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AN ANALYSIS OF THE GATT-COMPATIBILITY OF THE
NEW FOREIGN SALES CORPORATION

I. INTRODUCTION

For the past fourteen years, the United States has been embroiled in a dispute with its major trading partners over whether the Domestic International Sales Corporation (DISC) provisions constitute a prohibited export subsidy under the General Agreement on Tariffs and Trade (GATT). In response to increasing pressure from the GATT Council, which considered imposing penalties on the United States for continuing the use of the DISC, the Reagan Administration agreed in October 1982 to propose a GATT-acceptable, DISC revision to Congress. In August 1983, the Administration submitted a proposal to replace DISC with an offshore entity known as a Foreign Sales Corporation (FSC). Congress passed the Foreign Sales Corporation Act (Act) on June 27, 1984 as part of the Tax Reform Act of 1984, signed into law by President Reagan on July 18, 1984. The FSC provision became effective January 1.
This comment will first trace the genesis of the conflict which prompted the change from the DISC to the FSC, will determine the potential legal problems with the Act, and will then propose solutions to those problems. Section II examines how the conflict over the DISC developed. Section III examines the elements of the FSC which may conflict with GATT. These elements include the fifty percent United States content,\(^7\) the forgiveness of the DISC income taxes,\(^8\) the allowance of the United States possessions as places for incorporation of a FSC,\(^9\) and regulations on foreign presence and management requirements for FSCs.\(^10\)

The most objectionable of these elements to GATT members is the forgiveness of the DISC income taxes which had previously been deferred.\(^11\) A recent congressional study calculated that "in all $13.6 billion will be forgiven."\(^12\) Section IV proposes solutions to the above problems through elimination of the income tax forgiveness, tighter regulations and elimination of the United States possessions as qualifying locations for FSC incorporation.

II. GENESIS OF THE CONFLICT OVER THE DOMESTIC INTERNATIONAL SALES CORPORATION

GATT was created in 1947 to alleviate the staggering problems...
of "free trade" created during the Great Depression. At the end of World War II, the United States played a major role in international trade reforms which led to a world trading system. The instrument which revolutionized the chaotic system of high tariffs and restrictions was GATT. As a result of GATT, American and other exporters enjoy stability in and access to foreign trade markets.

Even with the post-World War II boom in trading by American exporters, stimulated by the advent of GATT, the United States foreign trade balance has recently plummeted. In 1981, the United States experienced a $10 billion trade deficit. By 1983, the deficit reached $21 billion. In recent years, the strength of the American dollar abroad has caused much of the United States foreign trade deficit by cutting foreign demand for American exports and by increasing the attractiveness of foreign imports.

The Nixon Administration proposed the DISC in 1971 with the goal of increasing American exports by relaxing and simplifying certain corporate income tax laws. This increase in American exports was achieved by providing American exporters with the opportunity to obtain an indefinite, interest-free tax deferral on at least twenty-five percent of their net export income. The DISC was a

13. During the 1930's, the high Smoot-Hawley tariff sparked retaliation from several other countries, in the form of similarly high tariffs and distorted bilateral deals in Europe. Denman, A Fair Deal for Free Trade - The Case for Resisting Rising Protectionist Pressures in Trans-Atlantic Trade, EUROPE Jan./Feb. 1984, at 11.

14. The reforms in international finance and trade which were developed at the end of the war were due in large part to the United States efforts. "Under the aegis of the General Agreement on Tariffs and Trade (GATT), tariffs and other restrictions were drastically cut in a series of major trade negotiations." The effect on world trade has been dramatic since 1947 — the West has experienced its greatest increase in prosperity in history. Id.

15. Id.

16. Id. at 12.

17. Id.

18. The DISC, while technically a separate entity, needed only to exist on paper (that is, with no substance beyond the paperwork required to create it, plus a modest initial capital investment of $2,500) in order to qualify its related supplier (normally the owner of the DISC or an affiliate) for the tax deferral. Cohen & Hankin, A Decade of DISC: Genesis and Analysis, 2 VA. TAX REV. 7, 25 (1982) [hereinafter cited as Cohen]. The DISC was not required to conduct any business at all, or even manifest any degree of physical presence, outside of the United States. See generally Rev. Rul. 72-166, 1972-1 C.B. 220.

19. The reason some exporters could achieve more than the 25% income tax deferral is due to the alternative formulas available under the law to DISCs. Under the original legislation, the DISC was deemed to have earned 50% of the net export income of its related supplier. I.R.C. § 994(a)(2) (1982).

An alternative formula permitted a tax deferral on four percent of the related supplier's gross sales of a particular product or line of products, plus ten percent of the DISC's own actual export promotion expenses. Id. at § 994(a)(1). Under a provision known as the "no-loss
response by the United States government to a perceived disparity between American and European exporters; according to the United States government, European exporters gained an advantage over their American competitors primarily through the differences in the respective taxation systems.

The enactment of the Foreign Sales Corporation Act was an attempt by the Reagan Administration and the United States Congress to quell the tide of criticism surrounding the DISC. Since its enactment in 1971, the DISC has been the subject of an ongoing controversy between the United States and certain other GATT signatories. From its inception, the DISC has been attacked as constituting an illegal "tax privilege" and a "tax incentive to exports" which violate the United States commitments under the General Agreement.

The United States taxes domestic corporations on their worldwide income, including profits from foreign permanent establishments. By contrast, most of the United States foreign trading partners employ a territorial system of taxation that exempts export-related income attributable to a foreign permanent establishment from taxes. Major exporting countries such as France, Belgium and the Netherlands, which use a territorial tax system, have low taxes on repatriated foreign profits.

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20. The United States position was that foreign manufacturing subsidiaries generally were able to postpone payment of United States income tax while United States exporters were forced to pay the tax immediately. Goldberg, *GATT and Export Incentives: The Proposed Foreign Sales Corporation*, 42 N.Y.U. Inst. on Fed. Tax’n § 32.01, at 32-33 (1984) [hereinafter cited as Goldberg].


22. Sharp, supra note 11.

23. Wagner, supra note 1.


25. Wagner, supra note 1.

26. Id. By 1973, both the U.S. and E.E.C. had formally complained to the GATT membership about the alleged tax export subsidies. The GATT council directed a panel of experts to examine DISC and the tax practices of France, Belgium, and the Netherlands. The GATT panel made separate reports on the four countries (including the U.S.); however, no action was taken on the reports until December 1981.

The delay in GATT action was due in part to the negotiations which culminated in 1979 with the adoption of an "Agreement on Interpretation and Application of Articles VI, XVI, and XXIII" of the General Agreement. See *Agreements Reached in the Tokyo Round of Multilateral Trade Negotiations*, H.R. Doc. No. 153, 96th Cong., 1st Sess. pt. 1
tems of taxation and the debate over which system was in compliance with GATT mandates, led the European Communities to file a formal complaint against the United States in 1973. The gravamen of the European Community's complaint, filed with the GATT Council, was that the DISC was an illegal export subsidy in violation of GATT.

A. The DISC Provisions

Before examining the European Communities' complaint and the GATT Council's reaction to it, a rudimentary understanding of the DISC provisions is necessary. As previously mentioned, the DISC was created to meet the dual goals of stimulating United States exports and removing a perceived disadvantage facing United States corporations involved in exportation. The central mechanism for achieving these compatible goals was the deferral of a portion of the United States income tax imposed on qualifying corporations.

This deferral of the DISC income taxes was achieved by treating the DISC as "not subject to" federal income tax. The legal fiction created by Congress to explain the "exemption" was that approximately fifty percent of the DISC income is deemed to have been distributed to its shareholders at the end of the DISC's taxable year. This distribution was treated as a dividend under the prior law. The balance of the DISC's taxable income was not taxed until the time of actual distribution to DISC shareholders.

The 1976 Tax Reform Act changed the tax law resulting in de-

(1979). This agreement is generally known as the "Subsidies Code." An Annex to that Agreement contained an updated "Illustrative List of Export Subsidies," with the relevant section stating: "(e) The full or partial exemption, remission, or deferral specifically related to exports, or direct taxes . . . payable by industry or commercial enterprises."

Significantly, the inclusion of "deferral" in the list brought the DISC clearly within the prohibited list of export subsidies. On the other hand, the 1981 GATT Qualifier (see infra notes 58-63 and accompanying text) impliedly approved of the tax systems used in France, Belgium, and the Netherlands, and the GATT council held that territorial systems of taxation used by these European countries, which do not tax offshore profits from exports, do not offend the anti-subsidy rules. Wagner, supra note 1.

28. Id.
29. See supra note 20 and accompanying text.
32. Id. at § 995(b).
33. Id. at §§ 995, 996.
increased benefits. However, annual reports prepared by the United States Treasury Department have continued to attribute billions of dollars in American exports to the tax incentives provided by the DISC.  

A feature of the DISC which is attractive to United States exporting corporations is that the DISC is essentially a "paper company." The DISC legislation has no requirements regarding DISC employees nor does it require that the DISC "perform any real function." In fact, the only distinct function of the DISC is that it serves as an accounting entity which determines the amount of deferred income and monitors its use before its eventual taxation at the shareholder level.

Because the DISC is a mere paper entity with no substantial operations and must be incorporated in the United States, GATT considers the economic processes of the DISCs to be located within the United States. This domestic nature of the DISC's operations has been highly criticized by members of GATT. The United States Congress attempted to enhance the DISC's GATT compatibility by creating two tests which limit the types of assets the DISC may own. Those tests are the ninety-five percent "qualified export receipts" test and the "qualified export assets" test.

Another problem, created by the indistinguishable nature of the DISC from its parent company or related supplier, involves application of the inter-company transfer pricing rules. GATT requires

34. See U.S. DEPT. OF THE TREASURY, 1981 ANNUAL REPORT, THE OPERATION AND EFFECT OF THE DOMESTIC INTERNATIONAL SALES CORPORATION (1983). The report estimates that United States exports were $7 to $11 billion higher in 1981 than they would have been without the DISC. The actual changes in the DISC law are beyond the scope of this comment.

35. See supra note 18 and accompanying text.

36. Goldberg, supra note 20, at 32-35.

37. "Distinct function" is used to mean separate from a related supplier or parent.

38. Cohen, supra note 18, at 25-29. Economic processes include negotiation, advertising, solicitation and related activities in connection with the making of a contract.

39. Id. See generally supra note 1 and accompanying text.

40. In order for a DISC to defer its accumulated income from taxation under the former law, two tests had to be met each year. One test required that at least 95% of the DISC's revenue each year had to consist of "qualified export receipts," which generally meant gross receipts from the sale or lease abroad of property which was manufactured, produced, or grown in the United States. I.R.C. § 992(a)(1)(A) (1985).

41. In addition to the "qualified export receipts" test, the DISC had to have at least 95% of its assets at the close of its fiscal year be deemed "qualified export assets," that is, export property, certain types of loans from the DISC to its related supplier, and some other specified property. Id. at § 992(a)(1)(B).

42. Goldberg, supra note 20, at 32-35.
arm's-length pricing,43 where sales between a DISC and its related supplier have no similar qualifications.44 Instead, the parent company may sell export property to its DISC and avoid the strict allocation requirements.45 Special inter-company pricing rules permit the DISC to elect one of the following three pricing rules:

1) four percent of qualified export receipts;
2) fifty percent of the combined taxable income of the DISC and its related supplier attributable to such sale; or
3) the taxable income based on the sales price actually charged.46

The net result is that the DISC will select the pricing rule which gives the greatest amount of deferred income attributable to an export sale.

B. The Attack on DISC

The deferral of the DISC income, the incorporation of a “paper company” for solely accounting purposes, the incorporation within the United States, and the failure to use arm’s-length pricing to transfers between related parties, caused the European Communities to protest the United States DISC legislation in 1973.47 The complaint filed with the GATT Council challenged the DISC as an illegal export subsidy under article XVI:4 of the General Agreement which provides that:

Contracting Parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product . . . which subsidy results in the sale of such product for export at a price lower than the comparable price charged for a like product to buyers in the domestic market.48

To clarify the meaning of article XVI:4, a GATT working group, on November 19, 1960, adopted an “illustrative list” of

43. The arm’s-length pricing mandated by the 1981 GATT Qualifier applies to transactions between exporting enterprises and foreign buyers under common control. Hence, it applies to sales between the parent or related supplier and its FSC. *Hearings, supra* note 2, at 24.
44. I.R.C. section 428 was the only provision under the former law which required arm’s-length pricing between unrelated parties.
45. “Strict allocation” means between supplier and the FSC which buys the export products from its parent and then sells them abroad for a profit.
47. *Hearings, supra* note 2, at 34.
48. See the General Agreement on Tariffs and Trade, art. XVI:4.
“practices generally considered as subsidies.” The European Community based its attack of the United States DISC on article XVI:4. The European Community identified the DISC as an illegal export subsidy by pointing out that the unlimited deferral of income from export practices constituted a remission or exemption of taxes.

In 1976, a panel of GATT-appointed experts issued a series of reports which found both the DISC taxation policies and certain tax practices conducted by France, Belgium and the Netherlands to constitute export subsidies in violation of article XVI of the General Agreement. Although the GATT Panel was not completely convinced that a tax deferral, for an indefinite time period, equaled a remission or an exemption of taxes under GATT, the panel did find that the DISC constituted a partial exemption that was improper under the 1960 Illustrative List of Illegal Export Subsidies. In its report, the GATT Panel found three consequences were likely to follow from an export subsidy such as the DISC: (1) lowering of prices, (2) increase of sales effort and (3) increase in profits per unit. The Panel predicted that all three of these effects would occur in connection with the DISC; therefore, it concluded that DISC was in violation of article XVI:4 of GATT.

No action on these Panel Reports was taken by GATT until December, 1981. The delay was caused by negotiations and the formulation of an “Agreement on Interpretation and Applications of Articles VI, XVI and XXIII” of the General Agreement. The revised list specifically added income tax “deferral” to the list of illegal export subsidies. A footnote to the amended list, however, explained that if interest was charged (and collected) on the deferred income, then no illegal subsidy would result.

49. Items listed as illegal export subsidies include: (1) “The remission, calculated in relation to exports, of direct taxes or social welfare charges on industrial or commercial enterprises;” and (2) “The exemption, in respect of exported goods, of charges or taxes. . . .” Hearings, supra, note 2, at 21. See also GATT, article XVI:4 (Basic Instruments and Selected Documents 9 Supp. 186).

50. Rosenblum, supra note 27 and accompanying text.

51. Hearings, supra note 2, at 23.

52. Id. See also supra note 49.

53. The GATT Panel reports on the tax systems of France, Belgium and the Netherlands were similar to those on the DISC. Hearings, supra note 2.

54. Id. at 24.

55. Id. Out of this new “interpretation” emerged an updated “Illustrative List of Export Subsidies” which had significant ramifications for the continued use of the DISC.

56. Hearings, supra note 2, at 89.

57. Under the Act, in addition to the FSC and small FSC, a third option will be available to United States exporters: the interest charged the DISC. This alternative will be GATT-compatible provided that the taxes which are deferred are eventually collected. Sanders, Trying
In December, 1981, the GATT Council formally adopted the 1976 Panel Reports subject to certain qualifications. The three qualifications are: (1) GATT does not require an exporting country to tax economic events that occur outside its territorial limits; (2) arm's-length pricing is mandatory, under GATT, in transactions between exporting enterprises and foreign buyers under common control; and (3) article XVI:4 does not prohibit the adoption of measures to avoid double taxation of foreign source income. These qualifications, referred to as the "1981 GATT Qualifier," legitimized the territorial taxation systems of France, Belgium, and the Netherlands and other European Community nations but left open questions as to the legality of the United States taxation of the DISC.

The United States and the European Community agreed that the tax system of France, Belgium and the Netherlands satisfies the 1981 GATT Qualifier's first two requirements. These systems exempt from taxation only those economic processes located outside their territorial limits and require arm's-length pricing on inter-company pricing. Since the tax policies of the DISC met neither of the two requirements contained in the 1981 GATT Qualifier, and thus remained in violation of article XVI of GATT, the European Community submitted a formal complaint to the GATT Council in May, 1982 requesting that the Council force the United States DISC to conform to GATT provisions. Furthermore, the complaint requested $2.3 billion in compensation for damages allegedly caused by the DISC.

The adoption of the Panel Reports with the accompanying 1981 GATT Qualifier gave further impetus to United States policymakers in reassessing the future of the DISC. To this end, Treasury Secretary Donald T. Regan told the GATT Council on October 1, 1982 that the Reagan Administration would find a replacement for the...
In March 1983, the Administration announced its proposal to meet its GATT commitment: the FSC would replace the DISC. After almost two years of debate and several proposals, President Reagan signed the Act into law. The new policy was part of the Tax Reform Act of 1984 and would affect tax years beginning January 1, 1985.

III. Why the Foreign Sales Corporation is Not GATT-Compliant

A. United States Response to GATT Criticism: FSC

After thirteen years of unwavering criticism aimed at the DISC, as well as repeated threats of GATT sanctions, the United States succumbed to its trading partners' pressure; the United States agreed to replace the lucrative export subsidy with the "GATT-compatible" FSC. While both the United States Treasury and Commerce Departments profusely lauded the DISC replacement for both its legal basis and profit-generating potential, grave reservations were raised by the European Community and others even before the proposal became law. Indeed, such rumblings regarding the FSC's lack of GATT-compatibility may well be the harbinger of a future GATT contest.

The sentiment among United States legislators and supporters of the new FSC is one of optimism and an unwillingness to compromise to foreign pressure. This sentiment was exemplified by the unabashed warning given to the European Community, and other would-be-antagonists at the initial United States Chamber of Commerce Conference on FSC: anyone who complains to GATT about FSC will be viewed with disfavor. The consensus among the con-
ference panel members\textsuperscript{69} was that the United States had met its GATT obligations by changing the DISC into the Foreign Sales Corporation (FSC).

1. **Forgiveness of DISC Income Taxes**

Despite the bold optimism expressed by representatives of the Administration, problems remain in the "GATT-compatibility" of the FSC. There seems to be general agreement among the United States trading partners that the most unacceptable provision of the new legislation, in terms of "GATT compatibility," is "the forgiveness of the DISC income taxes."\textsuperscript{70} One problem with this forgiveness of taxes on the DISC income is that it placed United States trading partners in a "Catch-22" situation.\textsuperscript{71} The trading partners could not officially object to the forgiveness until the new law took effect January 1, 1985. However, once the law took effect, it was difficult to reverse any resulting harm. Furthermore, the forgiveness of DISC taxes constituted a tax "remission" which violates the General Agreement.\textsuperscript{72}

2. **Elimination of the "Paper Entity"**

A significant change in the new law is the foreign presence requirement which will abolish the DISC both as a paper entity and

\textsuperscript{69} The Conference Panel Members included: Rachell Bernstein, Manager of Tax Policy Center - U.S. Chamber of Commerce; Charles M. Bruce, Cole and Corette, Washington, D.C.; William R. Evan, U.S. Dept. of Commerce; John Gallagher, Marine Midland; Steven A. Hornig, Cargill Inc.; James K. Jackson, Dawson, Riddle, Fox, Holroyd & Jackson; Edward H. Lieberman, Cole & Corette; H. Patrick Oglesby, Joint Committee on Taxation; Timothy Regan, Office of U.S. Trade Representative; Stephen E. Shay, Office of International Tax Counsel.

\textsuperscript{70} The European Communities were the first to openly object to the forgiveness. Bruce, \textit{Recent FSC Developments}, 25 Tax Notes 596 (Nov. 12, 1984) [hereinafter cited as Bruce]. See also \textit{Europe Upset with U.S. Over Sales Program}, The Washington Post, July 12, 1984, at D6, col. 6 [hereinafter cited as \textit{Europe Upset}].

\textsuperscript{71} Telephone interview with John St. Jacques, Canadian Commercial Counselor, Canadian Consulate in Washington, D.C., (Nov. 2, 1984) [hereinafter cited as \textit{St. Jacques Interview}]. Mr. St. Jacques' view does not reflect the official Canadian government's position which has yet to be fully revealed. Without elaborating, Mr. St. Jacques affirmed this author's analysis of his country's predicament discussed \textit{infra} notes 85-88 and accompanying text.

\textsuperscript{72} Interview with Anna Snow, Assistant to the Commercial Counselor, Delegation of the Commission of the European Communities in Washington, D.C. (Nov. 3, 1984) [hereinafter cited as \textit{Snow Interview}]. The European Communities are waiting for the United States explanation as to how the new legislation conforms with the 1981 GATT Panel Reports and the GATT Qualifier before deciding whether to object formally to the GATT Council. The European Communities estimate their losses caused by the FSC's predecessor, the DISC, to be between \$10 to \$12 million. \textit{Europe Upset}, supra note 70, at D6, col. 6.
as an entirely domestic corporation. In order to qualify for an income tax exemption under the Administration proposal, an FSC must have foreign trading gross receipts (FTGR).\(^7\) In order to have FTGR, a FSC must meet the following presence requirements:

1) Maintain an office outside the United States. The office may be shared with other entities and need not be either in the country where the FSC is incorporated or any country in which it is doing business.

2) Maintain books and records in its foreign office. These may be summary books and records, and need not be original books of record or entry;

3) Have at least one resident director outside of the United States; and

4) Participate outside of the United States, either itself or by contract, in solicitation, negotiation, or acceptance of sales.\(^7\)

3. Two-Part Test to Qualify for Tax Benefits Under the 1984 Act

For the FSC to meet GATT standards, it must comply with both principle tenets of the 1981 GATT Qualifier which recognize the legitimacy of territorial systems of taxation.\(^7\) The GATT Qualifier requires an exporting country to tax economic processes that take place within its territorial limits.\(^7\) The foreign economic process requirements of the FSC\(^7\) are a positive step toward bringing United States taxation of exporting corporations into compliance with GATT rules. It is doubtful, however, that the new requirements go far enough to satisfy the GATT community.

a. Processes

There are two categories of foreign economic process requirements that the FSC must satisfy to qualify as having foreign trading

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73. "Foreign trade gross receipts" is defined to mean gross receipts of any FSC attributable to: (1) receipts from the sale or exchange of property for use outside the United States; (2) leases or rentals of export property; (3) receipts from the performance of services; (4) receipts from engineering or architectural services; and (5) receipts for export management services. I.R.C. § 924(a) (1984).
74. Id. at §§ 922(a)(1), 924(d)(1)(A) (1984).
77. See infra notes 78-82.
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gross receipts (FTGR).\textsuperscript{78} Both categories may be satisfied by the FSC, or by another person on behalf of the FSC under a contractual basis.\textsuperscript{79} The first category is known as the “selling activities.” Under this requirement, the FSC must participate outside the United States in the solicitation (other than advertising), negotiation or making of the contract giving rise to foreign trading gross receipts.\textsuperscript{80}

b. Direct Costs

The second category is the “direct cost test.” Under this test, the FSC must demonstrate, with respect to each transaction generating the FTGR, the satisfaction of one of two tests. The first test is met if fifty percent or more of the total direct costs incurred by the FSC with respect to the five activities\textsuperscript{81} are attributable to activities performed outside the United States. The second test is met if eighty-five percent or more of the total direct costs incurred by the FSC with respect to each of the five activities are attributable to activities performed outside the United States.\textsuperscript{82}

B. FSC Falls Short of GATT Provisions

The facility with which a FSC may meet either of these tests creates GATT compatibility problems. First, by utilizing the eighty-five percent test, a FSC could, through careful planning, incur eighty-five percent of the costs derived from its least expensive activi-

\textsuperscript{78} See supra note 73. An FSC shall be treated as having Foreign Trading Gross Receipts under the temporary regulations if: (1) the management of the FSC takes place outside the United States; (2) all meetings of the board of directors of the FSC and all shareholder meetings of the FSC take place outside the United States; (3) the principle bank account of the FSC is maintained outside the United States; and (4) all dividends, legal fees, accounting fees and salaries of officers of the FSC are disbursed out of bank accounts outside the United States. I.R.C. §§ 924 (1984); Treas. Reg. § 1.924(c) (1984).


\textsuperscript{80} Id.

\textsuperscript{81} The five activities referred to in the test are: 1) advertising and sales promotion; 2) processing customer orders and arranging for delivery of the export property; 3) transportation of the property to the customer; 4) determining and transmitting the final invoice or statement of account and receiving payment; and 5) assumption of the credit risk. Id. at § 924(e).

The following is an illustration of how the 50% and 85% tests work:

If the total direct costs of the five activities is $1,000 and at least $500 of these costs was attributable to activities performed outside the United States, the 50 percent test would be met. Alternatively, if the $1,000 total direct costs included advertising costs of $100 and transportation costs of $200, of which $85 and $170, respectively, were attributable to activities performed outside the United States, the 85 percent test would be met.

Goldberg, supra note 20, at 32-35.

\textsuperscript{82} I.R.C. § 924(d)(2) (1984).
ties outside the United States while still satisfying the foreign economic processes test. In essence, the FSC could circumvent the purpose, if not the mandate, of article XVI:4 of GATT by relying on its least expensive foreign activities to meet the eighty-five percent test.

The alternative, the fifty percent direct costs test, is equally easy to meet. This test enables an FSC to conduct half of the activities necessary to complete an export transaction within the United States territorial limits.

1. The European Community’s Response to FSC

The European Community is concerned over the leniency of the foreign economic process requirements. GATT requires that trade, rather than fiscal implications, be the focal point of a taxation system. The United States, however, uses a trade-related taxing “tool” to achieve a reduction in its foreign trade deficit. A second concern is that the “attribution of profits in relation to economic processes discriminates in favor of United States versus foreign shareholders.” The European Community is also concerned that some of the foreign economic process requirements could be met on a “contractual basis” even if initiated in the United States.

83. Goldberg, supra note 20, at 32-36. The foreign economic process test is met by an FSC which has Foreign Trading Gross Receipts and meets the “direct costs test.” See supra notes 78-82 and accompanying text; I.R.C. § 924(d)(2) (1984).
84. Canadian Commercial Counselor John St. Jacques expressed his government’s concern over the “50% United States content” provision, agreeing with this author that the requirement is merely a “shell” designed to appease GATT Council members, while really continuing to foster United States export activity at the same or higher rate as with the DISC. St. Jacques Interview, supra note 71 and accompanying text.
85. Snow Interview, supra note 72. Ms. Snow stated that the European Community considers the United States system of taxation to be a “partial application of the territorial principal.” She added that the United States system of “not taxing earnings from export sales” violates article XVI:4 of GATT. Id.
86. In other words, the United States practices the converse of the GATT-approved system of taxation.
87. Because the FSC provisions effectively tax most of the export profit resulting from the sale of goods manufactured in the United States and maintain revenue neutrality or equivalent tax benefits with the old DISC provisions, this income is not taxed again when distributions are actually made from foreign trade income (FTI) to the United States corporate shareholders. Consequently, actual distributions made from FTI to United States corporate shareholders are eligible for a special 100% dividend received deduction; foreign shareholders, on the other hand, must pay taxes on dividends. FSC Conference, supra note 68.
88. Contractual basis means that a commission agent of a FSC can perform the five activities involved in making a contract with a foreign buyer by contract with the parent company in the U.S.
89. Treas. Reg. § 1.924(d)-1T(a) (1984). The FSC or its agent may act upon standing instructions of its parent corporation.
2. Economic Processes Outside the U.S.

All of the European Community objections concerning the FSC foreign economic process are based on the first provision of the 1981 GATT Qualifier. Under this provision, an exporting country is not required to tax economic events which occur outside its territorial limits. This means that economic processes occurring within the territorial limits of the exporting nation must be taxed in order to prevent an illegal export subsidy. Yet, under the new FSC, the United States allows an exporter to qualify for a fifteen percent exemption from United States taxes for export earnings, by meeting either the fifty or eighty-five percent test. The United States trading partners argue that if the United States is going to allow a substantial number of the activities connected with an export transaction to take place within the territorial limits of the United States, those activities should be taxed. It follows that the tax exemption or "remission" is in violation of GATT insofar as any export-related activities are conducted within the United States.

3. Price Regulation

Another FSC problem of GATT compatibility, which relates to the second element of the GATT Qualifier, is the choice of pricing rules given to FSCs. As explained in Section II of this comment, the 1981 GATT Council Qualifier made arm's-length pricing a prerequisite for compliance in all transactions in which exporting companies and foreign buyers are under common control. Under the

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90. Goldberg, supra note 20.
91. The 15% tax reduction is allowed under the "combined taxable income" method. I.R.C. § 923 (1984). Other approaches yield even greater exemptions. See infra notes 93-99 and accompanying text.
92. Snow Interview, supra note 72.
93. Rosenblum, supra note 27. The portion of taxable income earned by a FSC is based on the transfer pricing rules. The amount is either computed using arm's-length standards or administrative pricing rules. In order to use the administrative pricing rules, the FSC must either itself or through another person acting under contract perform all the activities under the foreign economic process requirements. The taxable income of an FSC can be based on a transfer price in an amount which does not exceed the greatest of the following:
   (i) 1.83 percent of the FTGR derived from the sale of such property by an FSC;
   (ii) 23 percent of the combined taxable income of a FSC and the related person attributable to the FTGR; or
   (iii) Taxable income based upon the sale price actually charged, but subject to the arm's-length rules of section 482.

Treas. Regs. §§ 1.924(d)-1T(e), 1.921-2T(h) (Q&As 12-13) (1985).
For purposes of section 925, the formulae contained in (i) and (ii) above are referred to as
1984 Deficit Reduction Act, an FSC may choose between administrative pricing rules and arm's-length pricing.94

In order to use administrative pricing rules, the FSC, or another person acting under contract, must perform all the activities required by the foreign economic process.95 By allowing some of the required foreign economic processes to be performed in the United States, the temporary regulations make the use of administrative pricing rules a direct violation of the second tenet of the Qualifier. Similarly, the fact that the new law allows the transfer price to be computed after the sale and close of the taxable year, appears to conflict with the purpose of GATT.96

More of the FSC's foreign trade income is excludable under the arm's-length pricing method than under either of the two administrative pricing methods. If an FSC uses "arm's-length" transfer pricing, thirty-two percent of its foreign trade income is exempt from United States taxes. If, instead, the FSC uses the special administrative pricing rules, it is only allowed a sixteen percent exemption.97 Without the benefit of the administrative pricing rules, however, taxable income of an FSC would be based upon the sale price actually charged by the related supplier.98 Instead, the FSC may compute its taxable income attributable to a sale at the reduced rate using either the 1.83% of foreign trading gross receipts or the 23% of combined taxable income methods.99 Such obvious benefits which inure to the FSC circumvent the GATT Qualifier because the benefits represent export subsidization by the United States.

4. Foreign Presence

The final category of concern over the FSC involves the GATT foreign presence requirements. Within this general category are a number of significant problems of GATT-compatibility. Perhaps the most objectionable provision of the FSC is that it may be organized in one of four qualifying possessions: American Samoa, Guam, Com-

the "administrative pricing rules." According to the Temporary Treasury Regulations, all of the activities referred to above do not have to take place outside of the United States. Id.

94. See supra text accompanying note 46. See also I.R.C. § 994(a)(1)-(3); Treas. Reg. § 994-1 (1985).


96. Snow Interview, supra note 72.


98. Id. at § 925(a)(3) (1984). The administrative pricing rules only apply to transactions between related parties, in contrast to the arm's-length pricing provision under the new law which only applies to transactions between non-related parties.

99. Id.
monwealth of Northern Mariana Islands or the United States Virgin Islands.\(^{100}\) The reason GATT required the United States to change the export entity from the DISC to a FSC was that the DISC was located within the United States. By requiring the exporting entity to move its location outside the territorial limits of the United States, the new law creates truly foreign source income which is not taxed under the GATT Qualifier. In addition, the new law would comply with the general purposes and policy objectives expressed in the GATT Preamble.\(^{101}\)

5. *Practical Effect of New Law*

It is easy to understand why the United States trading partners object to the organization of FSCs in United States possessions. As was discussed above, the DISC’s discriminatory tax treatment cost the United States trading partners millions of dollars.\(^{102}\) The question remains as to whether its replacement will do the same by permitting organization in United States possessions, the so-called “tax havens.”\(^{103}\)

The probability of negative reaction by other GATT signatories is linked, to a large degree, to the proportion of FSCs set up in United States possessions. The United States trading partners will not be able to realize the potential gain that would result from taxing FSCs incorporated in their countries. Also, the European Community and other GATT nations will not easily accept the new legislation’s two year prohibition on the taxation of the foreign trade income of FSCs incorporated in United States possessions.\(^{104}\)

6. *Treasury Department Regulations Exacerbate Shortcomings*

Although the Treasury Department released a list of 23 foreign countries in which an FSC may be organized,\(^{105}\) the United States

\(^{100}\) Snow Interview, supra note 72. See also St. Jacques Interview, supra note 71; infra note 106.

\(^{101}\) The contracting parties are to enter into “reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce.” Preamble to GATT, opened for signature Oct. 30, 1947, 61 Stat. A3, T.I.A.S. No. 1700, 55 U.N.T.S. 194.

\(^{102}\) Snow Interview, supra note 72.

\(^{103}\) Id.

\(^{104}\) Id.

\(^{105}\) Bruce, supra note 70. The FSC acceptable countries of incorporation are: Australia, Austria, Belgium, Canada, Denmark, Egypt, Finland, France, Germany, Iceland, Ireland, Jamaica, Korea, Malta, Morocco, Netherlands, New Zealand, Norway, Pakistan, Philippines,
possessions appear almost too inviting for most exporters to ignore. An example is the United States Virgin Islands' (USVI) FSC legislation which provides that foreign trade income on FSCs is exempt for two years with only a 0.85% subsequent income tax. In addition, an employer's tax credit, for eighty percent of wages paid to USVI resident employees, is available. Similarly, no tax liability will be imposed at all if a FSC pays out $100,000 in qualifying wages. Other benefits to FSCs located in the USVI include, for example, tax credits against income tax for FSCs which use the services of a qualified management firm and credits for wages paid to local contractors used by the FSC. In Guam, all FTI taxes are exempt (after 1987); thus, the only charge imposed on a FSC consists of a $1,000 annual license fee. American Samoa imposes no taxes on FSCs but has a one time incorporation fee of $100 and an annual license fee of $500.

With all of these attractive features luring potential FSCs to the United States possessions, it is no wonder that several large corporations have chosen to organize FSC's in these territories. General Electric Company has already organized a FSC in the USVI, while Boeing is organizing one in Guam. Many corporations will undoubtedly follow the lead of General Electric and Boeing, two of the biggest winners under the new legislation's forgiveness of DISC income taxes. Even small exporters like ICS Electronics in San Jose are taking advantage of the relaxed regulations for small companies by establishing a FSC in the Northern Mariana Islands.

Companies like ICS, with foreign taxable incomes of less than $5 million per year, can reap the tax exemptions without many of the regular FSC headaches. The new legislation contains specific

South Africa, Sweden and Trinidad & Tobago. These are the countries which have currently signed a CBI exchange of information agreement, or are countries which maintain a bilateral income tax treaty with the U.S., and are certified by the Secretary of the Treasury as “carrying out the purposes of this provision.”

106. Id. at 597.
107. Id.
108. Id.
109. Id.
110. Id.
111. Id. Kristof, supra note 12, at 28. As a New York Times staff writer recently wrote, “it is probably no accident that the most attractive locations for Foreign Sales Corporations are . . . the Virgin Islands or the Bahamas.”
112. Id. at 27.
113. Id. G.E. had well over $300 million and Boeing had $300 million of their DISC's deferred taxes forgiven.
114. Id. at 28.
provisions for small FSCs, which are designed to permit small businesses to take advantage of FSC provisions without meeting the more complex foreign requirements. Specifically, small FSCs are not required to meet the most onerous conditions of the FSC: the foreign presence and economic processes requirements. A small FSC may qualify by merely leasing a room in the USVI and keeping books. The effect is, once again, circumvention of GATT mandates under United States legislation enacted to stimulate export trade in the United States.

Finally, even the “burdensome” foreign economic processes, management and presence requirements have been relaxed by the recent temporary regulations issued by the Treasury Department. To meet the foreign economic process requirements, the regulations provide that “the FSC [or other person] may act upon standing instructions from another person in the performance of any activity.” This means that the parent corporation located in the United States can direct the FSC’s activities while the FSC merely responds to the orders. The similarities between the small FSC and the “paper company” or the DISC are striking.

The ease of meeting the foreign economic process test is also aided by temporary regulation section 1.924(e), which provides that activities will be deemed to take place where the FSC initiates them. The location where the instructions actually originate is irrelevant under the new law. Thus, the parent corporation in the United States can control all activities by telephone, mail or telegraph while the FSC is credited with “initiating” the “foreign” activity. It appears that the FSC can be manipulated by its related United States supplier. This regulation allows the FSC to act as a holding company rather than as an independent entity which performs real functions. The consequences will be that the FSC, like its predecessor, will be objectionable to GATT because it will receive the tax exemption while only performing perfunctory foreign exporting activities.

115. A small FSC must make an election to be treated like a small FSC; it cannot have more than $5 million of export gross receipts and may not be a part of a controlled group of corporations which includes any other FSC unless such other FSC elects small FSC status. I.R.C. § 922(b) (1984).
116. All the foreign economic processes can be conducted in the U.S. This can result in significant savings of administrative costs. Treas. Reg. § 1.921-27(h).
118. Treas. Reg. § 1.924(d)-1T.
119. Goldberg, supra note 20.
121. FSC Conference, supra note 68.
The other regulations regarding foreign presence and management are equally facile and therefore objectionable under GATT constructs. First, FSCs are required to maintain offices located outside the United States in a qualifying country or eligible possession. On its face, this appears to be a positive move toward GATT-compatibility. Yet the regulations define an office as a building or a portion of building consisting of at least one room, regularly used and operated for some corporate business, and owned or leased, by the corporation or the corporation's dependent or independent agent." Practically, this means that the parent corporation in the United States can hire a management firm in the USVI (or other possession) to lease a room in which to conduct the minimum business required under the new law. To facilitate the organization of FSCs, the Treasury Department allows FSCs to share facilities.

IV. A PROPOSAL TO BRING THE FOREIGN SALES CORPORATION INTO CONFORMITY WITH GATT

Despite all its GATT incompatibility problems, the FSC is an improvement over the DISC. In fact, the problems described in the preceding section of this comment arose solely because the United States goal of maintaining revenue neutrality outweighed its desire to appease its trading partners. One only has to look to the $13 billion tax windfall given to the DISC shareholders, by virtue of the forgiveness, to see that the current Administration had United States exporters, rather than its GATT partners, in mind when it drafted the new legislation. Thus, the problems which must be solved are: (1) DISC forgiveness; (2) economic processes; (3) price regulations; (4) presence requirements; and (5) small FSCs.

A. Forgiveness

The Administration justifies the forgiveness of tax on the DISC's deferred income by labeling it a cost of enactment of the FSC provisions. Proponents of the new legislation argue that taxing the deferred income would impose too great a burden on the DISCs

123. Treas. Reg. § 1.972-1T (emphasis added).
124. FSC Conference, supra note 68.
125. Revenue neutrality means that the revenue from a FSC will be equivalent (approximately) to that earned under a comparably sized DISC.
126. Sanders, supra note 57.
and their shareholders.\textsuperscript{127} The fact that most companies which used the DISC "operated on the assumption that they would not have to pay the taxes and incorporated the benefit into their earnings year by year" bolstered the argument.\textsuperscript{128} Not all the DISCs were so bold; some showed a one-time benefit in the third or fourth quarter of 1984, the last year of the DISC.\textsuperscript{129} Another purported argument in favor of the forgiveness of DISC income is that it would be too difficult to determine the end of each DISC's fiscal year for purposes of accounting for their profits.\textsuperscript{130}

All of the arguments stem from the underlying assumption that the tax break was given in order to create parity with the tax policies of the other GATT countries. Exporters such as General Electric, Boeing and McDonnell Douglas, which will avoid paying a total of at least $300 million in foreign taxes, believe that the tax break is simply owed to them due to the United States government assurances.\textsuperscript{131} The statutory language,\textsuperscript{132} however, indicates that DISCs are only entitled to the deferral, and not the remission of taxes.

However, any exporter who formed a DISC must have known that the European Community, Canada and others had been complaining about the DISC even before its enactment in 1971. That unrelenting attack culminated with the 1976 GATT Panel Reports, and the 1981 adoption of those reports with the GATT Qualifier, which declared the DISC to be an export subsidy in violation of GATT. If the attacks and the reports did not put the DISC owners on notice, then the European Community's request that GATT impose sanctions on the DISCs, in July 1982, surely did.\textsuperscript{133} Nor could these exporting companies have failed to hear about the Reagan Administration's 1982 concession to GATT which promised to change the DISC and bring it into conformity with GATT.\textsuperscript{134}

Given the fact that United States companies that reaped the

\textsuperscript{127} Goldberg, supra note 20, at 32-34.
\textsuperscript{128} Kristof, supra note 12, at 28.
\textsuperscript{129} Id.
\textsuperscript{130} FSC Conference, supra note 68.
\textsuperscript{131} Id.
\textsuperscript{132} M. Moore & R. Bagley, United States Tax Aspects of Doing Business Abroad 31 (1978). Concern with this deferral benefit led the Carter Administration to request its repeal by Congress. The repatriation of DISC income to its shareholders (the parent corporation) is effectuated through the payment of dividends which are taxable upon receipt and may afford the recipient a tax credit.
\textsuperscript{133} The European Community requested $2.3 billion in compensatory damages allegedly caused by the DISC. U.S. Export Weekly, July 27, 1982, at 597.
benefits of the DISC, such as General Electric, had at least constructive notice of the DISC's incompatibility with GATT, it does not seem unjust or inequitable to place the burden of the deferred payments on them. The alternative is to allow the forgiveness which indirectly shifts the burden to other GATT countries. Each DISC user should bear the burden of the assumed risk that it would eventually have to pay the taxes. The United States trading partners, who made no waiver of their right to object under GATT, should not be burdened with the DISC shareholders' calculated risk.

However, requiring DISC shareholders to pay the accumulated taxes in one lump sum would likewise be unjust; they expected to pay the deferred taxes over a period of time and should not bear this heavy burden merely because of a shift in United States tax policy. One solution to this problem would be to tax the deferred DISC income over a "ten year period." This would lighten the immediate impact of the tax to the DISC shareholders and eliminate the tax remission which is violative of GATT. Both sides would be treated fairly under such a compromise.

B. Economic Processes — Direct Cost Tests

The second problem with the new legislation is that some of the foreign economic process requirements can be met on a "contractual basis" even in the United States. The new law requires the FSC to perform certain activities, directly related to the making of an export contract for goods or services, outside the United States territorial limits. However, the temporary regulations effectively allow a parent corporation to circumvent this requirement. The solution to this problem is tightening the regulations by requiring that the FSC perform all the export-related activities outside the United States. The goal of the regulations should be to require the FSC to actually conduct the export activities outside the United States and not simply to go through the motions to appear GATT-compatible.

Intertwined with the foreign economic process test is the direct cost test. The present legislation does not suffice because both the fifty percent and the eighty-five percent tests allow the related supplier to perform a large portion of export related activities within the

135. Goldberg, supra note 20, at 32-34. Goldberg also suggested this solution as a possible alternative. The author of this comment suggests that this solution is the only equitable remedy to an otherwise GATT-incompatible law.

136. Snow Interview, supra note 72.
United States.187 As examined in section II of this comment, the new
law allows a tax break for sales by FSCs even when partly per-
formed in the United States.188

To solve this problem, the United States has two options: (1) it
can require that substantially all (approximately eighty-five percent)
of the export related activities be performed by the FSC outside the
United States territorial limits; or (2) it can tax that portion of the
activities conducted within the United States. Either method would
satisfy the GATT Qualifier which allows an exporting country not
to tax the foreign activities of exporters.

C. Price Regulations

The third GATT-compatibility problem of the FSC is the
choice of transfer pricing rules.189 The GATT Qualifier required all
transactions between exporting companies and foreign buyers under
common control to use arm's-length pricing rules. Under the new
law, United States exporters are able to select either administrative
pricing or arm's-length pricing rules and this selection can be made
after the close of the taxable year. The effect is to create the obvious
advantage of a “wait-and-see” approach for United States exporters
which use the FSC. The answer to this problem is simply to require
arm's-length pricing in all transactions between the FSC and its re-
lated suppliers. Arm's-length pricing is GATT-mandated and will
prevent FSC shareholders from obtaining the windfall that their
counterparts received under the DISC.

D. Presence

The fourth problem of GATT-compatibility stems from the
ability of an FSC to organize in one of the United States posses-
sions.140 The concern is over the autonomy of the United States pos-
sessions and therefore the “foreign” nature of an FSC which chooses
to incorporate there. The new legislation requires the qualifying
possessions to impose no taxes on FSCs until 1987.141 In essence, the

137. See supra note 82 and accompanying text.
138. Rosenblum, supra note 27, at 475.
139. St. Jacques Interview, supra note 71.
140. Snow Interview, supra note 72. This provision contradicts the Reagan Administra-
tion's proposal presented to GATT in March 1983. Under that proposal, a FSC could qualify
only if it were organized in a country with which the United States has an exchange of infor-
mation agreement. Goldberg, supra note 20, at 32-18.
141. It can be argued that this policy simply conforms with the 1981 GATT Qualifier
which provides that an exporting country can use devices to avoid double taxation. The
FSC could locate in a United States possession, avoid paying any foreign taxes for two years, and pay only a nominal amount thereafter. The consequence of such incorporation is that United States exporters avoid the "cost-plus"\textsuperscript{142} taxation policy used by most of its trading partners while still qualifying for the FSC tax exemptions.

Additionally, the legitimacy of incorporating in a United States possession which remains under United States control, but is technically "outside" the United States customs zone, is in question. This control is evidenced by the four qualifying possessions' submission to United States pressure to postpone taxation of FSCs until 1987. The possessions' dependence on the economic stimulus provided by FSC incorporation — more jobs, leasing and purchasing of office space, and the hiring of local management facilities — casts doubt on their independence from United States control. This in turn raises a suspicion about the "foreign" nature of the FSC.

The centerpiece of the new legislation is the removal of the DISC to foreign soil. By allowing the FSC to locate in a United States possession, the United States has not removed the taint of providing an export subsidy. The solution: return to our original GATT commitment and require FSCs to be organized in a country with which the United States has an exchange of information agreement.\textsuperscript{143} This solution would cause the FSC program to be in compliance with GATT, and United States exporters which utilize the program would incur greater costs. The increased costs, however, would be insignificant compared with the benefits to world trade.\textsuperscript{144}

E. Small FSCs

The fifth area of concern involves the small FSC.\textsuperscript{145} Under the new law, the small FSC can get all the tax benefits of a large FSC without having to meet foreign management and economic process requirements. With the exception of being required to maintain summary books of accounting and an office outside the United States, the small FSC is hardly a "foreign entity" within the mean-

\textsuperscript{142} "Cost-plus" means the cost of product plus an additional percent tax, usually 10%.

\textsuperscript{143} See supra note 105 and accompanying text.

\textsuperscript{144} The benefits to world trade from full U.S. compliance with GATT and its 1981 Qualifier might erase many of the hostile feelings of our trading partners carried over from U.S. enactment of the DISC. See Snow Interview, supra note 72.

\textsuperscript{145} Id. An in-depth discussion of the small FSC or the "Interest Charged DISC" is beyond the scope of this paper. See Goldberg, supra note 20 for a more detailed discussion.
ing of GATT. Again, the solution is simple: require the small FSC to meet the more stringent foreign economic process requirements outlined earlier in this comment and require small FSCs to incorporate in countries which have exchange of information agreements with the United States.

A related issue involves the lenient foreign management requirement which FSCs, but not small FSCs, must meet. Currently an FSC must have a board of directors of which only one member must be a non-United States resident. That "foreign" manager can even be a United States citizen so long as he lives in the place of incorporation. Nowhere in the new legislation is there more of a ruse than in this provision. The solution is to require at least a majority of the board of directors to be non-United States residents. This would further the FSC's GATT-compatibility while simultaneously improving relations with United States trading partners.

Under the temporary regulations, an FSC can do the bare minimum required by the Treasury Department and still be considered to be conducting business outside the United States. The regulations only require that an FSC rent a room and do some business there. This hardly seems to meet the "presence" outside the territorial limits required by GATT. To rectify this problem, stiffer regulations of the type described in this comment should be enacted, requiring at least a permanent office with substantially all export activities conducted therein.

V. CONCLUSION

January 1, 1985 marked the beginning of a new United States exporting entity: the FSC. All indications point toward a warm reception to the new legislation in this country. Attorneys, accountants and other interested parties have flocked to FSC conferences across the country so that they may represent potential and existing clients who export products or services from the United States. Many United States corporations such as General Electric, foreseeing the revenue-producing potential of the FSC or small FSC, have already set up offices in United States possessions. Even the European Community has welcomed the change from the DISC to the FSC.

Despite these initial favorable reviews, the FSC does not appear to be consistent with GATT. One of the Reagan Administration's stated goals in lobbying for the 1984 Deficit Reduction Act was to close tax "loopholes." Yet the Deficit Reduction Act allows a $13.6 billion forgiveness of taxes to the DISC shareholders on income earned from the DISC exporting vehicle.
The grounds for objection to the forgiveness are found in the GATT charter which prohibits illegal export subsidies by signatory nations. Throughout the existence of the DISC, GATT members, such as the European Community and Canada, objected to the deferral partly based on their fears that the DISC income taxes would never be collected. Rather than allay their fears, the United States government proved that the European Community and others were correct by forgiving back taxes owed by the DISC shareholders. The European Community estimated that their losses suffered under the DISC program were between $10 million and $12 million. United States taxpayers will also indirectly absorb the loss of $13.6 billion in revenue.

At the GATT council meetings beginning on November 6, 1984, the European Community requested that the United States explain how the new FSC legislation conforms to the GATT panel reports on the DISC. The United States refused to have multilateral consultations but has agreed to bilateral consultations. The United States has used disguised threats, negotiating techniques and tactical devices to silence the complaints that surely would be raised by the United States trading partners.

There are really no alternatives open to GATT member nations which press the United States for FSC modifications, but do not want the suspension of GATT. The inevitable result of a suspension of GATT would be trade anarchy and the raising of protective tariff barriers, halting the free flow of products between some of the most productive trade nations.

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