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10 DOWNING STREET

From the Private Secretary

28 November 1984

TAXATION AND PROVISIONS

The Prime Minister has seen your letter to me of 26 November. She has noted that the banks do not favour an extension of tax relief to any part of their general provisions. She has noted, however, that the banks are examining with Inland Revenue the possibility of considering the banks' taxation computations in stages.

I am copying this letter to John Bartlett (Governor of the Bank of England's office).

(Andrew Turnbull)

David Peretz, Esq.,
HM Treasury

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7.10 International Debt file

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Prime Minister
To note outcome. AT 26/11

CE/SO.

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

26 November 1984

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

Dear Andrew

TAXATION AND PROVISIONS

The Prime Minister may recall that, in June, the Governor suggested to her and the Chancellor a possible method of encouraging the banks to increase the level of their provisioning against bad and doubtful sovereign debt. He floated the idea of perhaps giving a measure of tax relief to banks' general provisions against sovereign debt owed by a "basket" of countries ("basket provisions"). At present, relief is confined to specific provisions against "bad debts proved to be such, and doubtful debts to the extent that they are respectively estimated to be bad".

Officials from the Treasury, Inland Revenue and Bank of England have looked into this. This letter reports their conclusions, with which the Chancellor and Governor concur.

The Bank of England have sought the views of the clearing banks as to whether additional tax relief on their provisions would be likely to result in increased provisioning overall. The banks took the view that they would not welcome an extension of tax relief to any part of their general provisions. They gave two reasons: first, under the Bank of England's supervisory arrangements, provisions against which tax relief has been granted are not allowed to count as part of the banks' capital base for prudential purposes; and secondly, the banks think it undesirable that provisioning policy should be influenced by considerations of tax planning, which, in the banks' view, might be implied if changes were made to the tax regime applied to provisions.

One suggestion has arisen from these discussions which the Inland Revenue are examining with the banks. This is the possibility that the Revenue might agree to consider the banks' taxation computations in stages, so that they could be given greater certainty at an earlier stage, as to whether or not they would obtain tax relief on their specific provisions. It would mean, however, that the banks themselves would have to supply some information earlier than at present. They do not file their full taxation computations until some 18 months after the end of their financial year, so that they do not know for some considerable time whether or not tax relief will be granted on provisions.

We will, of course, continue to keep under review the level of banks' provisions against bad and doubtful sovereign debt, and watch carefully for any problems which might arise.

I am copying this letter to John Bartlett (Bank of England).

Yours ever
David

D L C PERETZ
Principal Private Secretary