Econ Pol

Await DoE reply

MAP

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

9 January 1981

BF 20/1/81

The Rt. Hon. Michael Heseltine MP
Secretary of State for the Environment

Dear Michael

You wrote to me on 5 January about the review of the mortgage interest relief arrangements which we are planning to announce when the House comes back after the Christmas Recess. As you will now have seen the Prime Minister has agreed the text of the proposed Question and Answer.

I am sorry that it was not made clearer that the scheme the Prime Minister has agreed should be discussed with the lending institutions would not, unlike some of its predecessors, fall to be administered by your Department. When proposals of this kind have previously been considered they have, I am told, usually involved an extension of the option mortgage scheme. I do not now think that this would be a viable option. We have therefore been examining a scheme to be administered by the Revenue under which all (or most) borrowers would, as was commonly the case for other forms of interest prior to 1969, pay interest to lenders net of a deduction at the basic rate. Relief at the higher rates would continue to be given through the tax system. Clearly, however, if a scheme on these lines got off the ground we would need to consider whether the option mortgage scheme still had a role to play and it would, I am sure, be helpful if a member of your Department were to join the study team it is proposed to set up once the public announcement has been made.

As you rightly point out when schemes along these lines have been considered in the past the conclusion reached was that significant staff savings were dependent on the abolition of higher rate relief. As a result of the changes I have made in my two Budgets this problem has been largely overcome. In 1976/77 there were over 1.4 million higher rate taxpayers whereas today there are only

/about 0.7 million

about 0.7 million of which less than half a million are entitled to mortgage interest relief. We are now therefore hopeful that it will be possible to devise arrangements under which we shall be able to achieve eventual net savings of several hundred staff: there will however be a temporary need for additional staff in the period over which the present tax relief arrangements are phased out and the new ones introduced. But we do not envisage any significant staff costs falling on your Department. Indeed to the extent that the new scheme led to a drop in the demand for option mortgages there might I suppose be some small staff savings in DOE as well as the substantial staff savings in the Revenue.

I do not underestimate the difficulty of persuading the building societies and other lending institutions to go along with our plans. There will certainly be some additional costs falling on these institutions and we may, as you say, be pressed to make a financial contribution. This however is a bridge we can cross when we reach it. Computerisation has reduced some of the problems that have previously stood in the way of schemes of this kind and the new life assurance arrangements, while certainly not on all fours with the proposed new arrangements for mortgage interest, have served to pave the way for something in the lines of the proposed plan. We cannot really take the proposals any further without involving the lending institutions in the discussions and we cannot safely do this without a public announcement. A further study by officials would similarly run the risk of a lead - quite possibly a misleading one - which could damage the success of the scheme and could only delay the realisation of the projected staff savings.

As the draft Answer makes clear we are not at this stage committed to introduce a deduction of tax scheme and there will be adequate time to look at the housing and other implications of the proposal whilst the technical review is in progress. As however the proposed scheme does not involve any changes in the amount of relief provided to owner-occupiers I would be surprised if the implications for housing policy were major ones.

I am anxious that the proposed review should be announced as soon as possible and I trust that in the light of the explanations provided that you will be content for the proposed Question and Answer to go ahead.

I am copying this letter to the Prime Minister.

GEOFFREY HOWE

-9 JAN 1981

Econ Pol.

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/10228/80

Your ref:

15 January 1981

Dear Geoffrey

TAX AND HOUSING: ADMINISTRATION OF MORTGAGE INTEREST RELIEF

Thank you for your letter of 9 January.

I am reassured to learn that there is no intention of the revised scheme for the payment of tax relief being undertaken by my Department and I now accept that the staff savings which you hope to secure justify the study being made. I would, of course, be ready to associate my officials with the work of the proposed study team.

I remain of the view that there will be difficulties in convincing the lending institutions that they should accept the additional burden the scheme will involve for them. However, I do not object to a public announcement of your proposals and I have no substantive comments on the draft Answer attached to your Private Secretary's letter of 31 December.

I would, however, urge you to give the Building Societies Association some advance notice of the proposed study, a step which might prevent them from making a hasty and potentially hostile response, such as Press comment on possible implications for the mortgage rate. You will no doubt also have it in mind to tell the other lending institutions of the study at the time it is announced, although I doubt whether they would need advance warning.

I am copying this letter to the Prime Minister.

Yours ever

Michael

MICHAEL HESELTINE

Rt Hon Sir Geoffrey Howe MP

15 JAN 1981

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/19172/80

Your ref:

5 JAN 81

Dear Chancellor of the Exchequer

TAX AND HOUSING: ADMINISTRATION OF MORTGAGE INTEREST RELIEF

Thank you for sending me a copy of your minute of 28 November to the Prime Minister. I have also seen her Private Secretary's reply of 4 December to yours.

I can see the attraction of saving staff in the Inland Revenue by altering the mechanism by which tax relief is given. I understand that officials in our Departments have in the past looked closely at such a scheme and concluded that significant staff savings were critically dependent upon the abolition of higher rate relief, which is to be retained in your proposal. Indeed the study concluded that there could even be a net addition to civil service manpower. There would certainly be a very costly transition period for at least 2 years, with a net staff increase over that period. In addition, unless DOE staff had access to Revenue records safeguards to accountability would be inadequate.

Secondly, you acknowledge that there would be considerable practical administrative problems. It will be necessary to examine these thoroughly. You mention that higher rate relief would need to be administered separately, presumably by Inland Revenue. In your latest minute you do not say whether you envisage amalgamating the arrangements for standard rate relief with the existing option mortgage scheme. Your minute of 7 August, which I have only just seen, suggests however that you were then proposing that the administration of the new system should fall to my Department. Before I accepted that, I should need to know the staffing implications, and what arrangements were envisaged for policing the entitlement of mortgagors to deduct basic rate tax at source.

Thirdly, the attitude of the building societies and other lenders must be considered. The arrangements recently made for the payment of life assurance premiums net of tax are not an exact analogy. I would expect the building societies to require a lot of persuasion to adopt the suggested new arrangements. Although you visualise reimbursing the societies the net tax shortfall they would suffer, the administrative burden of the change would be inherently greater than it was for the life insurance offices: the interest component of most mortgage payments alters continually during the life of the mortgage, with consequent changes in the amount of relief.

Unless the Government were prepared to contribute to the administrative costs of the building societies and other mortgagees, I should think that they would have no alternative but to pass on their greater costs in a higher mortgage rate. And whether they would be willing to play their part on that basis - indeed whether the Government should be instrumental in pushing up mortgage costs - must be doubtful.

I conclude that we should look very hard at the implications of moving from the existing arrangements for mortgage interest tax relief to "mortgage interest at source" before making up our minds. Before any approach is made to the building societies and other lending institutions I suggest that the Treasury, the Inland Revenue and my own Department should work out in greater detail what a new system would entail, and what its administrative consequences would be, and what implications it might have for housing policy.

I am copying this letter to the Prime Minister.

Yours sincerely

For MICHAEL HESELTINE

(letter approved by the Secy of State and signed in his absence)

-5 JAN 1981

The Rt Hon Sir Geoffrey Howe QC MP

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10 DOWNING STREET

PRIME MINISTER

You agreed last week that the Chancellor could go ahead with an arranged PQ about a possible scheme for "mortgage interest relief at source".

Mr. Heseltine has, somewhat belatedly, argued that any such announcement would be premature. He believes that there are a number of obvious disadvantages to any such scheme, and that an announcement now would merely raise expectations which might not be fulfilled. I understand that he would prefer a quick study of the main issues between the Treasury, the Inland Revenue, and DOE before the Chancellor commits himself to a Parliamentary Answer. He is in discussion with the Treasury now.

MAP

M

6 January 1981