

# GENERAL AGREEMENT ON TARIFFS AND TRADE

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## PANEL REPORTS ON INCOME TAX PRACTICES

### Memorandum by the United States

In rejecting the findings of the Panel appointed to examine the tax practices maintained by France, the French Government has criticized the Panel's view of an export or of export activity. Specifically, the French Government has argued that the Panel's concept of an export or of export activity was too broad. In support of this argument, the French Government issued a memorandum (C/97/Add.1 of 21 July 1977), describing five stages to an international economic transaction. The memorandum concluded that, for tax purposes, the first three stages (manufacturing, sales to an intermediary, and export) should come under the jurisdiction of the country of origin and the final two stages (import and distribution) should come under the jurisdiction of the country of destination.

The United States believes that for many export transactions, the five stage characterization advanced by the French Government is incomplete and therefore inaccurate. It assumes that a product moves directly from the customs frontier of the origin country to the customs frontier of the country of ultimate destination. What frequently happens in transactions between related affiliates is that a product moves from the customs frontier of the origin country into a subsidiary in a tax haven country which is not the country of ultimate destination for the product. Sometimes the product is not physically moved to the tax-haven country but is transferred there in a paper transaction for tax purposes. The result in either case is that the origin country does not tax the transaction up to the point where the product enters the country of ultimate destination, as even the French Government concludes it should. Rather, the origin country taxes only up to where the product enters the country of immediate, as opposed to ultimate, destination. This is further aggravated if title is passed to the subsidiary in the tax-haven country at less than an arm's length price.

The basic concern of the United States is that this additional, tax-haven stage is not subject to domestic taxation under the territorial principle. The country of origin ceases to collect tax, not when the product moves into the country of ultimate destination, but as soon as it is passed to a subsidiary in a tax-haven

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country. The Panels were aware of this concern and carefully and thoroughly reviewed the issues which it raised in reaching their decisions on the tax practices of France, as well as on those of Belgium and the Netherlands. Indeed, the United States has the DISC legislation, in part, as a response to the option available to countries using the territorial system to reduce taxes on exports passed through a tax-haven subsidiary. As the Panel's reports make clear, reducing taxes on exports by using a tax-haven subsidiary is as much, perhaps more, a violation of GATT as is DISC. The only difference is that the tax benefits explicit in one system are implicit in the other.

The United States believes that all the economic activity associated with a product should be taxed in the origin country until that product moves into the country of ultimate destination. Furthermore, it is absolutely essential that the transfer to the country of ultimate destination be on an arm's length basis and that any activity occurring in a tax-haven country be subject to domestic taxation in the country of origin. We hope that these remarks will form a basis for acceptance of all four of the Panels' reports.