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Glossary of International Tax Terms

The language of international tax experts can be confusing, even to experienced audiences. To help decision makers understand the complex issues of international taxation, Business Roundtable has compiled this handy reference card that defines some of the most frequently used terms.

- ***Active Income***: Income earned by a corporation through the conduct of a trade or business activity (in contrast to a passive investment activity).

- ***Active Financing Income Exception**:* Under subpart F rules, interest and related income of a foreign subsidiary is generally subject to current taxation without benefit of deferral. These rules historically have aimed at requiring current taxation of income that is *passive* or easily moveable, although some forms of *active* income are also subject to these rules. A temporary exception to subpart F permits deferral of certain types of income derived from the *active* conduct of a banking, finance, or insurance business. This exception, initially enacted in 1997 and most recently extended in October 2008, expires for taxable years beginning after December 31, 2009.

- ***Controlled Foreign Corporation (CFC)**:* A foreign corporation in which more than 50% of the voting power or value of the stock is held by U.S. shareholders. Only a U.S. shareholder that owns 10% or more of the stock of the foreign corporation is included in this determination. Subpart F rules apply to foreign subsidiaries that are CFCs.

- ***Deferral**:* In order to maintain the ability of U.S.-based international companies to compete against their foreign-based competition and in conformance with tax policies of our trading partners, the U.S. government defers collecting taxes on earnings of the foreign subsidiaries of U.S.-based corporations until those earnings are actually paid to the U.S. parent, with some exceptions (*see* "Subpart F"). Most frequently, these foreign earnings will be paid as a cash dividend to the U.S. parent company. This method of taxation mirrors the tax treatment of individual shareholders in a domestic corporation who are not taxed on the earnings of the corporation until they receive a distribution from the corporation. All member countries in the Organization for Economic Cooperation and Development (OECD) and other developed nations that tax the worldwide earnings of their globally operating corporations permit some form of deferral.

- ***Exemption System:*** See *"Territorial Tax System"* below.

- ***Foreign Base Company Income (FBCI)**:* A type of foreign income that is subject to current U.S. taxation under subpart F rules whether or not distributed to U.S. shareholders. The four categories of FBCI are:
  - *Foreign personal holding company income* is defined as income which consists of dividends, interest, royalties, rents, and other kinds of investment income;
  - *Foreign base company sales income* is defined as income which is derived from the purchase and sale of property involving a related party where the property originates outside the country in which the controlled foreign corporation is organized and is sold for use outside such foreign country;
  - *Foreign base company services income* is defined as services income arising on behalf of a related person outside the country in which the controlled foreign corporation is organized; and

- *Foreign base company oil related income* is defined as income arising from the sale of oil and gas products except where the income is earned in the country in which it is extracted.

- ***Foreign Tax Credit****:* To avoid double taxation of foreign income, the U.S. provides a credit against U.S. income tax for income tax paid to the host country. Without this credit, significant double taxation would make foreign investments noncompetitive for U.S.-based international companies. The foreign tax credit is subject to various limitations to ensure that a U.S. company pays at least as much tax on its worldwide income as it would pay on the same income earned at home.

- ***Passive Income***: Income earned in the form of interest, dividends, and similar investment income through investment activities of the taxpayer (as opposed to active income earned from the taxpayer's conduct of a trade or business activity).

- ***Subpart F***: 10-percent U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC whether or not such income is actually distributed to the U.S. parent (i.e., without the advantage of "deferral"). These rules historically have aimed at requiring current taxation of income that is *passive* or easily moveable, although some forms of *active* income are also subject to these rules. Income subject to tax under subpart F includes certain insurance income and "foreign base company income" (defined above). U.S. anti-deferral rules are the most restrictive of our major trading partners and extend to many types of active business income.

- ***Subpart F Look-Through Rule****:* In May 2006, Congress enacted a temporary "look-through" exception for subpart F with respect to payments of dividends, interest, rents, and royalties between related controlled foreign corporations. The rule provides that such overseas payments will not give rise to subpart F income (thereby permitting deferral) to the extent that payments come from active, non-subpart F earnings of the payor CFC. In effect, the provision "looks through" the form of payment to the underlying source of income. The provision was adopted to permit foreign subsidiaries of U.S. companies to redeploy active foreign earnings in a manner similar to that permitted by most of our trading partners. This exception from subpart F, extended in October 2008, expires for taxable years beginning after December 31, 2009.

- ***Territorial Tax System****:* Under a territorial or "exemption" system, the active foreign earnings of a foreign subsidiary are not subject to tax by the home country when paid as a cash dividend to the parent corporation. In 2005, the President's Advisory Panel on Federal Tax Reform identified 21 of the 30 Organization for Economic Cooperation and Development (OECD) member countries as following an exemption approach, with the remainder following a worldwide approach. Since then, four more countries have adopted exemption systems, with Japan and the United Kingdom doing so in 2009. Exemption countries in the OECD are Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Japan, Italy, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, and the United Kingdom.

- ***Worldwide Tax System****:* Under a worldwide system of taxation, all foreign earnings of a domestic corporation are subject to tax in the home country. In practice, countries following a worldwide principle, including the United States, permit deferral on most forms of active foreign earnings until such income is paid to the domestic corporation. Within the 30 countries of the Organization for Economic Cooperation and Development (OECD), five countries follow a worldwide approach, with the other 25 countries following an exemption approach. Worldwide countries in the OECD are Ireland, Korea, Mexico, Poland, and the United States.

Let's maintain the foundation for sustained economic growth.
Business tax policy must promote U.S. international competitiveness.