



Organization for International Investment (“OFII”)
Written Statement for the Record of the House Judiciary Commercial and Administrative
Law Subcommittee Hearing on State Taxation – The Role of Congress in Defining Nexus

February 4, 2010

The Organization for International Investment (“OFII”) appreciates the opportunity to comment on the role of Congress in defining “nexus” within state taxation. OFII urges the Committee to play an active role in resolving the issue of economic nexus in order to address a growing concern for international businesses – the increasing number of U.S. states that have been inappropriately aggressive in attempting to increase their share of the global tax base of multinational companies by expanding their fiscal jurisdiction outside the United States. Expansive interpretations of economic nexus by U.S. states threaten to impose significant double taxation on non-U.S. companies and make the United States a less competitive location for global businesses to invest and create jobs. The extraterritorial taxation resulting from these interpretations is inconsistent with U.S. federal income tax laws, international norms of taxation and violates the spirit of U.S. double taxation treaties. Such tax treatment is fundamentally unfair and risks harmful and unnecessary disputes with our major trading partners.

OFII represents the U.S. operations of companies headquartered abroad; companies which directly employ over 5 million Americans across the 50 U.S. states. OFII promotes fair and equal treatment for these “Insourcing” companies in U.S. federal and state law. We undertake this mandate with the goal of making the U.S. an increasingly attractive market for international companies to invest and create American jobs. At a time when the U.S. Congress is considering ways of attracting new business investment, preserving fair and equitable tax treatment at the federal and state level is more critical than ever.

I. Insourcing Companies in the United States

As illustrated in the attached membership list, and by the facts below, “insourcing” companies, play a major role in our nation's economy, providing critically important jobs (and the associated tax base) in communities across the country.

Some salient facts about insourcing companies:

- U.S. subsidiaries employ 5.5 million Americans — 4.6% of total U.S. private sector employment;
- U.S. subsidiaries account for 6% of total U.S. GDP;

- U.S. subsidiaries support an annual payroll of \$403.6 billion — with average compensation per worker of \$73,124, which is 34.7 percent higher than compensation at all U.S. companies;
- U.S. subsidiaries heavily invest in the American manufacturing sector; with 29 percent of the jobs at U.S. subsidiaries in manufacturing industries;
- U.S. subsidiaries manufacture in America to export goods around the world — accounting for nearly 18.5 percent of all U.S. exports, or \$215.6 billion;
- U.S. subsidiaries pay over 14 % of U.S. federal corporate taxes, according to the IRS, a larger share than their relative size in the U.S. economy.
- U.S. subsidiaries have a larger percentage of workers covered by a union collective-bargaining agreement than other U.S. companies — 12.4% of employees at U.S. subsidiaries compared to just 8.2% at other U.S. firms.

II. Extraterritorial State Taxation Risks Economic Benefits

The significant contributions insourcing companies bring to the U.S. economy are a direct result of the U.S.’s open investment environment, which treats these companies and the Americans they employ on a level playing field with their domestic competitors. The growing trend of U.S. states moving to extraterritorial taxation of non-U.S. companies undermines these contributions.

- U.S. states’ aggressive fiscal behavior: (1) can deter foreign investment in the U.S. due to increased uncertainty for double taxation; (2) disrupts the international tax treaty network; (3) could encourage retaliatory foreign legislation; and (4) creates uncertainty, complexity, inadministrability and substantial costs.
- It is important that the U.S. government maintain its ability to speak with one voice on international fiscal matters and not be undermined by the efforts of individual states.
- States have other tools to combat perceived fiscal abuse. Current state actions are inappropriately sweeping in legitimate business transactions.
- When U.S. states have taken extraterritorial tax actions in the past, many U.S. treaty partners have issued strong objections and even adopted blocking statutes and laws mirroring this inappropriate tax treatment for U.S. multinationals.

U.S. states are expanding their fiscal reach in two different ways: (1) “economic nexus”; and, (2) expanded “water’s edge” provisions.

1) Economic Nexus

U.S. double taxation treaties require a physical presence (usually defined as property, employees, etc.) in Country A before Country A can levy an income tax on a company incorporated in Country B. However, since U.S. states are NOT bound by U.S.

tax treaties, some have adopted “economic nexus” provisions that impact foreign parents and affiliates incorporated in other countries.

Specifically, approximately 25 U.S. states have already adopted an expansive “economic nexus” theory, which does **NOT** require physical presence to assert taxing authority (see attached map).

For instance, a company incorporated in the U.K., with no physical presence or employees in the U.S., may find itself subject to tax in a particular U.S. state.

Example: Recently, New Jersey has sent tax assessments directly to certain foreign parents of U.S. subsidiaries under an “economic nexus” theory. New Jersey authorities claim they have a right to tax these foreign companies merely because they have received royalty payments from U.S. affiliates doing business in New Jersey. The foreign parent companies have NO physical presence in New Jersey. The international business community has been extremely active in fighting this effort. There has been no resolution to date.

“Economic nexus” provisions were originally developed to deter U.S. companies from directing intangible revenue to domestic affiliates located in states that do not tax this income, thus reducing their overall tax burden. However, U.S. states have other provisions to effectively combat such abuses and the use of a broad “economic nexus” theory unfortunately sweeps in legitimate business transactions.

2) Expanded “Water’s Edge”

Some U.S. states have taken the position that **all** foreign affiliates of a company doing business in a state should be included in a “combined return,” **regardless** of whether such foreign affiliates have physical presence or nexus in that state. However, most states with “combined reporting” allow companies with affiliates in other countries to make a “water’s edge” election. Under a “water’s edge” election, the combined group – i.e., the companies that are taxable in the state - is comprised only of those affiliated corporations within the “water’s edge” of the United States (the 50 states and the District of Columbia).

Various U.S. states are now expanding the definition of “water’s edge” beyond the Atlantic and Pacific Oceans. Specifically, foreign affiliates that earn a certain percentage of income from U.S. sources are being deemed part of a state’s “combined group” for tax purposes - even if the U.S. federal government does not subject such foreign affiliate to income taxes.

Example: Effective beginning in 2009, Massachusetts enacted a Combined Reporting Statute that includes an expanded definition of a “water’s edge” election. Specifically, the “water’s edge” group would include foreign companies that receive more than 20% of their income from a U.S. source. Importantly, these foreign companies have no physical presence or nexus in the U.S. Therefore,

foreign companies that are already subject to tax in their home country and that are not subject to federal income taxes would be required to file a Massachusetts tax return and pay tax in Massachusetts. The international business community is currently embroiled in an effort to change the law, with no resolution to date.

Acting on an expanded “water’s edge” approach in the 1990s, California attempted to bring foreign affiliates of U.S. companies into its tax base even though they had no physical presence in the U.S and were subject to tax in their home countries. This proposal drew strong objections from U.S subsidiaries of foreign companies and from U.S. treaty partners who rightly viewed California’s proposal as a revenue grab, and an erosion of treaty protections for its corporate citizens. Many countries raised serious concerns about California’s efforts and the U.K enacted retaliatory legislation against California-based companies. As a result, California dropped its extraterritorial aspirations and adopted a “water’s edge” election whereby a U.S. combined group could elect to limit such group to affiliates with physical presence or nexus in the U.S.

CONCLUSION

As stated above, a growing number of U.S. states have adopted aggressive “economic nexus” theories and expanded “water’s edge” statutes that increase the risk factor of double taxation for foreign parents and affiliates of U.S. subsidiaries. Although U.S. double taxation treaties are meant to offset these risks, U.S. states are NOT bound by the treaties. As a result, foreign companies that have no U.S. physical presence and are not subject to federal income taxes may find themselves subject to double taxation by their home country and U.S. states. This creates an unlevel playing field since nearly all U.S. double taxation treaties bind the non-U.S. treaty partners’ sub-national governments, such as cantons, provinces and states.

Moreover, this approach enables states to conduct their own individual foreign fiscal policies at the detriment of investment flows into the U.S., endangering and disrupting the treaty network, and violating the international norms respecting national fiscal jurisdictions. There is no U.S. Constitutional prohibition that would prevent the U.S. federal government from including the states in the treaties, only a potential political issue. It is important that the U.S. government maintain its ability to speak with one voice and not be undermined by the efforts of individual states.

The potential for damage from this aggressive approach is significant. Current economic conditions are provoking U.S. states to expand their fiscal jurisdictions beyond U.S. borders with overly broad legislation. It is extremely important for the U.S. Congress to address this aggressive behavior.



ORGANIZATION FOR INTERNATIONAL INVESTMENT
INTERNATIONAL BUSINESS INVESTING IN AMERICA

OFII is the only business association in Washington D.C. that exclusively represents U.S. subsidiaries of foreign companies and advocates for their non-discriminatory treatment under state and federal law.

Members

ABB Inc.	EMD Serono Inc.	Randstad North America
ACE INA Holdings, Inc.	Ericsson	Reed Elsevier Inc.
AEGON USA	Evonik Degussa Corporation	Rexam Inc
AgustaWestland Inc.	Experian	Rio Tinto America
Ahold USA, Inc.	Finmeccanica North America	Roche Financial USA, Inc.
Airbus North America Holdings	Flextronics International	Rolls-Royce North America Inc.
Air Liquide America L.P.	Food Lion, LLC	SABIC Innovation Plastics
Akzo Nobel Inc.	France Telecom North America	Saint-Gobain
Alcatel-Lucent	Garmin International, Inc.	sanofi-aventis
Alcon Laboratories, Inc.	GDF SUEZ Energy North America, Inc.	SAP America
Alfa Laval Inc.	Generali USA	Schlumberger Technology Corp.
Allianz of North America	Givaudan	Schott North America
ALSTOM	GKN America Corp.	SGL Carbon LLC
AMEC	GlaxoSmithKline	Shell Oil Company
American Honda Motor Co., Inc.	Hanson North America	Siemens Corporation
Anheuser-Busch	Hitachi, Ltd.	Smith & Nephew, Inc.
APL Limited	Holcim (US) Inc.	Sodexo, Inc.
AREVA, Inc.	HSBC North America Holdings	Solvay America
Astellas Pharma US, Inc.	Huhtamaki	Sony Corporation of America
AstraZeneca Pharmaceuticals	Hyundai Motor America	Square D Company
BAE Systems	ING America Insurance Holdings	Sumitomo Corp. of America
Barclays Capital	InterContinental Hotels Group	Sun Life Financial U.S.
Barrick Goldstrike Mines, Inc.	John Hancock Life Insurance Co.	Swiss Re America Holding Corp.
BASF Corporation	Lenovo	Syngenta Corporation
Bayer Corp.	Logitech Inc.	Takeda North America
BIC Corp.	L'Oréal USA, Inc.	Tate & Lyle North America, Inc.
Bimbo Foods, Inc.	Louisiana Energy Service (LES)	Thales USA, Inc.
bioMérieux, Inc.	Louisville Corporate Services, Inc.	The Tata Group
BNP Paribas	LVMH Moët Hennessy Louis Vuitton	Thomson Reuters
Boehringer Ingelheim Corp.	Macquarie Aircraft Leasing Services	ThyssenKrupp USA, Inc.
BOSCH	Macquarie Holdings Inc.	Tomkins Industries, Inc.
BP	Maersk Inc	TOTAL Holdings USA, Inc.
Bridgestone Americas Holding	Magna International	Toyota Motor North America
Brother International Corp.	Marvell Semiconductor	Tyco International (US), Inc.
Brunswick Group	McCain Foods USA	Tyco Electronics
Bunge Ltd.	Michelin North America, Inc.	UBS
Case New Holland	Miller Brewing Company	Unilever
CEMEX USA	Mitsubishi Electric & Electronics	Vivendi
Cobham	Munich Re	Vodafone
Covidien	Nestlé USA, Inc.	Voith Holding Inc
Credit Suisse Securities (USA)	The Nielsen Company (US), Inc.	Volkswagen of America, Inc.
Daiichi Sankyo, Inc.	Nokia, Inc.	Volvo Group North America, Inc.
Daimler	Novartis Corporation	Welspun
Dassault Falcon Jet Corp.	Novelis Inc.	Westfield LLC
Deutsche Post World Net USA	Novo Nordisk Pharmaceuticals	White Mountains, Inc.
Deutsche Telekom	Oldcastle, Inc.	Wolters Kluwer U.S. Corporation
Diageo, Inc.	Panasonic Corp. of North America	WPP Group USA, Inc.
EADS, Inc.	Pearson Inc.	XL Global Services
EDF International North America	Pernod Ricard USA	Zausner Foods Corporation
Elbit Systems of America, LLC	Petrobras North America	Zurich Insurance Group
Electrolux Home Products, Inc.	Philips Electronics North America	