Calendar No. 165

105TH CONGRESS, 1st Session | SENATE | REPORT 105–83

EXTENSION OF NONDISCRIMINATORY (MOST-FAVORED-NATION TREATMENT) TO THE PRODUCTS OF THE LAO PEOPLE'S DEMOCRATIC REPUBLIC

SEPTEMBER 17, 1997.—Ordered to be printed

Mr. ROTH, from the Committee on Finance, submitted the following

REPORT

[To accompany S. 1093]

[Including cost estimate of the Congressional Budget Office]

The Committee on Finance, to which was referred the bill (S. 1093) to authorize the extension of nondiscriminatory, most-favored-nation (MFN) tariff treatment (*i.e.,* normal trade relations) to products of the Lao People's Democratic Republic ("Laos"), having considered the same, reports favorably thereon with an amendment in the nature of a substitute and recommends that the bill, as amended, do pass.

I. BACKGROUND

General Note 3 of the Harmonized Tariff Schedule of the United States ("HTSUS") currently lists Laos among those countries whose products are denied MFN tariff treatment. As such, imports from Laos are subject to substantially higher duty rates under HTSUS column 2.

Title IV of the Trade Act of 1974, as amended by the Customs and Trade Act of 1990 ("Title IV"), which governs the extension of MFN status to non-market economy countries, has never applied to Laos. The provisions in Title IV apply only to countries denied MFN status as of January 3, 1975. Laos' MFN status was withdrawn later in 1975, when the President imposed a trade embargo on Laos following the Communist revolution in that country.

30–010—CC

II. Summary of the Bill, As Amended

A. Title I—Extension of Most-Favored-Nation Treatment to Laos

Section 101 sets forth six Congressional findings that support removing Laos from the list of countries denied MFN treatment under General Note 3 of the HTSUS and extending to Laos permanent unconditional nondiscriminatory MFN status. First, Laos is striving to shed centralized government control of its economy in favor of market-oriented reforms. Second, extension of unconditional MFN treatment would help Laos to develop its economy based on free-market principles and to become competitive in the global marketplace. Third, establishing normal commercial relations on a reciprocal basis with Laos will promote U.S. exports to the rapidly-growing Southeast Asian region and expand opportunities for U.S. business and investment in Laos. Fourth, U.S. and Laotian commercial interests would benefit from a commercial agreement between the two countries that provides for market access and the protection of intellectual property rights. Fifth, economic reform in Laos is increasingly important as that country integrates into the Association of Southeast Asian Nations' (ASEAN) Free Trade Area and accedes to the World Trade Organization (WTO). Finally, expanding bilateral trade relations, that include a commercial agreement, may promote further progress by Laos on human rights and democratic rule and help Laos adopt regional and world trading rules and principles.

Section 102(a) would grant Laotian imports unconditional MFN tariff treatment by striking Laos from the list of those countries denied MFN treatment under General Note 3 of the HTSUS.

Section 102(b) states that subsection (a) applies to goods entered, or withdrawn from warehouse for consumption after December 31, 1997.

Section 103 would require the President to submit a report to Congress, no later than 18 months after the enactment of the Act, on trade relations between the United States and Laos pursuant to the trade agreement between the two countries.

B. Title II—International Shipping Income Disclosure

Penalties for Failure To File Disclosure of Exemption for Income From the International Operation of Ships by Foreign Persons

Present Law

The United States generally imposes a 4-percent tax on the U.S.-source gross transportation income of foreign persons that is not effectively connected with the foreign person's conduct of a U.S. trade or business (sec. 887 of the Internal Revenue Code of 1986). Foreign persons generally are subject to U.S. tax at regular graduated rates on net income, including transportation income, that is effectively connected with a U.S. trade or business (secs. 871(b) and 882).

Transportation income is any income derived from, or in connection with, the use (or hiring or leasing for use) of a vessel or aircraft (or a container used in connection therewith) or the performance of services directly related to such use (sec. 863(c)(3)). Income attributable to transportation that begins and ends in the United

States is treated as derived from sources in the United States (sec. 863(c)(1)). Transportation income attributable to transportation that either begins or ends in the United States is treated as derived 50 percent from U.S. sources and 50 percent from foreign sources (sec. 863(c)(2)). U.S.-source transportation income is treated as effectively connected with a foreign person's conduct of a U.S. trade or business only if the foreign person has a fixed place of business in the United States that is involved in the earning of such income and substantially all of such income of the foreign person is attributable to regularly scheduled transportation (sec. 887(b)(4)).

An exemption from U.S. tax is provided for income derived by a nonresident alien individual or foreign corporation from the international operation of a ship, provided that the foreign country in which such individual is resident or such corporation is organized grants an equivalent exemption to individual residents of the United States or corporations organized in the United States (secs. 872(b)(1) and 883(a)(1)).

Pursuant to guidance published by the Internal Revenue Service, a nonresident alien individual or foreign corporation that is entitled to an exemption from U.S. tax for its income from the international operation of ships must file a U.S. income tax return and must attach to such return a statement claiming the exemption (Rev. Proc. 91–12, 1991–1 C.B. 473). If the foreign person is claiming an exemption based on an applicable income tax treaty, the foreign person must disclose that fact as required by the Secretary of the Treasury (sec. 6114). The penalty for failure to make disclosure of a treaty-based position as required under section 6114 is $1,000 for an individual and $10,000 for a corporation (sec. 6712).

At the time the 4-percent tax on U.S.-source gross transportation income was enacted, concern was expressed about whether compliance with the tax, which is collected by means of the filing of a return, would be adequate. It was intended that the tax-writing committees of Congress and the Secretary of the Treasury would study the issue of compliance and that the Secretary would make recommendations if compliance did not prove adequate.[1]

Reasons for Change

The Committee understands that there is an extremely high level of noncompliance with the U.S. tax rules by foreign persons that have U.S.-source shipping income. The Committee believes that, in order to address these noncompliance problems, it is appropriate to impose significant penalties for a failure to satisfy the filing requirements for claiming the exemption from U.S. tax that is available to certain foreign persons with respect to income from the international operation of ships.

Explanation of Provision

Under section 201 of the bill, a foreign person that claims exemption from U.S. tax for income from the international operation of ships, but does not satisfy the filing requirements for claiming such

[1] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS–10–87), May 4, 1987, p. 930.

exemption, is subject to the penalty of the denial of such exemption and any deductions or credits otherwise allowable in determining the U.S. tax liability with respect to such income. If a foreign person that has a fixed place of business in the United States fails to satisfy the filing requirements for claiming an exemption from U.S. tax for its income from the international operation of ships, such person is subject to the additional penalty that foreign source income from the international operation of ships would be treated as effectively connected with the conduct of a U.S. trade or business, but only to the extent that such income is attributable to such fixed place of business in the United States. Income so treated as effectively connected with a U.S. trade or business is subject to U.S. tax at graduated rates (and is subject to the disallowance of deductions and credits described above). These penalties are subject to a reasonable cause exception. The provision would not apply to the extent the application would be contrary to any treaty obligation of the United States.

The bill also provides for the provision of information by the U.S. Customs Service to the Secretary of the Treasury regarding foreign-flagged ships engaged in shipping to or from the United States.

Effective Date

The provision is effective for taxable years beginning after December 31, 1997 and before April 1, 2000.

III. General Explanation

A. Presidential and Congressional Action

1. Presidential action.—On August 13, 1997, the United States and Laos concluded a bilateral investment treaty and a bilateral agreement on trade relations and protection of intellectual property rights. The trade agreement includes a proposal for a reciprocal extension of MFN tariff treatment between the United States and Laos. Entry into force of this agreement would be contingent on Congress passing legislation extending MFN status to Laos.

2. Congressional action.—On July 30, 1997, Senators Kerry and McCain introduced legislation (S. 1093), which would provide Laos permanent MFN tariff status, by striking it from the list of those countries denied MFN treatment under General Note 3 of the HTSUS. The bill was referred to the Committee on Finance, which requested public comments on the legislation on August 8, 1997. As of the deadline of September 5, 1997, the Committee had received 21 comments in support and none in opposition to granting Laos unconditional MFN status.

B. U.S.-Laotian Trade

Two-way trade between the United States and Laos has remained at modest levels. In 1996, the amount of trade between the two countries was valued at $19.7 million and the balance in U.S. merchandise trade with Laos was a deficit of approximately $13 million. U.S. exports to Laos in 1996 totaled $3.4 million and included mainly capital goods. U.S. imports from Laos in 1996 totaled $16.3 million, chiefly textiles.

C. Committee Views

In approving MFN status for Laos, the Committee believes that establishing normal bilateral economic and commercial relations between the United States and Laos would help integrate Laos into the world economic system and promote economic growth based on free market principles. The Committee also believes that these developments would, in turn, help direct Laos towards broadening democratic civil society, strengthening the rule of law and respect for human rights, and achieving political stability. The Committee also hopes that establishing normal trade relations with Laos will encourage that country to provide further assistance to the United States in accounting for all American service personnel who were held prisoners of war or reported as missing in action in Laos during the Vietnam War.

The Committee expects that providing unconditional MFN status to Laos will expand opportunities for U.S. business and investment in the Laotian economy and will also promote U.S. exports to the rapidly growing Southeast Asian region as a whole. U.S. companies operating in Laos will be in a position to provide substantial assistance for Laos' return to a market-based economy, thereby further stimulating economic growth and improving the standard of living for the Laotian people. By facilitating Laos' integration into the world economy, MFN status will also encourage Laos' adoption of regional and world trading rules and principles and promote effective protection of intellectual-property rights. To this end, the Committee urges the Administration to press the Laotian Government to institute further reforms of its trade regime and to seek entry into the World Trade Organization.

Accordingly, the Committee supports the enactment of S. 1093, as amended, and the extension of unconditional MFN treatment to Laos.

IV. Vote of the Committee

In compliance with section 133 of the Legislative Reorganization Act of 1946, the Committee states that S. 1093, as amended, was ordered favorably reported unanimously by voice vote.

V. Budgetary Impact

In compliance with sections 308 and 403 of the Congressional Budget Act of 1974, and paragraph 11(a) of Rule XXVI of the Standing Rules of the Senate, the following letter has been received from the Congressional Budget Office on the budgetary impact of the legislation:

CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, D.C. 20515

June E. O'Neill
Director

September 16, 1997

Honorable William V. Roth, Jr.
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The Congressional Budget Office has prepared the enclosed cost estimate for S. 1093, a bill to authorize the extension of nondiscriminatory treatment (most-favored-nation treatment) to the products of the Lao People's Democratic Republic.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Alyssa Trzeszkowski, who can be reached at 226-2720.

Sincerely,

June E. O'Neill

Enclosure

cc: Honorable Daniel P. Moynihan
Ranking Minority Member

ESTIMATED BUDGET EFFECTS OF S. 1093
AS PASSED BY THE SENATE FINANCE COMMITTEE ON SEPTEMBER 11, 1997

Fiscal Years 1998 - 2007

[Millions of Dollars]

Provision	Effective	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1998-02	1998-07
1. Penalties for failure to file disclosure of exemption for income from international operation of ships by foreign persons (sunset 4/1/00)......	tyba 12/31/97	2	6	6	---	---	---	---	---	---	---	14	14
2. Laos MFN status [1]......	1/1/98	-2	-3	-3	-3	-3	-3	-3	-3	-3	-3	-14	-29
NET TOTAL......		---	3	3	-3	-3	-3	-3	-3	-3	-3	---	-15

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column: tyba = taxable years beginning after

[1] Estimate provided by the Congressional Budget Office.

VI. Regulatory Impact

In compliance with paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the Committee states that the legislation will not significantly regulate any individuals or businesses, will not impact on the personal privacy of individuals, and will result in no significant additional paperwork.

VII. Changes in Existing Law

In compliance with paragraph 12 of Rule XXVI of the Standing Rules of the Senate, changes in existing law made by the legislation, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

HARMONIZED TARIFF SCHEDULE OF THE UNITED STATES

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GENERAL NOTES

3. *Rates of Duty.* The rates of duty in the "Rates of Duty" columns designated 1 ("General" and "Special") and 2 of the tariff schedule apply to goods imported into the customs territory of the United States as hereinafter provided in this note:

(a) * * *

(b) Rate of Duty Column 2.[1] Notwithstanding any of the foregoing provisions of this note, the rates of duty shown in column 2 shall apply to products, whether imported directly or indirectly, of the following countries and areas pursuant to section 401 of the Tariff Classification Act of 1962, to section 231 or 257(e)(2) of the Trade Expansion Act of 1962, to section 404(a) of the Trade Act of 1974 or to any other applicable section of law, or to action taken by the President thereunder:

Afghanistan　　[Laos]　　Vietnam
Cuba　　North Korea

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INTERNAL REVENUE CODE OF 1986

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Sec. 872. Gross income.
(a) General rule.

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(b) Exclusions.

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(1) Ships operated by certain nonresidents. [Gross income] *Except as provided in section 883(d), gross income* derived by an individual resident of a foreign country from the

international operation of a ship or ships if such foreign country grants an equivalent exemption to individual residents to the United States.

* * * * * * *

Sec. 883. Exclusions from gross income.

(a) Income of foreign corporations from ships and aircraft. The following items shall not be included in gross income of a foreign corporation, and shall be exempt from taxation under this subtitle:

(1) Ships operated by certain foreign corporations. ⟦Gross income⟧ *Except as provided in subsection (d), gross income* derived by a corporation organized in a foreign country from the international operation of a ship or ships if such foreign country grants an equivalent exemption to corporations organized in the United States.

* * * * * * *

(d) Penalties for Failure to Disclose Position That Certain International Shipping Income Is Not Includible in Gross Income.—

(1) In general.*—A taxpayer who, with respect to any tax imposed by this title, takes the position that any of its gross income derived from the international operation of a ship or ships is not includible in gross income by reason of subsection (a)(1) or section 872(b)(1) (or by reason of any applicable treaty) shall be entitled to such treatment only if such position is disclosed (in such manner as the Secretary may prescribe) on the return of tax for such tax (or any statement attached to such return).*

(2) Additional penalties for failing to disclose position.*—If a taxpayer fails to meet the requirement of paragraph (1) with respect to any taxable year—*

(A) the amount of the income from international operation of a ship or ships—

(i) which is from sources without the United States, and

(ii) which is attributable to a fixed place of business in the United States,

shall be treated for purposes of this title as effectively connected with the conduct of a trade or business within the United States, and

(B) no deductions or credits shall be allowed which are attributable to income from the international operation of a ship or ships.

(3) Reasonable cause exception.*—This subsection shall not apply to a failure to disclose a position if it is shown that such failure is due to reasonable cause and not due to willful neglect.*

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