

SECRET AND
PERSONAL



Prime Minister

To note. I will arrange
a discussion with the two
Chancellors.

AT 19/1

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

TAX REFORM STRATEGY

In addition to tax reduction, I believe that we should aim to make substantial progress in the field of tax reform during the life of this Parliament. I have in mind a programme of reform covering both personal and company taxation.

Personal Taxation

2. The priorities here should be:-

- (i) to increase the scope for income tax cuts by continuing the process embarked on by Geoffrey Howe in his first Budget of switching some of the burden from income tax to VAT;
- (ii) to improve incentives; and
- (iii) to remove or reduce distortions.

3. (i) above should not be pursued by increasing the 15 per cent rate of VAT still further, but by broadening the base of the tax, bringing into the VAT net some items at present zero-rated. Only half of all consumer spending is now subject to VAT. The need to have regard to the impact effect on the RPI in any one year points to the desirability of making gradual progress, starting this year. The political sensitivities are obvious, but I believe there is appreciable scope for action.

4. As to (ii) above, the priority here must be to increase personal tax thresholds. The married man's allowance has fallen

SECRET AND
PERSONAL



as a percentage of average earnings from about 60 per cent in 1950 to just over 30 per cent today. The level of income at which people in this country start to pay income tax is well below that in our major competitors. A substantial increase in the thresholds would take many people out of the tax net altogether, ease the poverty and unemployment traps, and improve incentives. We also need to tackle the unsatisfactory 'kink' in the marginal rate of total deductions (income tax plus national insurance) in the present system, which starts at 39 per cent, then drops to 30 per cent, and then rises again to 40 per cent; and to improve the tax treatment of share option schemes. When we have raised the income tax threshold to a reasonable level, we can again turn our attention to the rates of tax.

5. So far as (iii) above is concerned, the present system runs completely counter to our fundamental philosophy by encouraging the institutionalisation of savings and discouraging share ownership by the individual. The specially favourable reliefs for life assurance are the obvious example, but we shall also need to consider, when Norman Fowler's review is complete, the tax privileges of the pension funds. On the other side of the coin, I should like to get rid of the investment income surcharge.

Business taxation

6. At the present time we suffer from an excessively high level of corporation tax (52 per cent) made to some extent tolerable by an extensive and somewhat capricious system of reliefs.

7. Our long term objective should be to bring the corporation tax rate down to 30 per cent, which would remove the present distortion in the system against equity finance and in favour of loan finance. A gradual move in this direction could be financed for the most part by a correspondingly gradual reduction in the generous allowances and reliefs which at present bias investment between different types of assets and between capital and labour.



8. I believe that over the lifetime of this Parliament we should aim to abolish, in stages, the first year allowance for plant and machinery and for industrial buildings. This would leave the annual writing down allowances of 25 per cent and 4 per cent respectively to take account of depreciation. We should make corresponding changes in the less important allowances. We should also abolish stock relief, now that the high inflation which made it necessary is behind us.

9. We are pledged to abolish the National Insurance Surcharge during the lifetime of this Parliament. I am considering the right timing.

Capital taxes

10. I have already mentioned the investment income surcharge. I intend to have completed within the coming year a full review of all the other major capital taxes, starting with capital gains tax. Capital transfer tax was reviewed in great detail during the last Parliament, and many improvements were made, but I plan to take stock again this summer, as soon as the CGT review, now under way, is completed. The retention or abolition of development land tax is, given its small net yield, a straight forward matter of political judgement. Far more important, I believe, is the question of stamp duty, on which replies to Geoffrey Howe's consultative document are still coming in. We must seek the earliest opportunity to reduce the burden of this task, which is a tax on mobility and a disincentive to wider share ownership, as well as a threat to the survival of a strong central securities market in London.

Public expenditure

11. This note sets out my broad thinking on the structure of taxation, on which a great deal of work has already been done within the Treasury, particularly since the Election. But it



is worth noting that tax reform will be greatly facilitated by our success on tax reduction, since only in this way can we be sure of reducing the number of losers (and there are gainers and losers from any reform, at least in the short term) to politically tolerable levels. And it goes without saying that a reduction in the overall tax burden depends on our holding public expenditure to the figures agreed in the Survey, and thereafter continuing to exercise the most stringent control of public spending.

The 1984 Budget

12. This note outlines my proposals for the longer term. In most of these areas I hope to take the first steps in this Budget. I will consult you about that separately.

13. A copy of this minute goes to Arthur Cockfield.

A handwritten signature in black ink, appearing to be 'N.L.' with a flourish.

(N.L.)

19 January 1984