

Economic Reconstruction Group

Minutes of the meeting held on 23rd June 1977
at the House of Commons

Present: Sir Geoffrey Howe (in the Chair)
Sir Keith Joseph
Sir Ian Gilmour
Mr David Howell
Mr Peter Hordern
Mr John Nott
Mr Peter Rees
Mr Adam Ridley
Miss Anne Bulloch } Secretaries
Mr Tim Boswell
Mr Peter Cropper

Apologies: Mr James Prior
Mr John Biffen
Mrs Sally Oppenheim
Mr Brian Griffiths,
Sir Leonard Neal
Mr Charles Bell

Capital Taxation

The Chairman thanked Mr Hordern, Mr Boswell and Mr Cropper for all the work that had gone into the two papers to be discussed (PG/10/77/35 and PG/10/77/36). We were committed to producing a green paper on capital taxation. Mr Sewell would draft this, and we hoped to publish before the Autumn. This might not, however, prove possible. The main themes would be, first, the general argument against excessive taxation of capital; second, an account of the damage such taxation caused; and third the case for spreading the ownership of wealth. There was a shortage of anecdotal evidence of the effects of CTT and he asked that any examples that Members heard of should be sent to Mr Cropper. The Chairman would ask the Law Society and the accountancy bodies whether they could provide material.

In forming our policy we were starting from a position in which there were already four taxes on capital in this country. We should aim to bring our structure more into line in form and impact with that in other countries, while at the same time creating a durable framework which would not invite a future Labour Government to introduce a wealth tax.

Policy points on CTT

The points for decision set out in PG/10/77/35 were then discussed.

6 (i) Donee or donor basis: the Tax Policy Group's view was that, for simplicity and in order to avoid a structural upheaval, we should stick to the present donor basis. Donee-based CTT involved considerable administrative problems, especially in relation to trusts. It could, however, be used as a smokescreen for substantial reductions in the rate of tax. We should indicate our preference for the donor basis in the green paper, without making a final decision.

(ii) Cumulation, lifetime or shorter period: Cumulation over one year, instead of lifetime, had been proposed. This would reduce the damage caused to small businesses, would encourage wider distribution of assets, and would increase revenue from the tax by encouraging earlier distribution. It would also bring us more closely into line with other countries where cumulation was usually over a short period. In Italy there was no cumulation, but lifetime cumulation applied

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The combined effect of 1-year cumulation and lower rate for lifetime transfers would, however, make us vulnerable to attack, and invite reversal by a future Labour Government.

An alternative might be a uniform low rate of tax - perhaps 10 per cent - on all transfers below a certain level with no cumulation, but with a substantially higher rate for large transfers. This would, however, mean a high marginal rate of tax at the threshold.

The political choice lay between lower rates of tax, consanguinity relief, and other reliefs carried over from estate duty, and cumulation or higher rates of tax with no cumulation. It was a matter of judgement which formula would prove less provocative. On the technical side, non-accumulation was easier to implement than consanguinity relief. It would, however, lay us open to the charge that it would be possible to transfer very large assets tax free over a lifetime.

We should test opinion by suggesting reduction (not abolition) of cumulation in the green paper, without entering into any firm commitment to it at present.

(iii) Same rates for lifetime transfers and at death? We should retain lower rates on lifetime transfers. Early distribution was to be encouraged, especially since people now lived longer.

(iv) Consanguinity relief: The policy Group did not favour this, except in so far as it made it easier to reduce the rates of tax. For farms and small businesses it was the most effective form of relief, although open to the objection that it would benefit an incompetent son rather than a competent non-relative. It could be justified on grounds of comparability with other countries. It might, however, be unnecessary if the rates of tax were low. We should propose it in the green paper as an option.

(v) Rates: It was agreed that rates both on death and inter vivos should be reduced.

(vi) Grossing up: The present system was incomprehensible to most people. Ending it would be an opaque method of cutting rates of tax. The Group had preferred reduced rates and non-cumulation. This view was supported.

(vii) Indexation of bands

This would probably be necessary. The problems of changing the rates every year were formidable.

(viii) Periodic charge on trusts Conservative lawyers had recommended changing the rates of tax. It was arguable that if assets were taxed when put into trust, and again when taken out there was no case for a periodic charge. There was a precedent for its abolition: the Labour Government had never sought to reverse our abolition of their periodic charge of CGT. It had been mentioned in Sir Geoffrey Howe's letter to the Chancellor in 1975. We should propose reducing the rate of tax, withholding consanguinity relief (if introduced) on transfers into trusts; and lengthening the period from 10 to 15, or possibly 30, years.

(ix) Special treatment for productive and other assets: Special treatment was needed for forests: no other asset took 50 years to mature.

In general, lower rates of tax, both CTF and income tax, were preferable to special reliefs. Maintenance funds might not be needed if income tax rates were lower. Special categories could be unfair to the owners of a non-museumable heritage asset. We should keep open a number of options in this area.

/ . . . (x) Employee trusts

(x) Employee Trusts: It was agreed that transfers into these should be exempt from both CTT and CGT.

TAXES

CGT the recommendations for reducing the rate: elimination of overlap with CTT, and tapering over a period of years, were agreed. It was, however, recognised that these were interim reforms only; in the long term more sophisticated changes were need to deal with the effects of inflation.

Stamp duty abolition was desirable and would increase foreign business on the Stock Exchange, the administrative cost in the private sector was very high. But abolition would be provocative, and should have fairly low priority compared to other proposals. Other EEC countries had similar taxes, and we might need to keep in line with them.

Investment income surcharge: abolition was strongly favoured, and might be no more vulnerable to attack than reduction of rates. We protect our position by emphasising the case for relieving small businesses and risk takers, and by retaining the tax with a high threshold. The green paper should argue the case for abolition strongly in the case of IIS, less strongly for stamp duty.

The meeting closed at 11.20 a.m.

AB/LSA

29th June 1977

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