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EUROPEAN COMMUNITY CONTESTS STATE UNITARY TAXATION OF MULTINATIONAL COMPANIES

Michael Welsh, a member of the European Parliament, will address a committee of the National Conference of State Legislatures this week in Washington, as part of a campaign against "unitary" taxation of multinational companies.

A number of American states have adopted unitary systems, under which they tax companies on a proportion of their worldwide earnings rather than on profits earned strictly within the state. The European Parliament, an elected body of the European Community, recently adopted a resolution criticizing that practice, saying it violates "the spirit of the various double-taxation treaties and discriminates unfairly against European-based companies with operations in the United States."

The resolution urges the U.S. Administration to support legislation that would exempt foreign companies from unitary systems, warning that the issue "can only damage relations between the Community and the United States to the detriment of their mutual economic and political interests."

Welsh, a British Conservative, will meet with the Government Operations Committee of the National Conference of State Legislatures at 3 p.m. Thursday, December 15, Columbia B Room, Hyatt Regency Washington Hotel, 400 New Jersey Avenue, N.W. The Conference is an organization of state legislators and legislative staff members.

The European Community also expressed its opposition to unitary taxation in a position paper submitted last month to the working group on the issue headed by U.S. Treasury Secretary Donald Regan.

In that paper, the Community says the unitary taxation matter is particularly urgent because of last summer's U.S. Supreme Court decision allowing California to tax the Container Corporation of America on the basis of worldwide profits. That ruling may encourage additional states to adopt a unitary system, it says. (After the EC submitted its paper, the Supreme Court refused to consider a unitary taxation case involving Dutch-based Shell Petroleum. The company was appealing lower-court rulings that it had no right to challenge California's unitary system.)

The Community paper says unitary taxation, by including non-American profits in its reporting scheme, can lead to double taxation because those profits are also taxed

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in the countries in which they are earned.

Unitary taxation, it adds, violates an accepted principle of international taxation - that a company's foreign operations should be taxed as if they were distinct and separate enterprises.

Furthermore, it invites foreign governments to take countermeasures or introduce unitary systems of their own. Developing countries in particular might be tempted to "follow the American example and to increase their government's take from foreign firms," the EC argues. That would create problems for industrialized countries, including the United States, that outweigh any short-term advantages to American states because of unitary taxation.

The EC contends that unitary taxation violates the 1977 Model Double Taxation Convention of the Organization for Economic Cooperation and Development, as well as Treaties on Friendship, Commerce and Navigation that nine of its 10 member states have concluded with the United States.

The EC position paper also makes these arguments against unitary taxation:

--It can lead to "an excessive attribution of profits to a U.S. state." The proportion of income that is taxed under a unitary system is determined by a formula based on a company's sales, payroll and fixed assets within the state. In the United States, however, payroll and property values are high compared with other countries, which gives the formula an "inbuilt tendency" to allocate higher profits to an American state than are justified.

--It may deny a parent company a "fair return" on its investment by including in a worldwide reporting system profits earned in developing countries. Those profits may be relatively high in relation to costs, but they compensate for higher risks, such as expropriation or currency exchange limitations.

--It would be particularly "anomalous" to apply it to businesses that earned profits worldwide, but none from U.S. activity - because of start-up losses, for example.

--It places a heavy administrative burden on non-domestic corporations. Financial returns must be translated into U.S. currency and English, and income figures must be adjusted to conform to state rules. This can be a massive task when one considers, for example, that Shell Petroleum has some 900 non-U.S. subsidiaries and affiliates operating in more than 100 countries.

Texts of the European Parliament resolution and the Community's position paper on unitary taxation are available from the European Community Information Service, 2100 M Street, N.W., Suite 707, Washington, D.C. 20037; (202) 862-9500.

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