Case Western Reserve Journal of International Law

Volume 14 | Issue 3 Article 11

1982

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Section 861 of the U.S. Internal Revenue Code (IRC) provides that interest and dividend income received by nonresident aliens or by foreign corporations from domestic corporations is U.S. source income. However, if the domestic corporation making such payments has derived less than 20 percent of its gross income from sources within the United States for its three prior taxable years, the interest or dividend payments will not be considered U.S. source income. From this section of the code, the Treasury Department, on December 27, 1982, issued Temporary Regulation Section 4a.861.

Temporary Regulation Section 4a.861 provides that income derived from Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands will be treated as U.S. source income for the purpose of sections 861(a)(1)(B) and 861(a)(2)(A) if the recipient of the income is not subject to tax in those jurisdictions. When this regulation is mirrored and incorporated into the Guam Tax Code by substituting the words "U.S. Corporation" and "Guam" with the words "Foreign Corporation" and "United States" respectively, it provides that interest and dividend income from the United States will be treated as Guam source income for the purpose of sections 861(a)(1)(B) and 861(a)(2)(A) if the recipient of that income is not subject to tax on that income in the United States. Accordingly when tax-free interest is received by a Guam company from sources within the United States under section 881(b) of the IRC, the Treasury Department's new Temporary Regulation requires Guam tax authorities to impose a 30% withholding tax under section 881(a) of the Guam code on that income when it is ultimately paid to a non-Guam parent.

Temporary Regulation Section 4a.861.1 introduces a rule that appears to be contrary to sections 861(a)(1)(B) and 861(a)(2)(A) of the IRC. Furthermore, there is no language in section 861 of the IRC authorizing the Treasury Department to issue this regulation. In effect, this regulation has changed the Guam Tax Code; an act well beyond the Treasury Department's regulatory authority. Moreover, absent proper statutory

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* J.D. Case Western Reserve University, 1982.

support, new rules and regulations of this nature should only be introduced by Congress.

From a policy position, this new regulation will restrict the ability of U.S. companies to secure foreign financing. This unintended result conflicts with public statements by the Internal Revenue Service that it does not want to preclude U.S. companies from utilizing advantageous foreign capital markets. This conflict of policy and practice is highlighted by the possibility that the U.S.-Netherlands Antilles Tax Treaty may not be successfully renegotiated. Presently, the U.S.-Netherlands Antilles Tax Treaty enables U.S. companies to obtain access to foreign capital markets free of adverse tax consequences. Assuming the U.S.-Netherlands Antilles Treaty is successfully renegotiated and the new Treasury Regulations are withdrawn, Guam would simply offer American business another means through which to participate in foreign capital markets. Conversely, if a new treaty is not renegotiated, Guam could prove to be an alternative for American business to obtain access to foreign capital markets without prohibitive tax consequences.

Furthermore, the critical issue in the current treaty negotiations is whether Article 16 of the U.S. model treaty should be incorporated into the existing treaty. That section, if adopted, would help restrict the common practice of treaty shopping; a practice which the U.S. Government insists must stop. Since the issue with the Netherlands Antilles Treaty is "treaty shopping" and since the United States does not have a treaty with Guam, there should be no objection to permitting American business to obtain access to the advantageous foreign capital markets through Guam.

In sum, the Treasury Department may have exceeded its regulatory authority when it issued Temporary Regulation Section 4a.861. Notwithstanding the absence of statutory support, this regulation also violates public policy by restricting the ability of American business to obtain access to foreign capital markets. For these reasons, Temporary Regulation Section 4a.861-1 should be withdrawn.