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Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

6 May 1987

Robin Young Esq
Private Secretary to the
Secretary of State for the Environment

NBPM.

Dear Robin

LOCAL AUTHORITY LEASEBACK DEALS

Thank you for your letter of 23 April about the article in the Sunday Times for 19 April on the Revenue's investigation of some of these deals. You asked for further information.

The Revenue's interest is confined to ensuring that the tax rules are correctly applied. They have to satisfy themselves that any UK profits are properly taxed or that any tax reliefs claimed are properly due. It is important that their investigation should not be seen or represented as an attack on the deals themselves, and it would be most unfortunate if local authorities were given any grounds for thinking that extraneous considerations had influenced the Inland Revenue's approach. As has been made clear in contacts between officials in the Inland Revenue and in your Department, the enquiries referred to go back much further than the current round of activity by local authorities that has led to the Sunday Times stories and stem from the Revenue's statutory responsibilities for the care and management of the tax system.

I understand that enquiries are continuing in individual cases involving the leasing of fixtures by on-shore and off-shore lessors. Copies of the circular letters sent to local authorities were sent to your FLC division. The response has been good but it is still too early to say in how many cases extra tax will be collected as a result of these initiatives.

You also asked again about the possibility of the Bank of England putting pressure on banks to deter them from entering into these transactions. The Chancellor has asked Sir Peter Middleton to chair a meeting with the Bank and with officials from your Department to discuss the issue further. It it seemed helpful, the Chancellor would be ready to hold a meeting after that with your Secretary of State and the Governor.

I am copying this letter to David Norgrove (10 Downing Street).

Yours
Alex

A C S ALLAN
Principal Private Secretary

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SECRETARY OF STATE FOR EDUCATION AND SCIENCE

ELIZABETH HOUSE
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01-934 9000

The Rt Hon Viscount Whitelaw CH MC
Lord President of the Council
Privy Council Office
68 Whitehall
LONDON SW1

NBPM

29 April 1987

Dear Willie

WILL REQUEST IF REQUIRED

Nick Ridley sent me a copy of his 13 March letter to you about the use of spurious disposal and lease-back arrangements as a means of creative accounting. I support his view that we should do what we can to stop this loop-hole.

I am concerned in particular for the assets of the polytechnics and those colleges which, in accordance with the policies set out in the White Paper "Higher Education - Meeting the Challenge" (Cm 114) will be taken out of local authority hands and incorporated as self-standing institutions. Our policy is that, as these assets will continue to form part of the national provision for higher education, the local authorities should not be compensated for their loss of ownership. For the time being I would expect authorities to devote their energies to opposing the principle of the transfer. But if we are re-elected with a mandate to carry through the policies of Cm 114, some less responsible Councils will consider devices of the kind Nick Ridley described in relation to their higher education assets.

I would aim to restrict the scope for that by providing that any disposal, after the date the Bill is first published, of land or other assets held or subsisting wholly or mainly for the purpose of providing advanced further education in the relevant institutions shall be void. That should put a stop to any negotiations for sale and lease-back or, indeed, for charges over such assets. There is of course the possibility that a council might try to complete a deal with a finance house in the interval before publication of the Bill. If I were informed that such a deal were in the offing I should need to consider the possibility of issuing a statement to the effect that disposals from the date of the statement would be void and include the necessary provision within the Bill. In the meantime John MacGregor's contacts with the City through the Bank of England are potentially very helpful.

I am copying this letter to the members of MISC 109 and of E(LA), and to Sir Robert Armstrong.

Kenneth

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SECRETARY OF STATE FOR THE ENVIRONMENT

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My ref:

Your ref:

Alex Allan Esq
Private Secretary to
The Rt Hon Nigel Lawson MP
HM Treasury
Parliament Street
LONDON
SW1

23 April 1987

NBPR.

Dear Alex,

LOCAL AUTHORITY LEASEBACK DEALS

My Secretary of State saw the attached article in the Sunday Times over the weekend, and has asked me to draw it to your attention, in case the Chancellor did not see it.

We are naturally interested in this further avenue of attack on these deals, and my Secretary of State would be grateful for the Chancellor's assessment of the likelihood of success. He also asks how you are getting on with the possibility which we have discussed before, of putting pressure via the Bank of England on banks to deter them from entering into these undesirable transactions.

I should be grateful if you could let me know the Chancellor's views on this. I am copying this letter to David Norgrove at No.10 and Jill Rutter in the Chief Secretary's office.

Yours,

Robin.

R U YOUNG
Private Secretary

SUNDAY TIMES

Town halls face tax probe over £5bn loan deals

by Maurice Chittenden and Margaret Park

THE Inland Revenue is investigating the leasing deals left-wing councils have struck with foreign banks to keep their town hall budgets afloat.

A leading tax expert has told The Sunday Times that although there is nothing illegal about the deals, the Treasury may unwittingly be helping to finance the loans if it allows banks to claim capital allowances on their "purchases" against the corporation tax due on their profits in this country.

The tax probe was confirmed yesterday after last week's revelations in The Sunday Times that local authorities using creative accountancy have built up a financial burden totalling £5 billion.

The councils are leasing property and furniture to banks, many of them Japanese and French, for 20 years in return for lump sums which they invest. The councils lease back the assets, but do not start paying rent for several years.

In the meantime, they use the interest from their investment to finance expanding services. Some councils have admitted they hope a future Labour government will bail them out before the repayments become due.

The banks have not been put off by Labour's dismal showing in opinion polls, the Audit Commission's warning that some London boroughs are heading for bankruptcy, or threats by some hard-left councillors to "do a Cuba" and refuse to pay the debts.

The lenders believe no government, Labour or Conservative, would allow a local authority to go bankrupt.

Exposed — the town halls in hock for £5bn

From last week's Sunday Times

Local authorities are exempt from paying tax. But the revenue is interested in the capital allowances the banks are claiming on the theoretical ownership of schools, office furniture and library books leased to them. These tax "credits" could total hundreds of millions of pounds.

The capital allowance could be as much as 25% on the £125 a French bank has "paid" for each of the 2,800 parking meters put in hock by Camden council in north London. In the case of assets with a much longer life, such as the town halls which Islington and Brent councils in London want to "remortgage," it might be only 4%.

Colin Mudd, a director of Combined Lease Finance, said the tax benefit was one reason banks could offer councils competitive terms.

"The Inland Revenue is, in a sense, subsidising the funds raised by this means," he said. "In effect, it's a hidden payout by the government which should be added to the public-sector borrowing requirement."

Many of the councils will have to start repaying the money in 1989. The annual repayment figure for the next 20 years will be about £125m and threaten council budgets.

Islington council has just leased its town hall and other buildings to Japanese banks to raise £150m. The council will get £42m interest over the next three years. But after 1990 the annual interest of £15m will be outweighed by the £27.2m a year due in rents. The difference equals half the council's housing programme or a third of its spending on social services.

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