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UNITARY TAXATION: IMPLICATIONS FOR INTERNATIONAL INVESTMENT

The "unitary" system of taxing multinational companies that has been adopted by some American states threatens to disrupt international investment and hinder world economic growth, Sir Roy Denman, head of the European Community's delegation to Washington, said yesterday.

Sir Roy said unitary taxation is not simply a domestic issue, but must be viewed in the context of a world trading system that is becoming increasingly interdependent. "This interdependence will bring benefits to us all, but it will also imply a changing set of obligations," he told government and corporation officials who attended a seminar on unitary taxation in Washington.

Under unitary taxation, companies are taxed on a proportion of their worldwide earnings rather than on profits earned strictly within a state. The European Community and other major trading partners of the United States contend that this practice violates the 1977 Model Double Taxation Convention of the Organization of Economic Cooperation and Development (O.E.C.D). That convention states that a company's foreign operations should be taxed as distinct and separate enterprises, not under worldwide accounting schemes.

The O.E.C.D. guidelines "cannot be unilaterally ignored for internal political reasons by one party without serious consequences to the whole equilibrium of international tax principles," Sir Roy said.

Sir Roy noted that the U.S. Supreme Court had ruled that in the absence of federal legislation, states have the right to impose unitary taxes. But states should recognize that the United States economy has become increasingly "inter-nationalized" since the 1970s, he said. Tax treaties

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concluded between sovereign nations - bilaterally or multilaterally - are an important part of the international trade system, working to enhance the investment flow, he added.

"It is unthinkable that we should regress and that each county in England, Länder (state) in Germany and department in France should have to negotiate a separate tax treaty with each state in the United States," he said.

Sir Roy called unitary taxation a "significant irritant" that is particularly disturbing in light of other international trading conflicts, including growing efforts to protect U.S. goods from foreign competition. The international debt problem "remains at best precarious" and will not improve without a growth in world trade, he added.

"Everything possible should be done to ease the path forward, to ease tensions wherever possible," Sir Roy said. "Refraining from practices like unitary taxation is a good example."

Sir Roy also raised the disturbing prospect that developing countries could follow the U.S. lead and adopt unitary systems. "Would a major U.S. company welcome it if its investment in a small developing country - useful to both partners in the way of increased business - were to be taxed on its worldwide activities?"

The unitary taxation issue is being considered by an official working group headed by U.S. Treasury Secretary Donald Regan. Opposition to unitary taxation was expressed in a note submitted jointly last month to the working group by the Community, the 10 E.C. member states, Australia, Canada, Japan and Switzerland. The European Parliament, an elected body of the Community, adopted a resolution last fall urging the U.S. Administration to support legislation that would exempt foreign companies from unitary systems.