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

1 June 1984

Andrew Turnbull Esq
10 Downing Street
LONDON
SW1

Dear Andrew,

US PROPOSALS TO LIMIT TAX BENEFITS ON COMPANY CARS

You sent David Peretz a copy of your letter of 24 May to Ruth Thompson at the Department of Trade and Industry.

I understand that the Secretary of State's Office will be letting you have information about the background to this issue and advice on how the Prime Minister might handle the matter in relation to President Reagan. We endorse any recommendation that the Prime Minister should not send a formal message to President Reagan but that, if she feels unable to raise the matter orally with the President, it should be brought to the attention of the White House staff.

I am attaching a note which outlines the present UK and American systems for taxing company cars and describes the proposals being put forward by Congress. The note brings out the fact that the American proposals would introduce into their system the sort of restrictions which are already found in our own. This is an added reason for the Prime Minister taking a relatively low-key approach.

I am copying this letter to Ruth Thompson (DTI) and Peter Ricketts (FCO).

Yours ever
Judith

MISS J C SIMPSON
Private Secretary

TAXATION OF BUSINESS CARS : DRAFT US LEGISLATION

Present US treatment of business cars

1. An American taxpayer acquiring a car for business use is entitled to the following tax deductions:

i. an investment tax credit (ie an investment incentive)

ii. annual depreciation allowances which write off the cost of the vehicle over 3 years

iii. relief for normal operating and maintenance costs.

2. The investment credit is 6 per cent of cost. If this is taken in full, the depreciation allowances are given on 97 per cent of the cost. But the taxpayer may elect a reduced investment credit of 4 per cent, in which case the depreciation allowances are given on the full 100 per cent of cost.

American proposals

3. In April, the Senate passed a Tax Bill containing a provision limiting the investment tax credit and the depreciation allowances to the first $15,000 of the vehicle's cost. The Bill also contained a provision under which relief is available only for cars (and boats and aircraft etc) which are used at least 90 per cent for business purposes.

4. The House of Representatives had earlier passed a Bill which would impose a similar limit, butof $21,000.

5. The proposals are said to derive partly from a wish to raise more revenue ($500 million over the next 3 years has been mentioned) and partly from a Democratic party objective of restricting the advantages of the better off.

6. The next stage in the legislative process is a House/Senate conference to produce a compromise version. This is presumably the Conference Committee referred to in paragraph 2 of the telex message annexed to Mr Plastow's letter.

UK treatment of business cars

7. In the UK, our capital allowances are the equivalent of their investment tax credits and depreciation allowances.

8. Even before the recent Budget, no first year capital allowances (ie investment incentive) were normally given on ordinary business cars. Only writing down allowances at 25 per cent of the reducing balance can be claimed. This applies to all used cars - at the bottom of the price range as well as the top.

9. We do, however, impose a limit on the amount of the capital allowances which can be given in any one year. In effect, annual allowances are not available in respect of the excess of cost over £8,000. An upper limit has existed since 1961. So we do discriminate against more expensive vehicles.

10. Moreover, if a car is blatently excessive in relation to its alleged use (eg a Bentley for a farm,) the Revenue can seek to limit still further the allowances, in accordance with normal tax principles, by arguing that part of the cost was a reflection of personal rather than business choice.

11. Where a car is used by a self-employed person for his personal transport as well as for business, a restriction in the allowances is normally made to reflect the non-business mileage.

12. The personal "benefit" that employees and directors earning £8,500 a year or more receive from the private use of cars provided by their employers or companies is taxable in their hands as part of used income.

Treatment elsewhere in Europe

13. We have no immediate knowledge of how Germany treats business cars for depreciation purposes, but in France only the first 3,500 Francs (about £3,000) qualifies for relief.

Assessment

14. On the taxation of the private benefit accruing to an employee from his use of a car provided by his employer, we and the Americans appear to take very much the same approach.

15. But the treatment of the costs of the car in the business accounts is rather different. The present US system of investment tax credits

and depreciation allowances is a lot more generous than ours in its treatment of business cars. There appears to be no limit to the deductions in respect of expensive cars. Nor does there appear to be any restriction to take account of either the element of personal choice or private mileage.

16. The current American proposals may have been inspired in part by an underlying element of protectionism - imported cars will be the most affected. But they appear to be of general application, and are moving in the direction of our own system - reflecting the view that expenditure on a luxury car reflects personal preference rather than business needs and that it is therefore appropriate to limit the tax relief available for the cost of such a vehicle. It is said that, of the 840,000 cars which would be affected if there were an upper limit of $15,000, only a few are US-built, and of the rest over 200,000 are German.

17. The UK motor industry has campaigned for a long time for a lifting of the restrictions here on relief. Whatever view Ministers might take on that issue in future years, the fact is that at the present time the UK is not in a position to argue against the American proposals, unless somehow they can be shown to discriminate directly against imported cars.

Inland Revenue
May 1984