



Director General
Walter Goldsmith

INSTITUTE OF DIRECTORS

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

11 January 1983

Dear Chancellor

1983 BUDGET AND FINANCE BILL

1. I am writing to let you have the Institute's general representations for the Budget and Finance Bill 1983. Our technical representations were submitted in December, and I attach a copy for ease of reference.
2. We welcome the innovation of an autumn economic statement on the Budget of the following spring. It is helpful to bring together income and spending projections in a single document, thus emphasising the tax cost of additional government expenditure. We disagree with those who would have liked the autumn statement to take the form of a "Green Budget"; the Budget should form a coherent package, and some of the principal decisions cannot be taken until nearer the time.

The economy

3. The principal developments over the last year have been the reductions in inflation, in interest rates and in wage settlements. All are of benefit to business, and profits have begun to recover from the very low levels reached at the beginning of 1981. These results have been achieved through the Government's firmness of purpose and readiness to ignore pressure for soft options and short-term remedies.
4. We are also glad that the Government have over the last year been pursuing a more vigorous policy of correcting the structural weaknesses of the economy, notably through privatisation and the reform of industrial relations legislation. The principal cause for concern, by contrast, has been the failure (at least until recently) to control the rise in government spending and the consequent increase in the tax burden since the Budget of 1979.
5. These are the underlying ideas in our representations this year. The Government should continue to reject proposals for reflation through additional government spending and should pursue and accelerate its programme for structural reform. At the same time, the need for tax reductions is becoming increasingly urgent, especially as there is still little evidence of the economic upturn that has been predicted for so long. The tax cuts should thus be designed both to ease the process of structural change and to bring forward the upturn in economic activity; and our proposals are intended to satisfy these requirements.

116 Pall Mall
London
SW1Y 5ED
Telephone
01-839 1233
Telegrams
Boardrooms
London SW1
Telex 21614

6. We are conscious of the pressure to reduce business costs but are firmly of the view that our recommendations are at least as likely to achieve the objective of a healthier business climate, particularly for those companies which have carried out adequate restructuring over the last few years. Similarly, current low levels of profitability are best improved by cuts in taxes on profits and income which benefit business by strengthening the economy in general.

Short term and long term

7. During the 1960's and 1970's fiscal and economic policy were too often dominated by short-term considerations and lacked long-term direction. Our long-term aim for the British tax system is to turn it into what has been described in another context as a "privileged tax regime" - with low taxes on income and low or no taxes on capital, much as in the Channel Islands at present. This form of privilege is within the reach of any well-run economy. In the long term, at least, tax reduction should be extended to value added tax and excise duties.
8. The reduction of tax rates reduces the value of tax reliefs and allowances at the same time as it reduces the need for them. We should, however, oppose attempts to find the resources for tax cuts by reducing or abolishing reliefs and allowances. The resources should be found by retrenchment of government spending, through privatisation and otherwise.
9. The present Administration has a much more modest and realistic assessment than its predecessors of what governments can do to promote economic prosperity. The scope for improvement at present lies primarily in the withdrawal by government from functions and activities which impede the working of the market economy. The two principal impediments of this kind are the over-regulation of private business and the distortion of the market by taxation.
10. The removal or reduction of these impediments is the only sound long-term policy for the reduction of unemployment. Policies of job creation, currently costing some £4 billion a year for employment subsidies alone, are at best a second best. Even if they are well designed, they merely serve to correct distortions caused in other areas of Government policy. We share the wish to see unemployment reduced as quickly as possible, if necessary by unconventional means; but we should prefer measures to be adopted for this purpose which also serve the aims of longer-term policy. Whereas the Government are cautious in their approach to tax reductions but are willing to spend large sums of public money on programmes of job creation yielding little long-term benefit, we should prefer a more cautious attitude towards public spending on job creation and a willingness to experiment boldly with tax reductions which may be at least as effective as public spending in reducing unemployment and have the additional and overriding merit of being desirable in themselves.

11. In particular, the increase of self-employment is not only one of the simplest and potentially most effective ways of reducing unemployment; it is also socially and economically desirable both in the short term and in the long. The Inland Revenue, however, are pursuing the opposite policy of trying to reclassify large numbers of self-employed workers as employees. This policy is at least as likely to reduce tax revenue as to increase it; and unemployment is increased and recovery delayed by imposing on self-employed workers the status of employees, since the over-regulation of employers is itself a prime cause of unemployment.
12. More generally, tax cuts are now urgently needed not only to assist economic recovery and to improve incentives in the conventional sense but also to improve taxpayer morale. The process of adjustment from inflation to stable money has proved longer and more difficult than had been expected. The success of the Government's policy requires continuing popular support. Tax cuts, and specifically cuts in income tax, show that your Government is able to honour its undertakings, especially your commitment to reduce the basic rate of income tax to 25 per cent; and they provide the most tangible evidence that the Government's programme is working. Furthermore income tax cuts help to take the pressure off pay awards and will therefore contribute to lower inflation.

Government spending

13. We were glad to note that in 1982, for the first time since 1977, the annual review did not lead to an increase in planned expenditure for the coming year. We recognise the hard work and determination on the part of Ministers needed to achieve even this limited result, which should be the precursor of increasingly effective control over Government spending in the years to come. It was therefore disappointing that a few days before the November statement the Government criticised local authorities and nationalised industries for underspending on capital account. This departure from the usual message of economy and retrenchment is not only confusing to the local authorities and nationalised industries, and to the public, but in our view wrong in itself.
14. No less important than the distinction between current and capital spending is the distinction between capital spending that will reduce subsequent spending on current account and capital spending that will increase it. Capital spending of the latter kind is less, not more, useful than current spending with a limited time-span. Where capital spending yields a financial return, on the other hand, we should prefer it to be privatised rather than increased at the taxpayer's expense. Underspending on either kind of capital account should be more a matter for congratulation rather than criticism.

15. At the level of local, as of national, government, substantial economies are obtainable only by the elimination of functions and activities, through privatisation or otherwise; for local government this includes the reduction of its statutory obligations. Large economies are unlikely to be obtained through the reduction of overmanning and other forms of waste unless the activities concerned are privatised, because it is in the nature of public-sector ownership and management to lead to inefficiency.
16. Similarly, the solution to the problem of heavy and increasing business rates lies through the reduction of functions, not through a shift in the burden from business to domestic ratepayers. In our submission on the Green Paper "Alternatives to Domestic Rates" (Cmnd. 8449), we recommended inter alia that private-sector businesses should have a statutory right to tender for the discharge of local authority functions as agent or sub-contractor. Private businesses supplying such services should not be subject to value added tax where public bodies with which they are in competition are exempt. Value added tax in these circumstances is a good example of a tax which does more damage than it yields revenue.
17. Another major reform that is desirable for reasons of economy as well as on more general grounds is the abolition of the Greater London Council and the metropolitan county authorities.

Scope for tax cuts

18. Whatever the size of the fiscal adjustment in your next Budget, it should be used to cut taxes and not to increase Government spending. We hope that the fiscal adjustment will be substantially more than the £1 billion mentioned in your autumn statement. We explain in the Appendix our reasons for believing that tax cuts with a first year cost of £2.3 billion (giving a fiscal adjustment of £2 billion after allowance for inflation) would be fully consistent with the thrust of the medium-term financial strategy which we have so strongly and consistently supported. A reduction in tax rates is becoming increasingly urgent, both as a spur to recovery and as a fillip to taxpayer morale; we believe that it would be a false economy to cut taxes by less than the £2 billion we have recommended.

Nature of tax cuts

19. The argument above indicates that the tax cuts in the next Budget should have one or more of the following characteristics:- they should be desirable in the long term as improving the efficient working of the market economy; they should accelerate the short-term process of economic recovery; and they should serve to maintain and improve public confidence in the success of your economic policies.

20. A cut in the basic rate of income tax scores heavily by all three tests; a cut of not less than 1 penny should be made, and could be afforded, within your next Budget. Pay-As-You-Earn, as a tax on employment, is no less a tax on business costs than is the national insurance surcharge; but it has the decisive advantage of being much more visible to employees, and business gains a second time from a cut in income tax since employees are also customers.
21. A cut in the basic rate of income tax is needed not only for the sake of taxpayer morale but also for its own sake; indeed, there is no sharp distinction. The 30 per cent basic rate of income tax is the highest starting rate of income tax in Europe and is a prime cause of the poverty trap in its various forms; and the marginal tax rate for even the poorest taxpayer subject to the basic rate of income tax has risen from some 55 per cent in 1979 to 57 per cent now when account is taken not only of income tax but also of national insurance contributions, value added tax and excise duties. By contrast, national insurance contributions, including the surcharge, are near the centre of the European range. Indeed, we wonder whether the national insurance surcharge would have attracted so much attention in certain quarters if it had been integrated into the employer's contribution instead of being called by a separate name. A further cut in the national insurance surcharge is indeed desirable in the longer term (as is the privatisation of national insurance, and for similar reasons); but it should not have high priority in the near future.
22. We hope that you will not make a virtue of unnecessary austerity and reject a cut in the basic rate of income tax on the ground that it would be popular and thus an easy option in some pejorative sense. A cut in the basic rate of income tax would be popular for the same reason that it would strengthen the market economy: it would bring gross-of-tax income and net-of-tax income closer together. Similarly, we reject the argument that the next tax reductions should be aimed at business because business has been losing ground to workers and consumers in recent years: the argument is wrong because it is based on the fallacious concepts of corporatism. There is not a separate business interest that needs to be restored to some historical level of prosperity at the expense of its employees and customers. The interests of business are not competitive with those of its employees and customers but complementary and even identical. The reason why business has been depressed and profits low in recent years is not that it has been losing ground to workers and consumers but that it has been suffering from the cumulative effect of some twenty years of mismanagement by previous Governments.

23. The argument that there is some special virtue in tax cuts designed for business to the exclusion of workers and consumers is equally fallacious at the technical level. It is sometimes suggested that cuts in income tax would result in a flood of imports; but the statistical evidence indicates that business purchasers have at least as high an import propensity as have consumers. In addition a healthy consumer market forms an important volume base for British exporters and is an encouragement for foreign investors for whom a healthy market for their products is a fundamental criterion for the establishment of their manufacturing activity in Britain.
24. Again, it is sometimes suggested that cuts in business taxes (like the national insurance surcharge) have a more rapid effect on economic activity and unemployment than cuts in general taxes (like income tax) at the same revenue cost; but the evidence strongly suggests the contrary. The national insurance surcharge was cut twice in 1982 with no noticeable effect on economic activity. By contrast, when substantial cuts in mortgage rates last autumn put more money into consumers' pockets, the result was seen within weeks in the form of record Christmas sales. Income tax cuts are comparable in this respect with cuts in interest on house mortgages, and we would expect the result to show up just as rapidly in increased activity.
25. The tax cuts that are clearly superior to other tax cuts in the speed of their contribution to economic recovery are not cuts in business taxes like the national insurance surcharge. They are cuts in taxes whose yield accrues to the revenue in arrears, sometimes after several years' delay. Cuts in these taxes are exceptionally cost-effective as a means of accelerating economic recovery: the incentive effect begins as soon as the tax cut is announced, whereas the revenue incurs the corresponding cost only after a considerable interval, if ever. The same taxes are cost-effective in a separate sense, because they are levied on the most entrepreneurial and capitalist parts of a capitalist economy. A principal theme of our representations this year is the urgency of reducing or relieving these taxes and the cost-effectiveness of so doing. The main proposals to which this argument applies concern: investment income surcharge, capital transfer tax, capital gains tax, six-year limit on the carry-forward of stock relief, restrictions on the use of tax losses, £25,000 limit on borrowings eligible for tax relief on interest, stock options, development land tax.
26. For firms currently making taxable profits, the present rate of corporation tax is too high and should be reduced (corporation tax, below). For tax-exhausted firms, liberalisation of the restrictions on the use of tax losses is a more cost-effective relief than reductions in business costs (use of tax losses, below).

Income tax

27. The main direct tax allowances should be accorded the full statutory indexation for inflation in 1982, in accordance with the "conventional assumption" used in the autumn statement. Indeed, they should be increased by more than this in order to regain some of the ground lost in the Finance Act 1981; one of the strongest themes to emerge from a wide-ranging consultation of our membership both before and after your autumn statement was the importance of a substantial increase in tax thresholds this year. However, any further indexation beyond the statutory minimum should take into account the desirability of a cut in the basic rate of tax. The defects in the income tax schedule are at least as much in the rates of tax as in the points of the scale at which they first apply; and increasing the thresholds without reducing the rates preserves the excessive rate structure intact. The continuing credibility of the Government's commitment to tax reduction requires a cut in the basic rate.
28. A cut in the basic rate of income tax also has the advantages of reducing the taxation of dividends and other forms of investment income and thus of reducing the cost of equity finance. In order to achieve this result, a cut in the basic rate of income tax must be complemented by a cut in the rate of corporation tax (Corporation tax, below).
29. A cut in the basic rate of income tax should be carried through to the higher rates of tax and should also be accompanied by cuts in the investment income surcharge and in capital transfer tax. We reaffirm that for each percentage point reduction in the basic rate there should be a reduction of not less than 3 points in the investment income surcharge and 10 points in the maximum rate of capital transfer tax. However, this target for the investment income surcharge is unduly modest and we urge you to reconsider the advantages of its abolition.

Investment income surcharge

30. There is a strong case for abolishing the investment income surcharge both at technical level and more generally. The original argument for discrimination against investment income, namely that earned income is more precarious than income from investments, now works in the opposite sense: employment income enjoys much statutory protection, whereas investment income is fully exposed to the hazards of inflation and economic recession. In addition, it is widely resented that savings already fully taxed as earnings should be subject to a discriminatory surcharge as investment income. It is therefore not surprising that the surcharge is inequitable and unpopular. It has few convinced supporters, if any, and its abolition would be widely welcomed. Not the least of the advantages of its abolition is the consequent reduction in the scale of avoidance and anti-avoidance activities.

31. In Inland Revenue Statistics 1982 Table 1.5 the cost of exempting the first £5,500 of investment income from the surcharge is put at £930 million (for 1981-82). In the autumn statement the full-year cost of abolishing the surcharge is put at some £240 million (for 1983-84). This means that the tax is being levied on only about one-fifth of its theoretical base (or even less when allowance is made for the two-year difference between the figures). It is one test of a good tax that its actual yield should represent a substantial proportion of the theoretical maximum; by this test, as by others, the surcharge is deeply defective.
32. The abolition of the investment income surcharge is also a cost-effective tax reduction for the reason mentioned earlier (paragraph 24): the incentive effects and other benefits are enjoyed immediately while the corresponding costs in tax forgone are incurred only after an interval. The autumn statement indicates that the first-year cost of abolition would be only some £15 million, or well under one-tenth of the cost in a full year.

Capital transfer tax

33. Despite a number of welcome technical reforms in the Finance Acts 1980-82, the rate structure still rises to 75 per cent and is indexed for inflation only from December 1982. For a wide range of taxpayers above the new threshold, the effective burden of the tax is now much heavier than when the scale was first set in 1974. We urge that the reform of this tax should be pressed forward, both through cuts in the rates of tax and through the reliefs specified in our technical representations.
34. Capital transfer tax of any kind, and especially in anything resembling its present form, works counter to the driving force of a market economy, which is people taking their own decisions with their own money. It frustrates the natural and proper wish of taxpayers to transmit the results of business success to their heirs. It promotes the high-spending one-generation society, which shows capitalism in the least attractive light. It is also counterproductive for its intended purpose of reducing the inequality of wealth: lifetime transfers are generally from richer taxpayers to poorer, and this process of voluntary redistribution is obstructed by capital transfer tax. The tax on lifetime transfers is the least productive part of CTT (bringing in less than a tenth of the total yield); it is also the most damaging part, in the sense that it impedes redistributions made voluntarily and in the taxpayer's own time. We urge that the good work begun in the Finance Act 1981 be continued: the top rate of tax on lifetime transfers should be reduced to not more than half the rate on death and the period of cumulation should be reduced from ten years to seven.

35. Reductions in capital transfer tax are a cost-effective stimulus to recovery because the tax is collected in arrears and the benefits are enjoyed by taxpayers before the corresponding costs are incurred by the revenue (Paragraph 25). Improvements in business and agricultural reliefs are also very cheap by comparison with alternatives such as industrial and employment subsidies because of the modest sums involved (£20 million for business relief in 1981-82 and £35 million for agricultural relief). Improvements in business reliefs also form a logical complement to the array of incentives to taxpayers starting in business introduced by the present Government: if these incentives serve their purpose the businesses should grow, and capital transfer tax at anywhere near its present rate is a grave discouragement to growth above a modest level. The arguments against levying capital transfer tax on business assets are also valid, though perhaps less strong, for assets of all kinds; and we should like to see capital transfer tax progressively reduced and preferably abolished for taxpayers in general. But on this occasion we put the main emphasis on business assets: the lower rates of relief should be consolidated into the present 50 per cent rate of business relief, as we have argued in our Technical Representations and, on grounds of general policy, this new standardised rate should be increased to not less than 75 per cent and preferably to 100 per cent. For business assets at least, capital transfer tax is immensely destructive by any reasonable economic or social criterion, and this damage should be brought to an end by its abolition.

Capital gains tax

36. We warmly welcome the indexation provisions in the Finance Act 1982. Our technical representations show inter alia how these provisions should be extended in order to yield their full benefit.
37. A long-term capital gains tax has no logical justification since the case for taxing the gain becomes weaker with each additional year the asset is held. Thus, even if prices were stable, there ought to be a taper or cut-off. But under the provisions of the Finance Act 1982, pre-1982 inflationary gains are entirely excluded from relief for inflation in the past and largely excluded from relief for inflation in the future; and this will remain a serious anomaly indefinitely. As we have argued in our technical representations, the answer to the problem of pre-1982 inflationary gains is exemption for assets held for seven years or more; and this exemption should be extended to all assets and not confined to those already held in 1982.
38. The rate of capital gains tax is a survivor from a distant age and is long overdue for reduction. Reduction of the rate of capital gains tax will be unavoidable if the basic rate of income tax is reduced; but it should not be dependent on the reduction in the basic rate of

income tax; the rate of capital gains tax should be reduced to not more than 25 per cent.

39. Capital gains tax is an exceptionally cost-effective tax to reduce since the yield accrues over a period of some six years (Inland Revenue Statistics 1982, Table 4.18).
40. Quantified and unquantified reliefs from capital gains tax on individuals and trustees indicate that it is being levied on not more than some 15 per cent of the theoretical base and perhaps on as little as 10 per cent or even considerably less (Inland Revenue Statistics 1982, Tables 1.5 and 1.6); and the percentage will fall steeply as a result of the indexation provisions in the Finance Act 1982. As we have argued earlier, such a low percentage is the mark of a bad tax. For the reasons explained in 1955 by the majority of the Royal Commission on the Taxation of Profits and Income, no separate tax on capital gains is required; any boundary problems between capital gains and income should be dealt with as such.

Corporation tax

41. The rate of corporation tax is a survivor from the same distant age as the rate of capital gains tax. As the basic rate of income tax, and thus the rate of advance corporation tax on dividends, has fallen, the rate of tax on corporations as such has risen correspondingly; meanwhile the small companies rate has fallen. A rate of 52 per cent is historically and absolutely high and especially anomalous at a time when a large proportion of companies are fiscally-exhausted and not paying mainstream corporation tax or perhaps even advance corporation tax at all. There is an excessive difference between the tax treatment of companies subject to fiscal exhaustion and of those subject to the full rate of corporation tax. The rate should be reduced to not more than 50 per cent, and the case for a further reduction is strengthened if the basic rate of income tax is reduced as we have proposed.
42. It is inequitable and uneconomic that small companies relief should be clawed back by an effective marginal rate of 60 per cent on profits between £90,000 and £225,000. This is just the range over which small firms that have succeeded in establishing themselves have the possibility of expanding; and the 60 per cent marginal rate is a serious discouragement to expansion over a wide range of profits. All profits over £90,000 should be taxed at a marginal rate of no more than 52 per cent.

43. We are making a separate submission on the Green Paper on Corporation Tax (Cmnd. 8456). On the main question of the structure of corporation tax the conflicts between the different possible opinions are best reconciled if the rate of corporation tax is the same as the basic rate of income tax or only a little above; and the reduction of corporation tax to this level should be the Government's long-term aim.
44. We shall also be making a submission within the next few weeks on the new consultative document on Taxation of International Business. We are very glad that the proposals for company residence and upstream loans have been dropped. The proposals for tax havens remain gravely defective and require radical alteration.

Use of tax losses

45. Companies not currently paying mainstream corporation tax should not and need not be excluded from the scope of tax reduction. We have two proposals for this purpose, one particular and one general.
46. In particular, the six-year limitation on the carry-forward of stock relief should be abolished. The arguments are familiar to you and need not be repeated here. The case for the limitation is apparently based on the "overhang" of £30 billion of unused tax reliefs and allowances increasing at some £5 billion a year (Green Paper, paragraph 14.1); but these figures must consist largely of dead losses which could never be used to relieve current tax bills. Again, we would emphasise the cost-effectiveness of our proposal: the change could remove an anomaly which is inhibiting investment and the effect would be immediate while the corresponding cost would not be incurred by the revenue for six years or so, if ever.
47. More generally, the most economical way of helping tax-exhausted firms would be to relax the restrictions on the use of tax losses, preferably by removing these restrictions in their entirety. This measure would also be correct in principle. The fundamental defect of present restrictions (under Section 483 ICTA 1970 and elsewhere) is that they are designed to prevent precisely those alterations in business practice which are most desirable economically. We are submitting a separate paper on a market in tax losses.

Incentives for small business

48. Through the Venture Capital Scheme, the Business Start-up Scheme and the incentives for investors, the Government have introduced an imaginative and wide-ranging set of measures to assist the establishment and early growth of small businesses. They are the kind of measure best

suited to assist recovery, since they reduce or remove tax obstacles to individuals helping themselves or co-operating with each other. First-round tax avoidance has rightly not been allowed to hobble these schemes, which should eventually yield their return, not only to the economy, but even to the revenue.

49. For similar reasons, we have welcomed the enterprise allowance system under which an individual moving from unemployment to self-employment may claim £40 a week in respect of the unemployment benefit he has forfeited by this move. This system should be extended from the present five experimental locations to country-wide coverage.
50. With this background, it is all the more disappointing that the Government's response to the Institute's proposal for tax-exemption for the first £5,000 of new self-employment income has been so negative and dilatory. The Revenue's own estimate of the first-round tax loss, at some £100 million, is a modest cost which should be acceptable in view of the potential benefits for the scheme. We do not regard the scheme as wide open to abuse, because the taxpayer who seeks to benefit can do so only in so far as he submits to the disciplines of self-employment; and these disciplines are more severe than many people with a steady job imagine. Any tax advantages obtainable from self-employment are paid for by the loss of other advantages which employees often take for granted.
51. We believe that our £5,000 proposal has large potential for assisting recovery and reducing unemployment. It would be much more economical than the employment subsidies on which the Government are at present spending some £4 billion annually. More than a year has gone by with no action taken on our proposal, which could have made a substantial contribution to reducing unemployment by now. If the proposal is to make progress, it requires the sympathy and interest from Ministers which it deserves.
52. We regret that the Class 4 national insurance contribution levied on the self-employed is still in force without abatement and that the rate of contribution and the ranges of income over which they are levied have been successively increased since the present Government came to power. The self-employed obtain no benefit from these contributions, which are simply a tax on self-employment as such. For many self-employed people in a small way of business, Class 4 contributions are a large proportion of the total tax bill; they are directly in conflict with other measures designed to encourage taxpayers to start in business. Reform in this area should not await the outcome of the current review: the

removal of the fiscal impediments to self-employment should be an important part of any programme for hastening economic recovery. We therefore recommend the abolition of Class 4 national insurance contributions on incomes earned in accounting periods ending in the tax years 1983-84 and 1984-85. The levy need not be reintroduced thereafter if the results of the current review indicate that it should be abolished permanently. As with a number of our other recommendations, the incentive effects would be immediate whereas the cost would not be incurred until a year or more later. We are writing again on this matter to the Secretary of State for Health and Social Security.

Construction

53. Given the low level of activity in the construction industry and the low import content of expenditure on construction, this industry offers the prospect of a rapid return to any fiscal stimulus. We do not recommend any additional government expenditure on construction; but we urge again our long-standing proposal that capital allowances be extended to new expenditure on commercial buildings. This would not only be helpful to the economy in the short term; it would also be right in principle.
54. We also ask you to give more serious consideration to removing the present anomaly by which value added tax is charged on repair and renovation but not on new construction. This discrimination has created a most unsatisfactory boundary; and it makes no economic sense, since it constitutes an artificial incentive to pull down buildings which would be worth repairing under a neutral tax regime. The removal of value added tax on repairs and renovations would also have the advantage of being a fast-working stimulus to the construction industry.

Freeports

55. Freeports in other countries are obtaining a rapidly increasing share of world trade. The introduction of freeports, as we have been urging Ministers, would give Britain the opportunity to participate in this growth and to improve its world market share; failure to do so would leave us at an increasing competitive disadvantage. We hope that you will be able to announce at the time of your Budget statement the Government's commitment in principle to the establishment of several freeports at British sea and air ports. The benefit to Britain would in our view be greatest if they were established in areas which already have growth potential which would be increased by freeport facilities rather than in depressed "lame duck" areas.

Personal tax - Directors and others

56. I end with several points of particular interest to Directors. Unlike a number of other bodies, the Institute seeks to benefit its members primarily by strengthening the capitalist economy, and our representations are not domestic in character. The following points likewise do not concern all Directors or Directors to the exclusion of other taxpayers; but they are more important to Directors than to taxpayers in general, and they are all measures that would strengthen the economy at a modest revenue cost. They are also important inasmuch as Directors are inevitably charged with the task of leading the recovery of the economy, so that tax alleviations and incentives of interest to Directors should receive sympathetic consideration.

Mortgage interest relief

57. The continuation of the £25,000 limit on loans qualifying for mortgage interest relief is deeply unsatisfactory; it is quite wrong that relief from income tax should be available only up to this limit. On previous occasions we have drawn to your attention the injustice suffered by taxpayers who are locked into arrangements undertaken in good faith under a more liberal tax regime. No less important is the obstacle to the mobility of labour represented by such a low ceiling. There is no logical case for a ceiling at any level. Tax reliefs of this kind become less important as tax rates fall; and this is the right long-term policy.

Stock options

58. We urge you to reintroduce the legislation for share option schemes in Sections 77-78 and Schedule 12 FA 1972, so as to make the benefits from these schemes liable only to capital gains tax rather than to income tax as at present. These provisions represent tightly drawn incentives from which the taxpayer can benefit only if his company, and thus the economy, has benefited already. Similar provisions are important in the United States, where they represent a principal method of employee motivation. The 1972 legislation was rescinded for ill-judged political reasons and should be restored.

Travel expenses etc.

59. I would next emphasise the importance of the recommendations on travel expenses and Superannuation Funds Office rules in Part I of our Technical Representations. On the question of travel expenses, relief should be given to anyone with multiple employments along the lines suggested by the 1955 Royal Commission on the Taxation of Profits and Income. On the question of Superannuation Funds Office rules, the present rule preventing non-executive Directors from participating in a superannuation fund if their remuneration is not taxed under Schedule E should be abolished. The present situation is difficult or impossible to justify, and amending legislation should be introduced in the next Finance Bill.

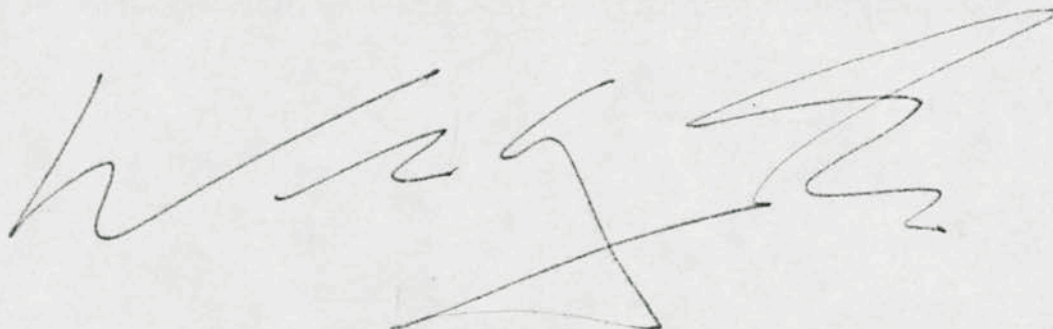
National Insurance

60. We have written to the Minister of State, Department of Health and Social Security, explaining why the proposed draft regulations on national insurance contributions on Directors' earnings are profoundly unsatisfactory and why they should be withdrawn, and fresh proposals brought forward which do not discriminate against Directors and which deal with the problems of persons in multiple employment. The National Insurance rules in conjunction with the travel expenses treatment (paragraph 59) of non-executive Directors add significantly and unfairly to the cost, particularly to smaller companies, of appointing such directors. This is surely wrong at a time when all are agreed that the use of non-executive directors should be actively encouraged.

Conclusions

61. The proposals in this letter would in our view serve to consolidate and extend the successful elements of the Government's economic policy. Nothing must be done to jeopardise the gains of the last few years in the battle with inflation. But the control of inflation is not a self-sufficient policy, economically or otherwise; it needs to be complemented by reductions of government spending and of taxation. Our recommendations offer the best way of helping both business and the private taxpayer. The main emphasis is put on increasing income tax thresholds; but it is important that tax reduction should be resumed over a broad front, and in addition to an increase in the thresholds and a cut in the basic rate of income tax we have put forward a number of proposals which would do much to strengthen the economy at little cost in tax forgone, especially in 1983-84.

Yours sincerely

A large, stylized handwritten signature in black ink, appearing to read 'Walter Goldsmith', is written across the lower half of the page.

WALTER GOLDSMITH

REVENUE IMPLICATIONS

1. The Institute has consistently supported the Medium-Term Financial Strategy for reducing monetary growth, public sector borrowing and inflation. This remains our position. In our recent canvass of membership opinion there was a strong consensus that the success already achieved in reducing inflation should not be jeopardised by a relaxation of fiscal and monetary discipline.
2. There are nevertheless a number of reasons why consistent with the broad thrust of the MTFs, the "fiscal adjustment" should in our view be somewhat higher than the £1 billion for 1983-84 mentioned in the November economic statement, if necessary at the expense of a slightly higher public sector borrowing requirement than the £8 billion mentioned in that statement.
3. First, whereas monetary policy is ahead of schedule in the control of inflation and the public sector borrowing requirement, the tax-cutting programme is far behind; indeed, the tax burden has risen substantially since 1979, both absolutely and as a proportion of national income. Tax reduction ranks as a high priority together with control of inflation.
4. Second, we are not neutral between a reduction in taxes and an increase in government spending. A fiscal adjustment of £1 billion would be excessive if it were used to increase government spending, but an adjustment of significantly more than £1 billion would be welcome if it were used to cut taxes, because of the benefit of tax cuts to the economy.
5. Third, although the public sector borrowing requirement, as the difference between two large magnitudes, is inevitably subject to a wide margin of error, it has been overestimated rather than underestimated in recent years, especially in 1981-82. If this pattern is repeated in 1983-84, the PSBR target of £8 billion will be more restrictive than it seems.
6. Fourth, the cause of this "overfunding" is underspending on the part of government authorities, whether by accident or design. Underspending should be encouraged and actively pursued, and we much regret that Ministers have followed the opposite policy, especially in statements made at the beginning of November. Governments, like households, have the opportunity to economise throughout the year and not merely at intervals of six months or so. If these opportunities were exploited instead of being wasted, the scope for tax reduction would be correspondingly increased.

7. Fifth, the indexation of personal allowances is not an economic cost from year to year because it merely restores the previous position; but it is an economic cost at the time that it is made, because it reduces taxes, and it is part of the budgetary arithmetic. Owing to the Government's success in reducing inflation, the cost of indexation will be less this year than for many years past. This is an easing of financial constraints at the time of the Budget, even though it is ignored in the "fiscal adjustment".
8. Sixth, further scope for tax reductions can be provided by accelerating the sale of assets. Sale by tender is a defence against the criticism that assets are being sold too cheap. Funds from this source are particularly suitable to underwrite reductions in taxes on capital.
9. Seventh, conventional budgetary arithmetic cannot handle the effect of incentives and other changes in relationships, which are a main purpose of the tax reductions we are proposing. This consideration is especially important for an increase in tax thresholds, a principal effect (and purpose) of which is to relieve the poverty trap in its various forms.
10. Some of the foregoing considerations cannot be quantified and, while others could be, the process would be beyond the scope of the present paper. We nevertheless believe that they are sufficiently weighty to justify increasing the 1983-84 fiscal adjustment from £1 billion to £2 billion.
11. As we have explained, an increase of this order should be possible without an increase in the PSBR. But if necessary, we should accept an increase in the 1983-84 PSBR from the £8 billion in the November economic statement to the £8½ billion in the Financial Statement and Budget Report 1982-83 as the price of securing more significant tax reductions in your next Budget, not least because the PSBR is subject to a wide margin of error.
12. We also favour exploiting the advantages obtainable from tax cuts with a low first year cost or no first year cost at all. Tax cuts of this kind have a double advantage. They yield benefits to taxpayers long before the corresponding cost is incurred by the revenue, and they impose a salutary discipline on government spending by giving ample warning of a loss of tax revenue in future years.

13. In the figures below, we put the main emphasis on the first year cost of our proposals, following the November economic statement which gives detailed figures for 1983-84 but not for later years. The additional full-year costs are added where they are known and material.
14. The figures for indexation of tax allowances and the valorisation of indirect taxes are taken from the November economic statement, except that we have abated the increase obtainable from beer and spirits, which are not buoyant sources of revenue.

COST OF TAX CHANGES 1983-84

£ Million

Indexation of income tax allowances and thresholds (6%)

Main personal allowances	835	
Basic rate limit	45	
Further higher rate thresholds	30	
Investment income surcharge threshold	-	
	<u>910</u>	
Indexation of CTT thresholds and bands	15	
Indexation of CGT exempt amounts	-	
	<u>925</u>	

Revalorisation of indirect taxes (6%)

Beer	- 83	
Wine	- 25	
Spirits	- 30	
Tobacco	-115	
Petrol	-225	
Derv	- 55	
Vehicle excise duty	<u>-107</u>	
	<u>-640</u>	
Adjustment for beer and spirits	+ 15	
	<u>-625</u>	<u>-625</u>
Net cost of indexation and revalorisation		<u><u>300</u></u>

£ Million

Institute of Directors recommendations

Further increase in main personal allowances (6½%)	900
Reduce basic rate and higher rates of income tax by 1p	905
Abolish investment income surcharge	15
Increase CTT business and agricultural reliefs to 100%	25
Reduce rates of CTT	25
Reduce corporation tax by 2 points	130
	<u>2,000</u>

Recommendations with little or no first-year cost

CGT cut rate to 25% and other reliefs	-
£5,000 of new self-employment income tax-free	-
Suspend Class 4 National Insurance contributions	-
Liberalise use of tax losses	-
Capital allowances for new commercial buildings	-
Reintroduce 1972 legislation for share options	-

TOTAL COST OF INSTITUTE RECOMMENDATIONS 2,000

Net cost of indexation and revalorisation on the assumptions in the November statement 300

TOTAL COST OF TAX CUTS 2,300

Comprising:

Increases in income tax thresholds	1,735
Other tax reductions net of revalorisation	565
	<u><u>2,300</u></u>

15. A number of these items would impose significant further costs in a full year. The most substantial of these items is income tax, with additions of ± £400 million for thresholds and £100 million for the reduction of the basic rate to 29p. The 2 point reduction in corporation tax would cost a further £120 million and the abolition of the investment income surcharge a further £225 million. The cost of the reductions in capital transfer tax is assumed to rise by £50 million. This gives a total of ± £900 million, say £1,000 million, to cover minor items. We regard an additional tax cost of this order as acceptable and indeed desirable.
16. The items listed in the table as having little or no first-year cost mostly reach their full-year cost only after a number of years. In the case of capital allowances for new expenditure on commercial buildings the eventual full year cost indicated in paragraph 15.45 of the Green Paper on Corporation Tax (Cmnd.8456) would not be reached for a very long time.

17. Two further items would have a significant first-year cost, abolition of the 60 per cent intra-marginal rate of corporation tax and abolition of value added tax on repairs. We recommend these if there is scope for tax reduction in excess of £2 billion.
18. We have not tried to cost all our technical representations: the cost is mostly unquantifiable or negligible. Where the cost is known and substantial, it is included above.

INSTITUTE OF DIRECTORS

TECHNICAL REPRESENTATIONS
FOR THE 1983 BUDGET

December 1982

PART I: INCOME TAX - DIRECTORS

TRAVEL EXPENSES

- 1.1 The expenses of travelling from home to work are not an allowable deduction from taxable income under Schedule E because they are not regarded as being incurred in the performance of the duties of the employment as required by section 189 ICTA 1970. It has long been recognised that this can be inequitable where a person has more than one place of work. Extra-statutory concession A5 allows the expenses of travelling to places of work other than the individual's main one provided that his work is all for the same employer or for 'associated' employers. However, no such relief is granted where the employers are not associated as defined for this purpose. Multiple directors are particularly caught by this because (a) it is desirable for a non-executive director to be drawn from a non-associated company, (b) the travelling distances involved may be substantial, and (c) such directors are likely to have high marginal tax rates.
- 1.2 The Royal Commission on the Taxation of Profits and Income in its Final Report (Cmnd. 9474 June 1955, paras. 238-241) expressed clearly its view that relief based on the extra-statutory concession should be extended statutorily to all those with multiple employments. The Commission discussed the matter in detail with the Revenue, and concluded that it was feasible to give relief on the following outline:-
1. The relief should extend to all persons who derive income from more than one source of earnings.
 2. It should be based on the conception that all sources of such income are, for this purpose, one source: that a main source should be selected from among the various sources to represent the normal place of employment: and that all extra expense thrown upon the taxpayer by travelling to the subsidiary sources of employment should be a deductible expense.
 3. The main source should be determined by the circumstances of the case, in particular, the relative amount of time devoted to it and the relative return from it by way of income. The taxpayer should be required to nominate his main source in the first instance: if the Inspector does not accept it, the taxpayer should have a right of appeal to the General Commissioners.
 4. The cost of travel to and from home from and to the main job would not be allowed.

- 1.3 Nothing has happened since that would invalidate the Commission's reasoning and recent developments in board structures and remuneration make it more necessary than ever to mitigate the tax problems in this area. There is unanimity in political and business quarters that the appointment of more non-executive directors to big and to small companies should be actively encouraged.
- 1.4 The days of the NED appointed to grace the notepaper for a nominal fee are gone. NEDs are expected to turn up to board meetings and to devote a significant portion of their working time to the company (typically 12-15 days for a "basic" NED and 20-24 days for a NED with special responsibilities). Their responsibilities and potential personal liabilities are increasingly onerous and there is a shortage of people of appropriate calibre able and willing to accept such appointments. It is therefore accepted that those who are prepared to do so should be properly remunerated. Whilst it is not appropriate for a NED to be paid such large fees by any one company that his independence is compromised, a director with several NED positions may now depend for a significant portion of his living on his aggregate remuneration therefrom.
- 1.5 The difficulty, however, remains of putting the NED adequately in pocket. At present the gross cost to the company of doing so is out of all proportion because of the cumulative effect of the income tax treatment of travel expenses and the National Insurance treatment of fees (each company pays full employer's contributions up to the annual limit regardless of how much other companies are contributing for the same person). The basic fee may therefore be dwarfed by the cost of monthly airflights grossed up for 60% tax and employer's NI contributions. Take the case of a small company, say in the North East or Scotland, which requires the expertise of an engineer from the Midlands or a specialist in Latin-American markets based in the South East. The company neither needs, nor could afford, such expertise full-time. Yet the proprietor may find that the gross cost to the company of appointing such a NED approaches the amount he draws from the company for working five, six or seven days a week. There is no question that the cost does deter small companies from appointing NEDs. Any unnecessary addition to that cost by the government is therefore an impediment to economic recovery.
- 1.6 We recognise the difficulties in tampering with the fiscal frontier around travel to work. However it makes no sense when at least four main government Departments and the Bank of England are encouraging the voluntary appointment of more NEDs for the tax authorities to inhibit this process by not making a change which is desirable in itself. The Institute has received more representations from its members than usual on this

subject in the past year. We strongly urge that relief be given along the lines suggested by the Royal Commission for anyone with multiple employments and would welcome the chance to discuss this in more detail.

- 1.7 We have made separate representations to the Department of Health and Social Security concerning the National Insurance aspects of NED fees, but it is if anything more urgent to deal with the travel expenses problem because of its disproportionate impact on small companies in the remoter and more depressed regions of the country.

SUPERANNUATION FUNDS OFFICE RULES

- 2.1. The SFO insists that non-executive directors cannot be in a superannuation fund if their remuneration is not taxed under Schedule E. The concession whereby professional people in particular are permitted, for ease of administration by both the Revenue and them, to include such remuneration in their profits taxed under Schedule D, Case I or II is thereby rendered nugatory. Moreover any such individual, to whom admission to an approved scheme is offered, has in effect to suffer tax on the same income twice in the year of charge and, depending on his practice year end, in the following year in some cases. This is quite unnecessary and it is urged that the SFO rule be changed.

PART II: INCOME TAX - GENERAL

INVESTMENT INCOME SURCHARGE

- 1.1 The Surcharge is obsolete and should be abolished. The differential in tax rates on earned and investment income was first introduced to reflect the fact that at that time the income from investments was relatively predictable and secure whilst income from employment was variable and insecure. If anything the opposite is now true, yet the tax on investment income is currently higher relative to that on earned income than it has ever been. Although a sufficient case for abolition can be made at the technical level we recognise that the yield is of some Budgetary significance and progress is therefore subject to Budget constraints.

TAXATION OF HUSBAND AND WIFE

- 2.1 As yet there have been no visible results of the Green Paper on this subject. Clearly there are long term issues involved which require careful consideration. However, we urge that no further delay be made in extending the arrangements for separate taxation of wife's earnings to cover investment income as well. For the reasons already given, we see no justification for taxing investment income more harshly than earned income, and there is neither moral nor economic justification for encouraging partners - especially those with children - to live in sin.

PERMANENT HEALTH INSURANCE

- 3.1 At the technical level it is wrong to disallow the premiums on such insurance when the benefits are taxable as investment income (after initial relief).
- 3.2 In terms of social policy the protection of those who fall victim to long term illness or disability, and their dependants, should be a high priority. Individuals should not be discouraged by the tax system from making their own provision against such misfortunes.

RETIREMENT ANNUITY PREMIUMS

- 4.1 Employees eligible to join approved occupational pension schemes are entitled to deduct from their pay before tax such contributions as together with any contributions made by the employer (which are deductible for corporation tax) are necessary for the scheme to fund on retirement a pension of two-thirds of final salary. As the effective limit is on the amount of the pension not of the contribution, the contributions can be increased to make good the damage done to the funding of the scheme by a higher than budgeted rate of inflation - as happened in the 1970's.

- 4.2 By contrast the self-employed and others not eligible to join such schemes are entitled to deduct from their pay before tax a certain proportion of their 'relevant income', if used to purchase a retirement annuity. For them the limit is imposed on the contributions not the pensions. The contribution limit has been so low that even with low inflation the value of the annuities purchased could not generally be expected to match the two-thirds of final salary which the employee receives; with the very high inflation prevailing for most of the 1970's, those now approaching the end of their working lives face the prospect of a derisory post-retirement income from what should be their main source of such income.
- 4.3 The principle is simple. It is only equitable that employees and the self-employed should have the opportunity to purchase equivalent retirement pensions out of pre-tax income.
- 4.4 In practice the only problem is the cost in lost tax revenue. We recognise and welcome the major improvements made by the present Government, first in raising the normal limit on contributions from 15% to 17½% and then in reducing from 65 to 50 the age from which a higher percentage applies. There is still a long way to go, but the cost of relaxing the limits further should not be exaggerated. Few of those eligible to increase their premiums would in practice have sufficient income to do so in this time of recession.
- 4.5 We therefore recommend further progress in relaxing the limits with emphasis on the over fifties who have suffered most from the inflation of the 1970's.

BUSINESS START-UP SCHEME

- 5.1 The Scheme was introduced as a temporary incentive for the three years 1981-82 to 1983-84. However the complexity of the Scheme is such that it was not until this autumn, half-way through the period, that the Institute of Chartered Accountants published its lengthy Tax Digest on the subject to help professional advisers to give proper advice on the Scheme. Professional advisers, stockbrokers and others have now made a substantial investment of time, money and effort in gaining a proper understanding of how to apply the provisions in practice and how to set up approved funds. That investment will be largely wasted if the Scheme ends in April 1984. We recommend that it be extended for a further two years.

COMPENSATION PAYMENTS

- 6.1 It is a general principle of income and capital taxation in the UK that tax is assessed on net gains or profits. This is not the case where a person incurs costs in

fighting a case for compensation before an employment tribunal or the courts. The person is assessed on the gross compensation awarded (less the statutory exemption) with no relief for the cost of legal representation which the person reasonably believed would materially improve his chances of winning the case or obtaining higher compensation. The judge in Warnett v. Jones (1980) S.T.C.131 clearly felt that this was unfair. We urge that the law be changed to permit the deduction of the costs of obtaining compensation from the amount brought into charge, if any.

STOCK OPTIONS

- 7.1 We urge that the tax treatment of stock options in the Finance Act 1972 (as amended in 1973) be restored. The present treatment discourages the remuneration of directors and senior executives in what is often the most appropriate form. The pre-tax rewards from stock options are highly geared to the company's longer term performance and can therefore, given reasonable tax treatment, be a very effective incentive for those taking the strategic decisions about the business. Savings - related schemes approved under FA 1980 are not effective for this purpose because of the numerous restrictions (in particular the low maximum contribution and the requirement that all employees can join on the same terms) which prevent such schemes being tailored to stimulate boardroom performance.

"NOTHINGS"

- 8.1 Just as no genuine business expenditure should be denied relief in the case of incorporated businesses subject to corporation tax as dealt with more fully in Part IV para 3.1, so no such expenditure should be excluded in the case of unincorporated businesses subject to income tax.

PART III: CAPITAL TAXES

GENERAL

- 1.1 Capital Transfer Tax and Capital Gains Tax continue to have substantial structural defects. The fact that curing those defects would make the taxes no longer worth the effort and cost of collection is not a good reason for not dealing with them. It brings the whole tax regime into serious disrepute when taxes intended to be levied on capital instead derive most of their yield from inflation, asymmetry and other obvious defects and inequities.

CAPITAL TRANSFER TAX

- 2.1 The following structural defects in Capital Transfer Tax should be dealt with as a matter of urgency:
 1. All business reliefs should be standardised at 50%.
 2. The tax on lifetime transfers should be half that on death at all points on the scale and should not be integrated with tax on death. We do not accept the need for either a tax on gifts or a tax on death, but if there are to be such taxes it is wrong that the tax payable on the involuntary occasion of death should be geared to the extent to which the deceased has previously voluntarily redistributed part of his wealth (redistribution being the underlying purpose of the tax).
 3. The rate schedule should be fully adjusted for inflation since 1974.
 4. The balance of the threshold exemption unused by one spouse should be available to the other.
 5. There should be no grossing up on gifts. Tax should be levied on the gift and not on the tax as well.
 6. Donors should be able to pay by instalments in the same way as donees and without interest charge except on instalments overdue.
 7. The present concessions for the payment by instalments of CTT on business assets should be extended to all assets.

TAXATION OF CAPITAL GAINS

- 3.1 The introduction of an indexation allowance for post-April 1982 inflation in the FA 1982 was a welcome but belated and partial recognition that the proper tax

base for CGT is real not inflationary gains. This was, however, coupled with a retrograde step towards taxing gains gross rather than net of losses in that the indexation allowance is not available on losses and is not allowed to turn a gain into a loss.

- 3.2 Pre-April 1982 inflation: Much the simplest remedy for the injustice of taxing pre-April 1982 inflationary gains would be to introduce a holding period after which the whole of any gain on any asset would be exempt. In previous years we have suggested a three-year taper period, but in recognition of last year's increase in the annual exemption we consider that a seven-year cut-off would not be unreasonable. Ten years would be the maximum period before exemption which could adequately remedy the effects of inflation in the 1970s.
- 3.3 The two simple changes in paragraphs 3.7 and 3.9 would be sufficient to create a rational structure with regard to future inflation. Apart from their economic advantages they could sweep away the whole concept of pooling with all the problems posed by pooling in relation to the indexation allowance. The impact on the Revenue's costs and staff numbers would therefore be beneficial, rather than as adverse as the "scare story" figures quoted by the Financial Secretary in the FA 1982 Standing Committee debate in relation to indexing losses.
- 3.4 Relief for Losses: The most serious defect with the provisions as enacted is that indexation cannot result in a loss. This violates the principle of symmetry. It is central to an equitable and efficient tax system that tax should be levied on net profits and that losses should be offsetable against profits. This applies with no less force to indexed gains. If an investor buys two security holdings for £100 and some years later (when the RPI has doubled) sells one for £250 and another for £150, he has made a nil real gain on his portfolio and should not, therefore, be taxed. Under FA 1982, he would be taxed on the £50 real gain on Security A without relief for the £50 real loss on Security B.
- 3.5 The Chancellor said "It is intolerable for people to be permanently condemned to pay tax on gains that are apparent but not real - gains that exist only on paper." It is equally intolerable to deny relief on losses which are real.
- 3.6 It may be argued that the investor could avoid this trap by investing through a unit trust or investment trust. This would be an economic distortion. Those who manage investment intermediaries should sell their services on the basis of superior investment skills rather than as a means of dealing with a tax anomaly.

The tax system should surely be neutral as between the investor who chooses his own securities and the investor who invests via investment trusts, life assurance policies or other intermediaries. There is already a slight bias (justifiable in the cause of simplicity) in favour of investment trusts and this should not be extended.

- 3.7 To deal with this anomaly it would only be necessary to repeal subsection 86(5) Finance Act 1982 and to delete the reference to it in paragraph 2(1) of Schedule 13.
- 3.8 Delayed Indexation: It is accepted that the indexation allowance should not apply to securities bought and sold within a year. The administrative cost would be excessive in relation to the tax at stake. However, FA 1982 goes further and denies indexation for the first year on securities which do qualify. This is unacceptable and amounts to a "wealth tax" of 30% of the first year's rate of inflation every time a security holding is switched. Moreover the Chancellor's declared intention was to eliminate the taxation of gains due to post-April 1982 inflation. That aim is not achieved unless the above change is made. Apart from the inequity and discouragement of investment in the first place, this will inhibit capital market activity.
- 3.9 We urge that provision be made in next year's Finance Bill to remove the words 'which is the twelfth month after that' from the definition of 'RI' in Section 87(2) Finance Act 1982. (The requirement for the minimum twelve month holding period is in Section 86(1)(b) and would not therefore be affected by this amendment).
- 3.10 The CGT proposals in FA 1982 have been widely criticised for their complexity which is causing considerable difficulties for stockbrokers, investment advisers and others who have to re-program their computers. This provision excluding the first twelve months from the indexation calculation is a major complication in respect of quoted securities where there may be frequent changes in a particular holding through transactions in the market, rights issues, takeovers, etc. Each addition has to be excluded for a year when calculating the indexation allowance. The changes proposed would greatly simplify the calculation and would better achieve the Chancellor's aim.
- 3.11 Annual Exemption - Companies: In his 1982 Budget Statement, the Chancellor said -

"Because we have not found it possible to extend the new scheme (of indexation for the capital gains tax) to cover past gains, I propose also that the exempt slice should be increased to £5,000".

Just as, again to quote the Chancellor -

"It is intolerable for people to be permanently taxed on gains that are apparent but not real,"

so it is equally intolerable for companies so to be taxed. If indexation is not to apply from a date earlier than 5th April 1982 (1st April in the case of companies), then companies should surely be given the same, or an equivalent, measure of exemption as individuals to enable them to mitigate the effect of inflation gains on assets acquired in the past.

- 3.12 Annual Exemption - Business Assets: Holdings of quoted investments are capable of being realised in parcels year by year to utilise the annual exemption. This is not so easy for business assets and family companies. We suggest therefore that any unused annual exemptions for 1982/83 onwards should be allowed to be carried forward for relief on the disposals of such assets held throughout the years in question.
- 3.13 Alternatively a similar relief could be given by permitting taxpayers to elect to make a deemed disposal and immediate re-acquisition of an asset on a certain date at its then value. This could be particularly helpful for business assets where there is no market in which actual disposals and re-acquisitions can be made.
- 3.14 Carry-back of Losses and Group Relief: The bias in favour of the Revenue would be greatly mitigated if, as we urge, losses could be carried back and set against the taxpayer's gains in the two previous years and, in the case of companies, surrendered to other companies in the same group. The availability of group relief would save the unnecessary costs incurred by groups in transferring assets between group companies solely for taxation reasons prior to disposal to a third party.
- 3.15 Section 151, CGTA 1979: The effect of this anti-avoidance provision (formerly paragraph 16, Schedule 7, Finance Act 1965) is to penalise severely innocent transactions in many cases. We have suggested before that the section would achieve its object without such penal side effects if it were amended by deleting the words in the first line "from one or more persons" and substituting for them the words "directly or indirectly from a person".

DEVELOPMENT LAND TAX

- 4.1 The yield of this tax is derisory in relation to the heavy compliance and collection costs and the tax is a significant disincentive. Failing abolition we would draw attention again to the Chancellor's 1981 Budget speech in which he presented what is now section 133 FA 1981 as one of three changes intended to benefit the

construction industry. That purpose (which is just as urgent now) was then partly frustrated in the drafting of the section: the size of extension which is exempt was increased from one tenth to one third in respect of extensions where the existing building is retained (paragraph 5(1)(a) Schedule 4 DLTA 1976) but not in respect of extensions made when the existing building is rebuilt (paragraph 5(1)(b)). The latter situation surely generates more work for the construction industry than the former. Moreover, there is no sense in encouraging industry to tack on extensions to buildings which may well be outdated or otherwise unsuited to current needs when they could take the opportunity to rebuild a larger, more modern and efficient building from scratch. We therefore urge that sub-section (1) be extended to cover paragraph 5(1)(b).

PART IV: CORPORATION TAX

GREEN PAPER ON CORPORATION TAX

- 1.1 The Green Paper has been used as an excuse to delay changes which were already urgent in March 1980 when the Chancellor first announced that the Paper would be forthcoming. It is already apparent that there is no consensus, as there would need to be, for major restructuring of Corporation Tax. We therefore urge that there be no further delay in making a start on the following changes which are both urgent and have wide support in the business community.

SMALL COMPANY RATE

- 2.1 The high marginal rates of tax on the intermediate band of profits should be avoided by making the "small company" rate on the first band of profits available to all companies. The cost would be modest, while a major deterrent to the expansion of small companies would be removed.

3.1 "NOTHING"

No expenditure incurred bona fide for the purposes of a business should be excluded from appropriate tax relief. Items at present excluded include:

- expenditure on abortive capital projects
- incidental costs of raising equity finance
- discounts and other expenses on acceptance credits
- post-trading expenditure

and, most significant of all,

- expenditure on commercial buildings.

- 3.2 In the latter case we accept that for reasons of cost it may be necessary to confine relief initially to new expenditure on such buildings.

LOSSES ON FOREIGN CURRENCY BORROWING

- 4.1 The Government has persistently refused to consider any relief to tax for the losses incurred by a business on the repayment of loans in a foreign currency. At the same time it taxes exchange gains arising from investment of the proceeds by the borrower. This is out of line with normal practice in developed countries in those cases where such losses arise from transactions forming part of the normal business activities of borrowers.

- 4.2 The Government has rejected representations year after year on this issue and has claimed that the amendments suggested to them would carry a heavy budgetary cost. But it is well known that no serious attempt has been made to discover this cost, nor to find out the span of years over which it would be spread. It is likely that the cost now would be less than a few years ago.
- 4.3 We do not accept that the loss falling upon a taxpayer from a loan repayment falling at some time in the future can be called "retrospective". However, with a view to meeting objections based on the "retrospection" argument, we suggest that a taxpayer should in future be able to elect that:-
- a. Exchange profits and losses arising from the repayment of foreign currency borrowing should be taxable or allowable to the extent that they arise from currency fluctuations which have taken place after a date to be determined.
 - b. When a taxpayer repays a loan and can show that a loss has arisen on the repayment from currency fluctuations occurring before the determined date, that loss may be deducted from any profit arising under the terms of (a) in determining the amount of that profit.
- 4.4 The present rules are the product of many years of neglect which cannot be divorced from the fact that, for the past decade, they have operated mainly in favour of the Revenue. The amendments we propose would increase symmetry and fairness within the tax system in a field where they are noticeably absent.

CHANGES OF OWNERSHIP - SECTIONS 483 ICTA 1970 AND 101, FA 1972

- 5.1 These anti-avoidance sections disallow the carry forward of losses and unrelieved ACT where there has been a change in ownership of the company within three years of a major change in the nature or conduct of its trade. The criteria for what constitutes such a change are unnecessarily wide, including major changes in the type of property dealt in, services supplied, customers, outlets or markets, any one of which is sufficient to trigger the provision even though it may have happened for reasons unconnected with the change of ownership (or indeed before the ownership change was contemplated).
- 5.2 This is particularly causing problems in the present economic climate since
- (a) manufacturing companies frequently are having to make alternative arrangements for the marketing/distribution/retailing of their products following the closure of their previous distributors/outlets,

- (b) many companies faced with the collapse of UK domestic demand have survived only by turning to export markets,
- (c) the normal commercial process of rationalising existing parts of the business while developing new products and markets has been greatly accelerated so that changes are being made which would be acceptable under the present criteria if phased over many years but may constitute a "major" change if concentrated in a shorter period.
- 5.3 Sections 483 ICTA 1970 and 101, FA 1972 would be less of an inhibition on the changes which companies must make to survive and remain competitive, and would still fulfil their anti-avoidance role effectively, if amended as follows: a company's losses and unrelieved ACT should not be forfeit in circumstances where the change(s) in products, markets etc would not have been treated as a cessation of the trade if there had been no change of ownership. Preferably this should be dealt with by amendment to the legislation, but failing that we urge the Revenue to adopt this approach in practice and confirm that they have done so by issuing an extra-statutory concession or statement of practice.

RELIEF FOR ACT, DOUBLE TAXATION AND LOSSES

- 6.1 Tax exhaustion and double taxation of overseas income have become serious problems in recent years because of the unnecessary restrictions on the utilisation of reliefs to which companies are entitled. ACT for many companies has become a tax in its own right because of the restrictions on set-off. We urge that the present rules be liberalised to allow
- set-off of ACT against mainstream tax without restriction
 - surrender of brought forward as well as current ACT to subsidiaries
 - set-off of ACT against next mainstream payment after the date of distribution
 - set-off of ACT against the tax on chargeable gains
 - set-off of double taxation relief against ACT to the extent that distributions are made out of foreign source income
 - carry forward of unused double taxation relief
- 6.2 In addition to the above we consider that carry-back provisions and group relief for capital losses should be available (see Part III para 3.14) and the consortium relief rules relaxed (see next paragraph).

CONSORTIUM RELIEF

- 7.1 At present it is not possible for a company in respect of the same year to claim both group relief under subsection (i) and consortium relief under subsection (ii) of section 258 ICTA 1970 by virtue of section 263. There would appear to be no reason for this restriction applying in bona fide cases where losses cannot be immediately relieved in other ways, other than that it would involve some difficult drafting to confine it to bona fide cases. This restriction has caused difficulty in actual cases, and we urge that it be removed.

STOCK RELIEF

- 8.1 We remain totally opposed to the six-year limit on the carry forward of stock relief. Reliefs to which a taxpayer has become entitled in respect of economic costs actually incurred should not arbitrarily be removed in this way, especially since the reason for the taxpayer being unable to utilise the relief sooner may well be the unnecessary restrictions referred to in paragraph 6.1 above. The six year restriction should be abolished so that companies can plan ahead without having to worry about taking steps to avoid losing relief.

REPURCHASE OF OWN SHARES

- 9.1 Relief under the FA 1982 provisions is not available in the case of non-resident shareholders. We can see no reason to restrict relief in this way, given that there is the prior clearance procedure, if the company can show that not make the repurchase would adversely affect the company. There must be many cases where a foreign distributor or agent has been permitted to participate in the UK company's equity and their ways have subsequently parted.

PART V: INTEREST RATES AND APPEALS

INTEREST RATES

- 1.1 The system of charging interest on late payments of tax and granting repayment supplement on late repayments of tax is heavily biased to the disadvantage of the taxpayer; section 69 FA 1982 increased the bias further. If, in addition to the lack of symmetry in the rules and the non-deductibility of such interest, the rate of interest is well above market rates, then it becomes a substantial tax in its own right which it was never intended to be. Whilst an element of penalty may be necessary to encourage the taxpayer to settle his tax affairs promptly, the taxpayer should not be unduly penalised for the many tax delays that are often the inevitable consequence of the complexity of tax law and the seasonal work burden on accountants; such delays are in no sense the fault of the taxpayer.
- 1.2 We recognise the administrative arguments for keeping changes in the interest rates on late payments and repayments to a minimum (though we note that interest rates on certificates of tax deposit have been altered several times a month in recent months); but the recent reduction in such rates was by any criterion overdue and was only sufficient to recognise the fall in market rates to that date. We urge that a further reduction be made as soon as market rates fall again. The recession combined with positive real market rates makes any delay particularly damaging at present. Moreover, a further reduction would be an indication that the Government believes its forecasts that inflation and interest rates will be lower in 1983 and thereafter.
- 1.3 Similar considerations apply to the 'official rate' which determines whether, and if so the extent to which, an employee receives a taxable benefit in relation to the interest on a staff loan.

COSTS OF APPEALS

- 2.1 If a taxpayer has won at any stage of the appeal procedure, from the General Commissioners up to the Court of Appeal, and the Revenue wish to appeal to the next higher tribunal, the Revenue should bear all the costs of that next stage only. We recognise that there is some concern lest taxpayers who indulge in ingenious and artificial schemes of tax avoidance might benefit from such a provision. We are strongly of the opinion that this factor is far outweighed by the injustice which the present rules produce in cases (as do occur) of small amounts of tax and individuals, who are by no means wealthy, where the Revenue's insistence on taking an appeal to the High Court or higher on a technical point can mean that the taxpayer will lose more than the tax at issue in unrecoverable costs, even if he wins.