



European Union Treated as One Country for Purposes of Subpart F

Issue

By imposing U.S. tax on intercompany payments between foreign subsidiaries, subpart F of the Internal Revenue Code unfairly penalizes U.S. companies for legitimate business transactions, and causes U.S. multinationals to operate at a competitive disadvantage in the global marketplace.

Background

Subpart F was originally enacted out of concern that U.S. multinationals were artificially shifting foreign profits to tax havens, in part by making payments to related companies located in tax havens. In general, where it applies, subpart F imposes U.S. tax on income of U.S.-owned foreign companies. When such tax is imposed on intercompany payments, the amount of capital that a U.S.-based multinational business has to invest is reduced, thereby putting it at a disadvantage as compared to its local competitors.

Subpart F generally does not apply to transactions within a single "country" under the rationale that, in such cases, artificial profit-shifting between tax jurisdictions does not occur. For example, the provisions applicable to intercompany payments (the "foreign personal holding company income" rules) exclude dividends and interest received by a controlled foreign corporation ("CFC") from a related person that is 1) a corporation organized under the laws of the same country in which the CFC was created; and 2) has a substantial part of its assets used in a trade or business located in such same foreign country.

When enacting subpart F in 1962, Congress considered but rejected a proposal to treat the European Economic Community (the predecessor to the EU) as a single country for purposes of the subpart F related person provisions. According to the legislative history, the basis for this decision was the fact that, although the European countries had formed a common market, they did not yet have a unified tax system.

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Policy Considerations

Recent proposals introduced to simplify subpart F include provisions relating to the treatment of the EU as one country. For example, in H.R. 4151 (107th Congress), the Secretary of the Treasury would have been tasked with analyzing the impact of treating the EU as one country for purposes of applying the same country exceptions under subpart F.

This treatment makes even more sense today than it did in 1962, not only because of the greater political and economic integration that the EU countries have achieved over the last forty years, but also because of their current efforts to achieve tax harmonization. For the past three years, the EU members have been negotiating a "code of conduct" with respect to tax matters, in order to eliminate harmful tax competition among member states. More recently, the EU Commission has begun investigating whether certain member state tax regimes constitute unlawful state aids.

Recommendation

The SVTDG supports the treatment of business transactions within the EU as occurring within the same country for purposes of subpart F of the Internal Revenue Code.