



VSC

10 DOWNING STREET

From the Private Secretary

28 June 1984

Thank you for sending the aide memoire setting out the position on the tax reform measures currently before Congress as they relate to imported cars.

I will pass this to other Government departments for further consideration.

ANDREW TURNBULL

Mr. Timothy E. Deal



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10 DOWNING STREET

From the Private Secretary

28 June 1984

US Tax Treatment of Imported Cars

In the margins of the Prime Minister's bilateral with President Reagan on 5 June, an aide memoire prepared by your Department on the tax treatment of imported cars was handed to White House officials. Mr. Timothy Deal of the US Embassy has transmitted the attached aide memoire in response. I have sent him a holding reply.

BT I would be grateful if you could examine the note to see whether any further action needs to be taken.

I am copying this letter to David Peretz (HM Treasury) and Peter Ricketts (FCO).

(ANDREW TURNBULL)

Miss Ruth Thompson,
Department of Trade and Industry.



AIDE MEMOIRE

The position of Her Majesty's Government on a possible tax on luxury automobiles contained in the Aide Memoire of June 5, 1984, which was handed to United States officials in London, has been conveyed to appropriate officials in Washington.

The United States Administration has, of course, been following closely the negotiation in the House-Senate conference on tax reform measures, including the provisions to limit overstatement of tax deductions for cars used for business purposes. As Her Majesty's Government is aware, the Administration opposed the proposals to set specific caps on the value of a car which could be claimed for tax credits or depreciation, and worked instead for stricter reporting and substantiation requirements as well as a percentage business use threshold before

Embassy of the United States of America,

London, June 26, 1984.

accelerated depreciation and tax credits are available.

In the process, the Administration pointed out the concern expressed particularly by the Governments of Great Britain and West Germany over the impact such a value cap would have on imported vehicles.

On June 18, the Congressional conferees reached a compromise agreement on revised provisions governing use of luxury vehicles for business purposes. They abandoned the cap approach and provided instead that taxpayers may recover the cost of an automobile at the rate of six thousand dollars per year (four thousand dollars the first year). In addition, the conferees generally limited the investment tax credit available for automobiles to one thousand dollars. The conferees also agreed on other provisions, including a business use threshold.

It is unlikely that these provisions will undergo further change in conference. However, we would underline that these new depreciation rules for automobiles are not discriminatory in relation to imports, since they allow taxpayers to recover the full cost of any automobile used

for business purposes. The Administration believes the attempt to tighten the provisions on the business deductibility of vehicles is an appropriate effort by the Congress to restrict what has been a seriously abused loophole in the existing tax code, an effort which is only a part of the process aimed at reducing the federal deficit.

JD

Mr Young
to see X and return
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AT 26/2

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TO PRIORITY FCO
TELEGRAM NUMBER 1974 OF 25 JUNE

Mr Turnbull

AT - noted,
with Hanks.
R.J.
26/6.

US DEFICIT REDUCTION PACKAGE: TAX BILL

SUMMARY

1. THE HOUSE/SENATE CONFERENCE ON THE TAX BILL COMPLETED ITS WORK ON 23 JUNE AND AGREED ON A PACKAGE OF MEASURES TO REDUCE THE US BUDGET DEFICIT BY DLRS 61 BILLION OVER THREE YEARS. THE PACKAGE INCLUDES DLRS 11 BN IN SPENDING CUTS, MAINLY ON MEDICARE, AND MEDICAID, AND THE REMAINDER OF THE PACKAGE CONSISTS OF A NET INCREASE IN REVENUE FROM A LONG SERIES OF TAX CHANGES. WHILE THE AGREEMENT ON THE TAX BILL STILL NEEDS TO BE RATIFIED BY THE HOUSE OF REPRESENTATIVES AND THE SENATE, THIS IS EXPECTED TO BE A FORMALITY. THE DRLS 140 - DLRS 180 BILLION DEFICIT REDUCTION PACKAGE NOW NEEDS TO BE COMPLETED BY THE ACHIEVEMENT OF SAVINGS IN APPROPRIATED EXPENDITURE.

DETAIL

2. THE CONFERENCE OUTCOME ON THE MAIN TAX MEASURES AFFECTING THE UK WAS:

- 1) INSURANCE OR REINSURANCE PREMIUMS PAID TO UK INSURANCE COMPANIES IN RESPECT OF US RISKS WILL CONTINUE TO BE EXEMPT FROM FEDERAL EXCISE TAX.
- 2) THE CONFERENCE MODERATED THE PROVISIONS FOR WITHHOLDING TO ENFORCE THE FOREIGN INVESTMENT IN REAL PROPERTY TAX ACT FROM A WITHHOLDING RATE OF UP TO 28% TO ONE OF 10%, ALONG THE LINES OF A COMPROMISE THAT WAS PROPOSED BY THE FLORIDA BAR ASSOCIATION.
- 3) THE HOUSE AND SENATE PROVISIONS AFFECTING THE ALLOWABLE DEPRECIATION ON LUXURY CARS USED FOR BUSINESS PURPOSES WERE MODERATED SO THAT, INSTEAD OF A CEILING ON THE TOTAL AMOUNT OF DEPRECIATION ALLOWABLE, A CEILING HAS BEEN PLACED ONLY ON THE ANNUAL AMOUNT OF DEPRECIATION WITH NO LIMIT IMPOSED ON TOTAL DEPRECIATION. THE EFFECT OF THIS IS THAT THE MORE EXPENSIVE CARS HAVE TO BE DEPRECIATED OVER LONGER PERIODS THAN LESS EXPENSIVE ONES (SEE MY TELNO 1907 OF 19 JUNE). A LIMIT OF DOLLARS 1,000 WAS HOWEVER PLACED ON THE AMOUNT OF INVESTMENTS TAX CREDIT THAT IS PAYABLE.
- 4) THE CONFERENCE ALSO DECIDED TO RAISE THE EXCISE TAX ON LIQUOR BY ABOUT 35 CENTS A BOTTLE (FIFTH), WITH NO INCREASE ON WINE OR BEER. THIS WILL OBVIOUSLY ADVERSELY AFFECT UK SCOTCH WHISKY PRODUCERS ALONG WITH THE DOMESTIC MANUFACTURERS OF WHISKY. NO DISCRIMINATION IS INVOLVED AS TO THE NATIONALITY OF MANUFACTURERS TO WHOM THE TAX APPLIES.

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5) THE CONFERENCE DECIDED ON THE ABOLITION OF THE WITHHOLDING TAX ON INTEREST PAID TO TO FOREIGNERS ON NEW ISSUES OF TREASURY AND CORPORATE BONDS. THIS ABOLITION EXTENDS TO ALL REGISTERED CORPORATE AND TREASURY BONDS, AND NOT SIMPLY TO SPECIAL ISSUES AIMED AT FOREIGNERS, AND WILL TAKE EFFECT IMMEDIATELY AFTER THE LEGISLATION IS SIGNED INTO LAW. WITHHOLDING WILL BE RETAINED FOR BEARER BONDS.

3. OTHER IMPORTANT DECISIONS TO EMERGE FROM CONFERENCE WERE THAT IT REFUSED TO ENDORSE LEGISLATION INTRODUCING ENTERPRISE ZONES, EVEN THOUGH SUCH LEGISLATION WAS SUPPORTED BY THE ADMINISTRATION. IT ALSO DECIDED TO LIMIT THE AMOUNT OF TAX-EXEMPT INDUSTRIAL DEVELOPMENT BONDS (IDBS) WHICH A STATE CAN ISSUE TO DLRS 150 PER STATE RESIDENT OR DLRS 200 MILLION PER STATE PER YEAR, WHICHEVER IS THE HIGHER.

4. WHILE THE CONFERENCE REPORT HAS TO BE APPROVED ON THE FLOOR OF THE HOUSE AND THE SENATE, IT IS UNLIKELY THAT THERE WILL BE ANY SUPPORT FOR RE-OPENING A CAREFULLY NEGOTIATED COMPROMISE. THE INCREASES IN REVENUE THAT HAVE BEEN SECURED BY THE TAX INCREASES HAVE BEEN VERY HARD WON, AND THE MISCELLANEOUS LEGISLATION THAT WAS CONSIDERED BY THE CONFERENCE COVERED OVER 1,000 PAGES. IT IS UNKNOWN WHETHER THE PRESIDENT WILL SIGN THE TAX LEGISLATION AFTER IT IS APPROVED ON THE FLOOR OF EACH HOUSE, OR WHETHER HE WILL WAIT UNTIL THERE IS AGREEMENT ON THE COMPLETE DOWN PAYMENT PACKAGE OF DLRS 140 - DLRS 180 BN BEFORE SIGNING THE TAX LEGISLATION INTO LAW.

5. TEXT OF CONFERENCE REPORT WILL FOLLOW BY BAG WHEN AVAILABLE.

6. FC0 PLEASE PASS TO BOTTRILL AND R I G ALLEN (TREASURY), SPENCE AND GRAY (INLAND REVENUE), OLDHAM HILTON AND BESTON (DTI) HOLLIS (MAFF) SNOXELL (ERD) AND GREEN (BANK).

WRIGHT

FINANCIAL

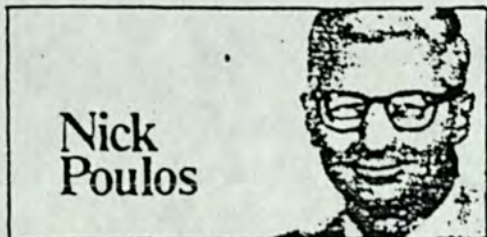
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(ADVANCED AS REQUESTED)

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US file



Briton offers U.S. deficit prescription

Alan Arthur Walters, who for three years served as personal economic adviser to British Prime Minister Margaret Thatcher, almost cancelled out on a long-standing commitment to speak to Atlanta business leaders last week.

The British economist explained at a dinner sponsored by the Federal Reserve Bank of Atlanta last Thursday that he thought he might be obliged to attend the economic summit conference which opened the same day in London.

"As it turned out, my presence was not required," he said dryly. "Besides, I've always wanted to see where Sherman marched."

Walters, currently a resident scholar at the American Enterprise Institute in Washington, acknowledged that he was the economist who persuaded Mrs. Thatcher to adopt the unconventional measures to right the falling British economy back in 1981.

"With unemployment rising to new peak rates and output falling, the conventional economic wisdom was to expand the fiscal deficit, which was already very large," he said.

"My advice to the prime minister was to do the very opposite: reduce the deficit sharply and massively by cutting back government spending as much as possible and raising taxes.

Great moral courage

"It took great moral courage for the prime minister to adopt such a program. Most economists asserted that such a policy would prove disastrous; that the British economy would descend into a 'black hole.'"

Walters recalled that the economic community was so outraged by the proposed economic program that 365 leading economists signed a letter of protest which was published in an ad in the Financial Times.

"But economists had fallen into such disrepute in England that their outcry was taken as affirmation that the government probably was on the right track," said Walters.

"You know, bankers are very reluctant to write down the assets in their portfolios when loans go awry. Like bankers, economists are very reluctant to depreciate their intellectual capital notwithstanding the fact it has become completely worthless."

At any rate, said Walters, the program worked; the economy turned around, and the British recovery is now in its fourth year.

Walters asserted that public confidence is the most important element of economic policy.

Keynes recognized it

"Keynes (British economist John Maynard Keynes) recognized that a long time ago," Walters said. "But he noted that economists didn't pay much attention to it because they couldn't quantify it."

Walters went on to explain that continuing high budget deficits upset the markets, creating all kinds of problems for the economy. That's the effect of a lack of confidence, he said.

Walters said he would prescribe the same medicine for the U.S. economy as Mrs. Thatcher did for the British economy.

Walters said congressional action to reduce the U.S. budget deficit with a "down payment" is quite inadequate to revive market confidence.

"I recognize it is terribly difficult to reduce spending, so the only alternative is to raise taxes sufficiently to greatly reduce the deficit," he said. "It's got to be done sooner or later, and it's better to do it right away to restore confidence in the markets."

Asked about economist Milton Friedman's argument that it does no good to raise taxes because Congress will simply spend more money, Walters replied:

"That wouldn't and didn't happen in Britain, but if that did happen here, then there wouldn't be any point in raising taxes. It would simply be a treadmill. But I don't know whether the Congress would, as Milton Friedman suggests, spend the additional revenue."

Nick Poulos is business editor of The Atlanta Constitution and The Atlanta Journal.