed, because of the arbitrary matching of distributions and profits there is a strong case for allowing excess distribution relief to be carried back without time limit and not restricting this to one year only.

Conclusion

As mentioned earlier, the terms of reference of the Select Committee on Corporation Tax restricted the Committee to report on the merits and demerits of the two-rate and imputation systems. We have welcomed the report of the Select Committee and its findings; we consider however that the timetable imposed on the Select Committee and its witnesses has been too burdensome to allow the consideration in sufficient detail of certain detailed provisions, notably the transitional problems that would arise. In this respect, all companies would benefit from the publication by the Government of its choice of system prior to the 1972 Finance Bill.

PERSONAL INCOME TAX

We welcome the substantial steps which the Chancellor has already taken in the directions we have advocated for the reform of income tax and surtax. The standard rate of income tax has been reduced by $2\frac{1}{2}$ per cent. Married couples have been given the option of separate assessment on earned income on the basis of the tax liability they would have as single persons. The rate of surtax on earned income has been reduced. The proposals for the unified system of personal income tax contained in the White Paper (Cmd. 4653) offer wide scope for administrative simplification and foreshadow at least some reduction in the present discrimination against investment income.

In view of the forthcoming introduction of this unified personal tax system in 1973-4 it would be inappropriate for us to propose substantial structural reforms this year in the present income tax and surtax systems. Instead, we urge that the opportunity be taken to reconsider the structure of the personal income tax system so that the unification of income tax and surtax may represent a reform in fact as well as in name. We give below our recommendations for structural reforms affecting administrative simplification, the removal of the discrimination against investment income and the rate schedule.

Administrative simplification

The Chancellor in his 1971 Budget speech pointed out that "we have two taxes on personal income - ordinary income tax and surtax. Each of these is subject to separate and often different rules there is no sense in this division".

Unfortunately ending this senseless division is just what the unified tax system as outlined in the White Paper does not do:-

"Where in the past particular items of income are treated differently under the income tax and surtax rules the practical effect of these differences is (with a few exceptions) being preserved inside the new tax structure". (Cmd. 4653 Paragraph 9).

We believe that a great opportunity is being missed here and urge that the intention expressed in the White Paper be reconsidered.

Discrimination against investment income

There is no economic justification for the maintenance of the discrimination against investment income in the new unified tax system. The increase in consumption resulting from the abolition of the additional tax on investment income would certainly be small, probably be negligible and possibly be negative because of the additional saving which such a reduction could be expected to induce.

Nor do we regard this discrimination as justified on social grounds: the present system taxes spending relatively lightly and saving heavily, and a reduction of the burden on saving would bring the United Kingdom more into line with the usual pattern abroad.

We urge that no surcharge be imposed on investment income. Investment income is far more exposed than earned income to erosion by the fall in value of money, and the arguments for discriminating against investment income have long since lost any justification they may have had two or three generations ago. The removal of the discrimination would provide at least some compensation for the losses inflicted by inflation.

The rate schedule

The provisional maximum marginal rate of 75 per cent under the unified tax system remains well above the European norm of some 60 per cent. Such very high rates bring in little revenue and do still less to reduce consumption. The maximum rate should be cut to 60 per cent as soon as possible; the long-term aim should be a maximum of not more than 50 per cent.

If an investment income surcharge is to be retained (contrary to our view that it should be abolished), it should be as low as possible. If expressed in terms of taxable income (or of the basic rate of income tax above the exemption limit) a constant rate of surcharge takes an increasing proportion of net-of-tax income as income rises; it thus adds a second measure of graduation to an earned-income tax structure that is already graduated. In order to counteract this tendency, we propose that any surcharge on investment income should be subject to an overall limitation that the average rate of tax should not exceed the maximum rate on earned income. Similar provisions operate in a number of European countries, and in the United Kingdom a similar overall limit already applies to estate duty.

SALE AND LEASEBACK TRANSACTIONS

Following the recent decision by the Special Commissioners in the Austin Reed case, the Financial Secretary to the Treasury described in his statement on 4th August two possible forms of legislation to be introduced for the taxation of sale and leaseback transactions, and invited representations. We set out below the reasons why we believe that the proposed legislation should not be introduced.

Sale and leaseback arrangements have become of great importance to industry and commerce as a means of raising funds to finance the acquisition of plant and other capital assets. They are essential if modernisation is to continue and to meet the increased calls brought about by current inflation for more working capital than is made available by the banks. Borrowing companies have become acutely aware that mortgages have to be repaid out of retained profits, currently taxed at 40 per cent and rising to 50 per cent if the present Green Paper proposals for the reform of corporation tax are implemented, and that in the majority of cases the maximum amount which can be raised is restricted to two-thirds of the current value of the property. On the other side, continuing inflation has made fixed interest investments unattractive, especially as it can result in a negative return in terms of purchasing power. In consequence there has been a marked decline in the amount of such funds available coupled with high rates of interest. To sell and lease back a property overcomes many of these objections. The investor acquires an asset with the right to have the income derived therefrom increased, but never decreased, at regular intervals; this constitutes a partial inflation cover. For that cover, he is willing to accept an initial return lower than that expected from a mortgage investment. The borrower is enabled to raise the full current value of the property whilst the original rental paid is often less than the interest cost of such borrowing if the total money raised by a sale could be borrowed; nor will he be burdened with onerous capital repayments.

In view of the essential commercial function of sale and leaseback transactions we recommend that these transactions should be encouraged and not penalised. We oppose the proposed legislation on ground of principle and do not therefore seek to evaluate either of the two proposed methods; the proposed legislation is itself defective.

High rates of personal taxation coupled with inflation have created special problems for the professional men whose activities do not permit them to operate as limited companies. In order to maintain adequate working capital as the elder partners retire, more and more partnerships are being forced to sell properties owned and lease them back. Whilst this is a once for all palliative, any legislation which discourages young professional men from personal practice must be to the detriment of the country.

Similarly, the proposed legislation would give rise to the anomaly that if a company wishes to raise finance by the sale of its property, the lease of which has less than 15 years to run, it would be penalised by the proposed legislation. To avoid this result it might be compelled to adopt the unsatisfactory and illogical alternative of selling the property in which the business was operating and moving to other rented premises at considerable cost and with the danger of disruption of the business. Finally, regardless of the manner in which the proposed legislation is drafted it must necessarily be complex and have a frustrating effect on future business of this nature and reduce the amount or increase the cost of the finance needed to modernise industry.

We recommend that the position prior to the Austin Reed case should be perpetuated; commercial transactions should not be attacked by the Inland Revenue. Section 491 of the Taxes Act, which provides for the disallowance of any amount which exceeds a commercial rent, is generally adequate for preventing tax avoidance, and if it is deficient it can be strengthened. We accept that legislation may be needed to nullify a tax advantage that is proved to be the sole purpose of an artificial sale and leaseback transaction. We emphasise, however, that in no circumstances should a sale and leaseback transaction undertaken for normal commercial reasons be penalised, even if a tax saving can be shown to accrue from a transaction which produces genuine commercial benefits for the company concerned. This would be a more acceptable solution to the problem of curtailing transactions of an artificial nature which would generally be considered undesirable, rather than the course proposed of seeking to penalise genuine commercial transactions which, because of their inherent advantages, have become an accepted form of financing the maintenance and expansion of business.

VALUE ADDED TAX

The text of this representation will be released at the Press Conference on value added tax to be held on Thursday 17 February at 11.30 a.m.

The Government is the first to... (The text is extremely faint and largely illegible, appearing to be a continuation of a speech or report.)

REPRESENTATION

Representing the... (The text is extremely faint and largely illegible, appearing to be a continuation of a speech or report.)

The only... (The text is extremely faint and largely illegible, appearing to be a continuation of a speech or report.)

In 1970... (The text is extremely faint and largely illegible, appearing to be a continuation of a speech or report.)

VALUE ADDED TAX

The text of this representation will be placed on value added tax to be held on Thursday 17 1971

The text of this representation will be placed on value added tax to be held on Thursday 17 1971

The text of this representation will be placed on value added tax to be held on Thursday 17 1971

RATING

Introduction

The Green Paper on the Future Shape of Local Government Finance (Cmd. 4741) contains some welcome proposals such as a reduction in rates payable by those with low incomes and the extension of rate payments by instalments to non-domestic ratepayers; the decision to establish a small expert committee to examine anomalies in the rating of plant and machinery is also welcome. We repeat our representations about the rating of plant and machinery, and describe anomalies to which it gives rise, and set out the reasons for which we reject the concept of super-rating described in the Green Paper.

Super-rating

Super-rating is defined as empowering local authorities to levy on the rateable value of non-domestic properties a higher rate poundage than on domestic properties. The Green Paper states that either non-domestic ratepayers as a whole could be required to pay a certain percentage above the rate poundage paid by the domestic ratepayer, or increases in rate poundage for domestic property could be fixed at a proportion of the increases applied to non-domestic property. This latter form would entail a progressive, and cumulative, degree of domestic de-rating.

The only argument in favour of super-rating is that of administrative convenience. It is without justification on either economic or equity grounds. It is not justified by any additional costs which industry imposes on the local authority for which a special charge could be made, for example, in the case of the disposal of trade refuse. Nor is there much validity in the argument that super-rating would not be a burden to industry because it can be passed on to the consumer. Although the incidence of rates can be shifted either forwards to consumers or backwards to suppliers depending upon the elasticities of supply and demand, in all but a few exceptional cases some incidence will fall on the profits of the local company.

In 1970 gross company profits represented 11.6 per cent of total domestic income, in contrast to an average share of 13.9 per cent over the period 1960-1970. A number of surveys have pointed to the dangerously low level of industrial investment. If Britain is to meet successfully the challenge presented by membership of an enlarged European Economic Community, it is necessary that industry should be able to improve its productive facilities. Super-rating would be a form of tax on investment and as such stands condemned.

To the extent that the burden of super-rating would be passed on, the prices of British goods and services will rise. The effect on the prices paid by final buyers will be magnified by its heavy impact on commerce and services. The dangers and disadvantages of our recent inflation need hardly be emphasised. The deliberate adoption of a measure which will inevitably stimulate additional price increases is incompatible with the overriding necessity to modify the rate of inflation. The effect of super-rating on our exports is equally clear and equally undesirable. Such a tax would reduce Britain's international competitiveness.

The Green Paper concedes that even if the degree of super-rating were laid down nationally, its impact would vary between regions in relation to their respective proportion of domestic and non-domestic rateable values. If the burden of rates on industry were to increase in the problem areas, where rateable values for other property are generally low and rate poundage consequently high, it could act as a disincentive for firms to move to these regions; for some assisted areas super-rating might thus work against the regional incentives.

Super-rating would thus distort the allocation of resources for two reasons: first as a tax on capital intensive industry and second as a regional distortion. Such distortions should be avoided unless they are consciously pursued to further some aim of government policy which is clearly not the case in this instance; because of its undesirable consequences for investment, prices and our international competitiveness, we reject the concept of super-rating.

Rating of Plant and Machinery

The existing legislation provides that the categories of plant described in Class 4 of the Plant and Machinery (Rating) Order 1960 are to be rated unless the item is within one of two general exclusions; the first exclusion is any item which is not, and is not in the nature of, a building or structure; and the second exclusion is any part of a scheduled item which does not form an integral part of such item as a building or structure or as being in the nature of a building or structure. We recommend that there should be two additional exclusions from rateability under Class 4.

Firstly, plant and machinery used in the course of a productive process should not be rated. This recommendation was submitted to the Ritson Committee but the Committee decided that consideration of this proposal was not within its remit; however, two members, Mr. Dulake and Mr. Pickworth, recorded in the Report their view that "the proposal to exempt (like tools of trade) all process plant and machinery has great merit".⁹ This exclusion would avoid a common source of anomalies.

⁹ Report of the Committee on the Rating of Plant and Machinery (1959). Page 14, paragraph 35.

Secondly, plant used to mitigate environmental problems such as precipitators, grit or dust extraction plant, etc. should not be rated. The addition of such plant to industrial works conforms with Government policy to encourage the suppression of pollution, and may in certain cases reduce the burden of expenditure on Local Authorities.

CBI accepts that the following items may continue to be rated under Class 4 to the extent that they are not within one of the four exclusions described in the preceding paragraph: foundations, settings, fixed gantries, supports, and platforms and stagings for plant and machinery; all containers (tanks, storage vessels, silos, bins, hoppers and funnels, etc.,) used for storage of raw materials or finished products; and chimneys.

An important merit of our recommendation is that the presentation of the items of plant and machinery rateable under Class 4 would be simplified, and as a consequence the administration of the Order would be eased because the problems of definition to which the existing categorisation gives rise would be almost entirely removed.

APPENDIX I

COST OF BUDGET REPRESENTATIONS

The table which follows shows our estimates of the likely cost of our main recommendations over the next two years. The figures are in "1971-72 prices", so that no estimate of the rate of inflation has been needed. We have assumed that gross national product grows by 4 per cent a year in real terms and that most types of income and expenditure move in line with this. The figures for investment incentives, however, assume that qualifying investment grows less quickly than gross national product in 1972-73.

A number of our recommendations are not included in the table. In some cases, this is because they would not affect exchequer receipts until after 1973-74; for example, because they apply to the proposed new system of corporation tax. We have assumed that this system will not become effective until 1973-74, so that payments under it will be made in later years. Other uncosted representations are of a structural character, rather than specific proposals for implementation at a given date; we would hope that some progress would be made towards these objectives within the next two years, but we have not included any allowance for this in the table. Other technical points have not been included in order to restrict the table to the main recommendations; the cost of these technical recommendations would generally be small.

The costings shown for improved investment incentives are on a cash flow basis and do not represent the increased value of the incentives discounted over the lifetime of the assets concerned; this latter basis is equally valid, and would show a lower figure for the introduction of depreciation at choice, but for consistency and simplicity of exposition we have limited the table to cash flow figures. In other words, the Budgetary cost would fall in later years. Our proposals for the acceleration of relief for capital allowances have not been costed in the table. They could, if adopted, mean a very substantial Budgetary cost in the first full year of operation.

The table shows estimates of consumption cost as well as Budgetary cost. The consumption cost figures indicate the order of magnitude of the likely increase in consumption spending which would result from the recommended tax changes. We have not shown estimates of the likely increase in investment expenditure, both because of the uncertainties which would be involved, and because at least in the circumstances of the next few years the relevant constraint on Budget decisions will be the increase in consumption rather than the total increase in demand for resources. Put at its simplest, resources should be made available for as large an increase in investment spending as is likely to be achieved.

ESTIMATE OF THE COST OF THE PRINCIPAL BUDGET PROPOSALS £M (1971-72 prices)

	<u>1972-73</u>		<u>1973-74</u>	
	<u>Budget Cost</u>	<u>Consumption Cost</u>	<u>Budget Cost</u>	<u>Consumption Cost</u>
1. HEAVY OIL DUTY	69	17	52	13
2. CORPORATION TAX	57	14	109	27
3. LOW INCOME RELIEF	£80	100	83	104
4. INVESTMENT INCENTIVES				
i) Depreciation at choice	0	0	109	*
ii) Capital allowances-commercial buildings	0	0	12	*
iii) Allowances additional to asset cost	0	0	136	*
iv) Pollution abatement	0	0	**	*
5. DISALLOWANCE OF INTEREST	6	4	21	14
6. CAPITAL GAINS TAX	0	0	36	7
7. ESTATE DUTY	66	0	100	0
TOTAL	278	135	658+	165+

NOTES TO TABLE

The costings are not intended to be accurate to the nearest £1m; they have been presented in this form in order to show the relationships of the figures more clearly.

1. HEAVY OIL DUTY: The estimate relates to a halving of the rate of duty on rebatable oils. The 1973-74 Budgetary cost is net of Exchequer "ploughback" via increased corporation tax yield. In principle, similar adjustments could be made to the estimated effects of other tax changes; this has not been done because of the complexity of the necessary assumptions.
2. CORPORATION TAX: The estimate relates to a $2\frac{1}{2}$ percentage points reduction in the rate of tax.
3. LOW INCOME RELIEF: £100m, in terms of consumption cost, is set aside in the first year.
4. INVESTMENT INCENTIVES: * We recognise that the resource cost of these items will ultimately be considerable but consider that no useful purpose would be served by attempting to estimate it. The resource cost in our view would consist more of additional investment demand than additional consumption demand, so that the additional consumption cost would be small.
 - i) DEPRECIATION AT CHOICE: For costing purposes, the provision is assumed to apply initially to plant and machinery outside the development areas. Depreciation at choice can be extended to other assets when Budgetary constraints permit.
 - ii) CAPITAL ALLOWANCES FOR COMMERCIAL BUILDINGS: The cost is estimated for development areas only on the basis of the industrial buildings allowances.
 - iii) ALLOWANCES ADDITIONAL TO ASSET COST: The cost is for plant and machinery only at rates of 15 per cent and 30 per cent in the non-development and development areas respectively. Like depreciation at choice, allowances additional to asset cost can be extended to other assets when Budgetary constraints permit.
 - iv) POLLUTION ABATEMENT: ** The cost of this recommendation would be significant but difficult to estimate.
5. DISALLOWANCE OF INTEREST: The cost relates to the repeal of the provisions for the disallowance of interest as a deduction for tax purposes.
6. CAPITAL GAINS TAX: The cost relates to a 7-year cut-off point for the taxation of capital gains. The Budgetary cost in the first year has been put at zero because in practice the tax is paid a year in arrear.
7. ESTATE DUTY: The cost relates to a 25 per cent reduction in the rates of estate duty. The increase in cost in 1973-74 arises because the duty on realty is payable a year after death.

APPENDIX II

REFORM OF CORPORATION TAX

In the General Representations we describe two essential modifications to the Green Paper proposals for companies whose income is derived predominantly from abroad and for unquoted companies. Our proposals are set out in greater detail below.

Companies with mainly overseas income

CBI has argued for years that overseas investment should not be frustrated or impeded by the tax system; the 1965 system, with its relatively low rate of corporation tax and high rate of withholding tax, taxes overseas income more heavily than domestic income whenever the overseas rate of tax exceeds the United Kingdom rate of corporation tax (currently 40 per cent).

Under the system put forward in the Green Paper, companies whose domestic income exceeds their dividend distributions will pay no more tax on foreign income than on domestic income unless the foreign rate of tax exceeds 50 per cent. This resolves the problem for a substantial proportion of companies with income from overseas; but the Green Paper would leave companies with income wholly or mainly from overseas as badly off as ever, since withholding tax would be payable on distributions at or near the full rate of 30 per cent. Tax would thus in total take 30 per cent more from the dividends of a wholly overseas company whose income was taxed abroad at 50 per cent than from the dividends of a company with mixed or wholly domestic income paying corporation tax at 50 per cent in the United Kingdom: the yield to the shareholders of a mixed income or domestic company would be some 43 per cent higher than to the overseas company if the gross yields were the same. We can find no economic justification for this sharp distinction between the tax treatment of foreign income that can be matched with domestic income and foreign income which cannot. A differentiation of this kind provides a strong fiscal incentive to mergers with little economic justification.

We accordingly propose that companies should be allowed to elect for a United Kingdom tax basis by which overseas tax is set off against UK corporation tax. The salient features of the solution we propose are that:

- (1) liability to United Kingdom corporation tax would be extinguished by the greater amount of foreign tax set against it,
- (2) there would be no tax on distributions by these companies,
- (3) these distributions would be treated as franked for basic income tax when received by individuals but there would be no repayment of income tax to individuals,

- (4) these distributions would be treated as not liable to corporation tax when received by corporate shareholders,
- (5) there would be a restriction when these distributions were used by intermediate corporate shareholders to frank distributions made by them to other corporate shareholders or to individuals, and on the repayment of income tax to gross funds and individuals in respect of such distributions (for this purpose distributions would be treated as franked first by other income and dividends received, and the restriction would be by reference to the proportion that the distributions paid out of dividends received from companies subject to the exemption method bore to the total distribution),
- (6) companies that elected to be treated under the exemption method could be required to do so irrevocably for a period of five years; this would enable a company to change its tax basis in the event of a major change in the geographical sources of its income.

The Select Committee has recommended an imputation system with a minimum precompte (withholding tax) as an essential element. If this minimum is set at a rate that does no more than cover the cost to the Revenue of tax repayments to charities and other taxpayers below the standard rate, it could be a realistic alternative option to the method outlined above.

Unquoted companies

A serious disadvantage of the Green Paper proposals is that there will be a substantial increase in the corporation tax liability for companies that have a low level of distributions. On the basis of the notional figures in the Green Paper, companies will lose from the change in system unless they distribute five-ninths or more of their profits net of corporation tax; companies which are unable to make any distributions will suffer a 25 per cent increase in their corporation tax liability. We are greatly concerned about the effect of this increase on those whose outside sources of finance are limited and who do not have access to the capital market. The Select Committee accepted the need for small companies to be able to accumulate the funds needed for their expansion out of retained earnings, and admitted that both the systems proposed in the Green Paper would be damaging to these companies in this respect.

We accordingly propose that unquoted companies should be accorded relief from the full rate of corporation tax on retained profits until such time as the maximum rate of the unified personal tax system is equated with the rate of corporation tax.

Conclusion

The rate of corporation tax levied on domestic and mixed-income companies should be decided on economic and social grounds appropriate to these companies and should not be affected by the choice of fiscal regime for overseas companies. Similarly, the rate of corporation tax levied on overseas companies should be decided by economic criteria appropriate to them and by considerations of fairness between these companies and other classes of taxpayer; and any concession accorded to unquoted companies should be justified on grounds of the financial needs of these companies and their contribution to the economy.

It is unrealistic to regard the yield of corporate taxation as a fixed quantum requiring any reduction in one part to be made good by an increase in another. If it were assumed that the cost of our proposals, had to be borne in the form of a higher rate of corporation tax elsewhere, they could not be expected to command support throughout British industry; but this assumption would be unnecessarily restrictive. The cost could be borne, for example, by a switch to indirect taxation or by a general tax-cutting programme such as the Government has been following since it came to power.



Treasury Chambers, Great George Street, SW1P 3AG
01-930 1234

21st January, 1972

Dear Robert,

Many thanks for your letter of 17th January with the note of the Chequers discussion of 10th January. We are entirely content with it.

Yours ever,

Alan.

A.M. Bailey

R.T. Armstrong, Esq.,

RA

SECRET

URGENT

1

(a) I want discuss urgently with you & Am leading
 (b) Amster etc the left long some key things
 spend before he gets any further at his budget
 planning.



Treasury Chambers, Great George Street, SW1P 3AG

01-930 1234

AK 12/2

AK 12/2

PRIME MINISTER

I am sending herewith a copy of the latest
 "Economic Outlook", which I received at the weekend.
 During this week I shall be having discussions on
 this and its bearing on the Budget judgment. I
 outlined at Chequers the various Budget measures on
 which I have been working, and to those will be added
 the outcome of the "Armstrong package" which is now
 firming up well. I have had a full discussion about
 the latter with John Davies and we will be submitting
 a joint paper to E.S. very soon. Although there is
 the obvious interdependence of the measures so far
 proposed and the overall Budget judgment, no action
 is yet being taken which would restrict our room for
 manoeuvre on that judgment. When I am further
 advanced with the consideration of all these matters,
 I would like to have a talk with you about the overall
 picture so that thereafter final decisions can be taken
 consequent on the size of the stimulus which we agree.

Y
G.

/I am

SECRET

S E C R E T



I am sending a copy of this minute and the enclosure to Sir Burke Trend.

AB.

7th February 1972

S E C R E T

17 January, 1972

I have made a summary note of the discussion which the Chancellor had with the Prime Minister at Chequers on 10 January. I enclose a copy, not because there will be anything new to you in it but in case there are any mistakes which I have made and which should be corrected.

RTA

A.M. Bailey, Esq.,
H.M. Treasury.

BUDGET - TOP SECRETNOTE FOR THE RECORD

When the Chancellor of the Exchequer visited Chequers on 10 January, he gave the Prime Minister an outline of the proposals which he expected to include in his Budget.

Value Added Tax

The Value Added Tax would come into force in April, 1973, replacing Purchase Tax and Selective Employment Tax. Value Added Tax would be levied at one rate, with an additional excise duty on new motor cars to bring the total tax on new motor cars up to broadly the present level. The Chancellor proposed a standard rate for Value Added Tax of 10%, which was estimated to produce about £30m. to £40m. less revenue than the combination of Purchase Tax and Selective Employment Tax at present rates. There would be exemption from Value Added Tax for broadcasting services, health services, education services, charities, financial services, postal services and small businesses. There would be zero rating (which was more favourable than exemption) for books and newspapers, press advertising, food (other than foods now liable to Purchase Tax) new buildings, domestic passenger transport, fuel and exports.

Levying the tax at a single standard rate would have great advantages of convenience, above all for the distributive trades.

The effect upon the cost of living index of a change from Purchase Tax and Selective Employment Tax to Value Added Tax at 10% would be an increase of approximately 0.7%. But the effect of the change would be progressive, in the sense that the

BUDGET - TOP SECRET

BUDGET - TOP SECRET

- 2 -

incidence of Value Added Tax would be heavier on those who were better able to bear it.

Corporation Tax

It was necessary to choose between the imputation system of Corporation Tax or the two-rate system. The Chancellor's original preference had been for the two-rate system; but most businessmen preferred the imputation system. The imputation system was already in use in France, and the Germans were believed to be likely to move over to it. The European Community was therefore likely to harmonise on the basis of the imputation system, and a second change, if the two-rate system were introduced now, would be intolerable. He had therefore decided to go for the imputation system. In this year's Budget speech he would announce that Corporation Tax would be charged at 50% on undistributed profits and 20% on distributed profits. There would be considerable reliefs for closed companies and small businesses; steps would be taken to ensure that small businesses were generally speaking not worse off as a result of the changeover. The cost of the changeover was expected to be about £200m. in a full year.

Income Tax

The Chancellor proposed to increase the single and married allowances by £40 each for 1972-1973. This would cost £300m. in the first year and £375m. in the full year. The effect on demand would be of the order of £250m. (annual rate, in the fourth quarter after introduction).

The Chancellor would also announce in this year's Budget the unified scale for Income Tax which would

BUDGET - TOP SECRET

operate from April 1973. The Chancellor recalled that it had been announced that the scale would run from 30% to 75%. The cost of introducing the scale would be of the order of £250m. and the benefit would be concentrated at the higher income levels. He therefore proposed to announce this change at the same time as the change in allowances, which would have the effect of raising the tax threshold and thus taking many lower income groups out of tax altogether.

Estate Duty

The Chancellor proposed the following changes:

- (a) Substantial relief for a surviving spouse, which would take the form of exemption for the first £12,500 of an estate left to a spouse, ^{in addition to} the general exemption ^{of} ~~being~~ £12,500.

The cost of this would be about £15m.-£20m. in

the first year and £30m.-£40m. in a full year, ^{over and above the cost of the new scale (see (c) below).}

- (b) Relief for charitable bequests up to a limit of £50,000 (with no limit for bequests to certain special charities such as the National Trust).
- (c) A new estate duty scale, which would in effect restore the incidence of estate duty to roughly the same levels as were introduced by Sir Stafford Cripps in 1949. This was expected to cost between £65m. and £105m. in a full year.

BUDGET - TOP SECRETStamp Duty

The Chancellor was proposing to exempt stamp duty on all transactions in houses (including small amounts of surrounding land), at a cost of £20m. in a full year.

Allowance of interest ~~as chargeable for~~^{against} tax

The Chancellor was proposing to allow all payments of interest in excess of £50 as a charge for tax. He would have preferred to make all interest ~~chargeable~~^{deductible}, but he was advised that this would require a thousand extra staff in the Inland Revenue.

Minor Changes

The Chancellor also proposed minor tax changes in relation to stock options, capital gains relief for gifts to charities, and capital gains tax in relation to unit and investment trusts.

Tax Reform

The Chancellor said that he had in mind the publication of a Green Paper on possible alternatives to estate duty, discussing in particular the possibility of an inheritance tax.

He also had in mind the possibility of announcing that a White Paper would be published later in the year, foreshadowing a major change in P.A.Y.E. and the introduction of a negative income tax. Such a reform could not now take effect in this Parliament, in view of the amount of work which would be required; but he thought that work was nearing the point where the outline of a scheme could be described for public discussion.

BUDGET - TOP SECRET

- 5 -

The Chancellor and the Prime Minister then discussed the timing of the changes proposed in the report by Sir William Armstrong and Sir William Nield in relation to the Budget. The Chancellor said that he thought that the proposals for a new development agency required a good deal of thought to get them right; and he saw certain difficulties about announcing free depreciation and the other measures in the Nield Report at the end of January or early February if there was to be a Budget in March. He would therefore see considerable merit in keeping the whole package until the Budget in March; he was ready to examine the possibility of bringing forward the date of the Budget from 21 March to 14 March.

The Prime Minister congratulated the Chancellor of the Exchequer on his proposals and intentions. He said that they and their colleagues would need to consider carefully the proposals in Sir William Armstrong and Sir William Nield's Report. He was not convinced that they were on a sufficiently large scale, given the desirability of effecting an early reduction in the level of unemployment.

REA

17 January 1972



Treasury Chambers, Great George Street, SW1P 3AG
 01-930 1234

PRIME MINISTER

Shortly before I went to Washington last week I asked Sir Douglas Allen to consider with the Budget Committee what measures of a fiscal character might be necessary or desirable in the next Budget. We have, of course, been considering these matters in a preliminary way for some time. I asked Sir Douglas to take full account of the Report of the Economic Advisers under Sir Donald MacDougall (which was sent to No. 10 before I left for Washington) and of the proposals which Sir William Armstrong's group were formulating. I have not yet seen Sir William's Report, but I know the general lines of what is being suggested and the orders of magnitude of those suggestions.

2. I have so far only had an opportunity of glancing at the Budget Committee's conclusions, but I shall be pondering them over the Christmas holiday. When I have seen the Armstrong Report, I think that it would be useful for us to have a general talk about the balance between the respective demand consequences of what he proposes and the possible taxation changes in the 1972 and 1973 Budgets. Some of these taxation changes are inevitable

/and stem



and stem from the programme of reform already announced - the new scale of the unified income tax and the new rates for corporation tax. There are also other highly desirable proposals such as an increase in the personal tax allowances, which is long overdue and costly. Inflation is continually drawing lowly-paid people into the tax net and unless the tax threshold is raised at least in line with the growth in earnings there is a danger that we shall find it very difficult successfully to implement some of our reforms in the social field - e.g., the further raising of the FIS make-up levels.

*Perhaps we could have a talk when I come to
refer on the arrangements for V.A.T.*

RB

23rd December 1971

PART two begins:-

Ch/Exh to PIR 23.12.71
~~RTA Note for the Record 17.1.72~~

PART one ends:-

Hansard 5.4.71.