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Breaking Developments in Tax Law
08/14/09

Tax Provisions in Proposed Health Care Legislation Would Limit Benefits Provided by U.S. Income Tax Treaties

Foreign companies with activities in the United States should take note of the "Americans Affordable Health Choices Act of 2009" ("H.R. 3200"). Although H.R. 3200 primarily addresses health care reform in the United States, it also includes a tax provision that affects the U.S. taxation of U.S. source interest, dividends, rents and royalties paid to foreign companies otherwise entitled to preferential tax rates under U.S. income tax treaties.

If H.R. 3200 is enacted, the preferential tax rates provided by U.S. income tax treaties for interest, dividends, rents and royalties may not be available to a foreign corporation if received from its U.S. subsidiary corporation.

H.R. 3200 applies to a U.S. subsidiary corporation owned by a foreign corporation organized in a treaty jurisdiction ("treaty corporation"), and the treaty corporation is a subsidiary of a parent corporation located in a country that does not have an income tax treaty with the United States ("non-treaty corporation"). Since the non-treaty corporation is located in a country without a U.S. income tax treaty, a 30 percent U.S. withholding rate will apply to interest, dividends, rents and royalties paid by a U.S. subsidiary corporation to the treaty corporation. (See diagram below.)

In order to determine treaty benefits, H.R. 3200 tests whether the parent corporation would receive the benefit of preferential tax rates provided by a U.S. income tax treaty had the U.S. subsidiary corporation directly paid interest, dividends, rents or royalties to the parent corporation.

In the following illustration, H.R. 3200 would make the preferential tax rates on the interest payment made by the U.S. subsidiary corporation ("USCO") unavailable to the treaty corporation ("Treaty Co."). The parent corporation ("SINGCO"), located in Singapore, does not benefit from preferential tax rates because Singapore is not a party to a U.S. income tax treaty. The preferential tax rates provided by the U.S. income tax treaty between the United States and the treaty country would be unavailable and instead, the interest payment would be subject to a 30 percent U.S. withholding rate.

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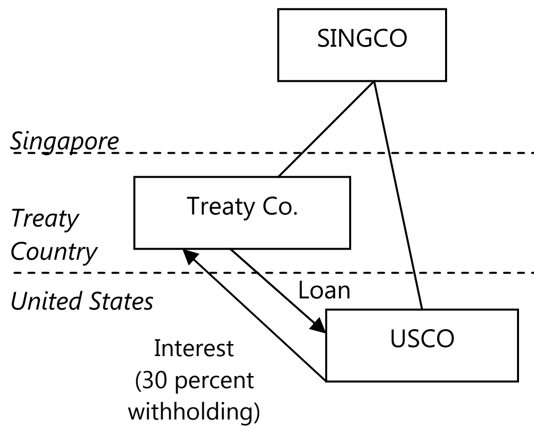

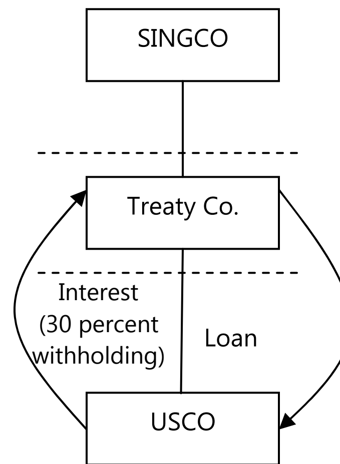

1) SINGCO does not benefit from preferential tax rates if USCO directly pays interest to it because Singapore does not have an income tax treaty with the United States.

2) Treaty Co. does not benefit from the preferential tax rates for the interest payment under the income tax treaty. The interest payment is subject to a 30 percent U.S. withholding rate.

3) USCO deducts the interest payment from its income.

The tax provision limiting benefits under U.S. income tax treaties will generate $7.5 billion in revenue by the year 2019. If passed, H.R. 3200 will become effective on January 1, 2010.

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