Joint Committee on Taxation
JCX-12-85
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Proposed Income Tax Treaties
Prepared for the Senate Committee on Foreign Relations

The treaties with Barbados, the People's Republic of China, Cyprus, Denmark, and Italy are generally consistent with U.S. tax policy. They present some issues, however.

Four of these treaties were signed before Congress enacted the Tax Reform Act of 1984. The Committee should address some apparent conflicts (discussed below) between these treaties and that 1984 Act.

The treaty with Barbados would override amendments that the Tax Reform Act of 1984 made to the accumulated earnings tax. This result would be inadvertent. A reservation would be appropriate to prevent tax haven abuse.

Through an ambiguity, the treaty with Italy might allow double foreign tax credits in some cases. This was not intended. An understanding to prevent double credits would be appropriate.

Four of the treaties fail to reflect a provision of the Tax Reform Act of 1984 that pierces the veil of foreign corporations. The 1984 Act provision resources payments from foreign corporations that earn American income to prevent abuse of the foreign tax credit. It would be appropriate for the Senate to make it clear to the other countries that these treaties do not override the 1984 Act on this point.

The treaty with Denmark would allow foreign tax credits for payments that oil companies make to Denmark. This Committee approved this treaty last year, but the Senate did not act on it. U.S. treaties with Norway and the United Kingdom allow foreign tax credits for similar taxes. If the Committee again approves this treaty, it should make it clear that allowing a treaty benefit to one country does not require the United States to extend similar benefits to other countries.

The treaty with Cyprus would tend to promote a tax haven in the eyes of investors. If the Committee approves this treaty, it might wish to question the wisdom of entering into treaties with tax havens.

The treaty with China does not effectively prohibit "treaty shopping"--use by third country investors. If the Committee approves this treaty, the Committee should call for a reexamination of the treaty if treaty shopping develops.

The Administration's tax reform proposal would impose two new taxes on foreigners. Each of these five treaties would prohibit at least one of these two new taxes. Treasury proposes that the United States renegotiate (or override) these treaties after enactment of tax reform legislation. The question is whether current action is appropriate in this uncertain climate.