RELEASED

DOCUMENT RESUME

00576 - [A1051916]

Compensation Provided to American Claimants through Foreign Claims Settlements. B-186184; ID-77-26. April 6, 1977. Released April 13, 1977. 3 pp. + appendices (11 pp.).

Report to Rep. Dante B. Fascell, Chairman, House Committee on International Relations: International Operations Subcommittee; by Robert F. Keller, Acting Comptroller General.

Issue Area: International Economic and Military Programs (600).
Contact: International Div.
Budget Function: International Affairs: Conduct of Foreign Affairs (152).
Organization Concerned: Department of the Treasury; Foreign Claims Settlement Commission of the United States.
Congressional Relevance: House Committee on International Relations: International Operations Subcommittee.
Authority: International Claims Settlement Act of 1949, as amended (22 U.S.C. 1621 et seq. (Supp. IV)). War Claims Act of 1948 (50 U.S.C. 2001 et seq. (Supp. IV)). P.L. 94-542.

Claims for losses arising from a foreign government's nationalization, expropriation, or other takeover of the property of United States nationals are administered under provisions of the International Settlement Claims Act of 1948. This Act has served as the authority for adjudication and payment of claims resulting from American property losses in nine foreign countries, and has provided authority for determining the validity and amounts of U.S. claims against the Governments of Cuba, the People's Republic of China, and East Germany. The Foreign Claims Settlement Commission is solely responsible for receiving and determining the validity of the claims. Upon the Commission's certification, the claims are paid by the Treasury, using funds obtained from the foreign governments. Findings/Conclusions: Tax savings attributable to the deduction of foreign expropriation losses by claimants are not considered in computing compensation payments made by Treasury. If payments were adjusted for tax benefits, net losses would be spread more equitably among the claimants, but tax revenues would decline. It is felt that payment adjustments for tax benefits should be made only to preclude the availability of windfall profits to claimants as a result of tax rate changes. The usual provision of authorizing initial payments of up to a maximum of $1,000 per award is not sufficient to discharge many of the smaller awards. Under the Cuba program, awards in the $1,001 to $5,000 range were about 50 percent more frequent than those of less than $1,000. Recommendations: The initial payment claim should be raised to accommodate more of the smaller claims. (RRS)

REPORT OF THE COMPTROLLER GENERAL OF THE UNITED STATES

Compensation Provided To American Claimants Through Foreign Claims Settlements

Foreign Claims Settlement Commission Department of the Treasury

Americans can be compensated for property taken in foreign countries using funds obtained from those countries.

It has been suggested that claims payments be adjusted to consider tax benefits, so money recovered will balance out. GAO believes that smaller claimants and the U.S. Government would be better served if, instead, the maximum for initial payment were raised to satisfy more small claims.

ID-77-26

APRIL 6, 1977

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-186184

The Honorable Dante B. Fascell
Chairman, Subcommittee on
International Operations
Committee on International Relations
House of Representatives

Dear Mr. Chairman:

This is in response to your request for a report on past practices, procedures, and criteria for compensating American claimants in negotiated foreign claims settlements to give perspective on how such claims might be handled in the future. Pursuant to the information enclosed with the request, we are also addressing the relationship between tax writeoffs and subsequent claims payments and its effect on claims against the Government of Cuba.

As you know, claims for losses arising from a foreign government's nationalization, expropriation, or other takeover of the property of nationals of the United States are administered under the provisions of the International Claims Settlement Act of 1949, as amended. The act has served as the authority for adjudication and payment of claims resulting from American property losses in nine foreign countries. It also provided the authority for determining the validity and amounts of U.S. claims against the Governments of Cuba, the People's Republic of China, and East Germany with the aim of facilitating claims settlement agreements with these governments. No provision has been made for paying the Cuba and China claims.

The Foreign Claims Settlement Commission is solely responsible for receiving and determining the validity of the claims. Upon the Commission's certification, the claims are paid by Treasury using funds obtained from the foreign governments. Appendix I contains details on filing, validating, award, and payment procedures and status of the authorized claims programs.

Tax savings attributable to the deduction of foreign expropriation losses by claimants are not considered when computing the compensation payments made by Treasury. After claimants receive an initial payment of up to $1,000 per award, payments are made proportionately as funds become available. If payments were adjusted for tax benefits, net losses would be spread more equitably among the claimants but tax revenues would decline. Payments would be shifted away from those claimants with exhausted tax deductions (who would have to pay tax on any future payments) to those with lesser or no tax liability on recoveries. Also, since tax benefit data would have to be determined, administration costs would increase.

Previously, payment adjustments have been considered by congressional committees and, in the case of a related program--the War Claims Program--adjustment was actually made. However, in these cases, the concern was not with eliminating inequities in recovery between claimants but with precluding the possibility of windfall profits to claimants since the tax deductions were available in a period of higher tax rates than those prevailing at the time of payment. (See app. II for a more detailed discussion of this matter).

Considering the increased administrative expenses and potential loss of tax revenue to the Treasury, we believe that payment adjustments for tax benefits should be made only to preclude the availability of windfall profits to claimants as a result of significant tax rate changes. However, we believe another step can be taken to help alleviate the impact of losses for smaller claimants not in position to realize much or any tax savings.

Our review indicated that the usual provision of authorizing initial payments of up to a maximum of $1,000 per award will not be sufficient to discharge many of the smaller awards. For example, under the Cuba program, awards in the $1,001 to $5,000 range were about 50 percent more frequent than those of $1,000 or less. Also, while awards up to $5,000 numbered over half the total, they represented less than 1 percent of the total dollar value.

We discussed this matter with Commission officials, and they expressed interest in raising the maximum amount of the initial payment to $2,500 per award. If such a step were taken, the administrative costs would be reduced with minimum effect on the larger claimants but with relatively significant help to the smaller claimants. We recommend, therefore, that the Chairman, Foreign Claims Settlement Commission, take steps to introduce appropriate legislation that would raise the initial payment on those programs for which payments have not yet commenced.

For the amount required for settlement with the Government of Cuba, whether payments are adjusted for tax benefits or not, the legislative history of the act makes it clear that any such adjustment would not diminish U.S. Government rights to seek full restitution of its claims against Cuba.

We trust this report meets your needs. We are sending copies of it to the Chairman, Foreign Claims Settlement Commission; Secretaries of Treasury and State; Director, Office of Management and Budget; and other interested congressional committees.

If we can be of further assistance in this matter, please let us know.

Sincerely yours,

ACTING Comptroller General
of the United States

COMPENSATION OF AMERICANS THROUGH FOREIGN CLAIMS SETTLEMENTS

Claims by U.S. nationals for losses arising from a foreign government's nationalization, expropriation, or other takeover of their property are administered under the provisions of the International Claims Settlement Act of 1949, as amended. 22 U.S.C. §§ 1621, et seq., (1970 & Supp. IV 1974), as amended by Act of October 18, 1976, Public Law 94-542.

The Act of 1949 originally authorized the International Claims Commission to adjudicate claims pursuant to an agreement negotiated between the U.S. Government and Yugoslavia. During ensuing years, the act has been amended a number of times to authorize the Foreign Claims Settlement Commission (successor to the International Claims Commission) to determine claims against the Governments of Panama, Bulgaria, Hungary, Italy, Romania, the Soviet Union, Czechoslovakia, Poland, Cuba, the People's Republic of China, and East Germany.

Where funds exist to pay all or a portion of the adjudicated claims and the recently authorized East German claims program, the act specifies how Treasury is to make the payments. No funds exist to make payments on the Cuba and China claims programs. For these programs, the act merely authorizes the Commission to determine the validity and amounts of U.S. claims with the aim of facilitating negotiation of claims settlement agreements with these governments.

CLAIMS FILING AND VALIDATING PROCEDURES

The Commission functions under its own specific rules and regulations promulgated under the legislative authority. The regulations are published in the Federal Register and generally apply to all programs.

As programs are authorized by the Congress and undertaken by the Commission, pertinent forms, instructions for preparing and filing, a copy of the enabling legislation, and applicable Commission regulations are mailed to all parties

who have indicated to the Commission or other agencies their interest in filing claims. To provide further publicity regarding programs, the Commission issues releases to various news media.

After each claim filed with the Commission is docketed, it is examined to determine whether the necessary documentation is available to establish a valid claim. Claimant and/or counsel are advised that the claimant shall have the burden of proof on all issues involved in the determination of his claim. Generally, the issues involved in a claim include proof of American nationality, extent of ownership interest in the property claimed, value of the property, and the dates and circumstances of the asserted loss.

After a full review of the claim, the Commission issues a "Proposed Decision." The claimant or counsel is advised that he may object to the findings and conclusions contained in the proposed decision. The claimant is afforded the opportunity either to appear personally before the Commission or to submit, in writing, any evidence and argument in support of his objections.

Subsequent to either an oral hearing or a hearing on the claimant's written submission, the Commission renders its determination in the matter by the issuance of a "Final Decision." When no objections are received from the claimant within the prescribed time, the Proposed Decision is entered as the Commission's Final Decision. However, this does not preclude the reopening of a claim for further consideration if new evidence is obtained which warrants a change in the final decision.

It is important to note, however, that the Commission's decisions are final and conclusive on all questions of law and fact and are not subject to review by any other official, department or agency or any establishment of the United States or any court. This prohibition against judicial or other review makes it necessary that the Commission follow proper administrative and legal procedures to assure claimants a full and fair opportunity to present their claims.

AWARD PAYMENT PROCEDURES

Payment of awards is not the responsibility of the Commission. The Commission's responsibility is discharged upon entry of a final decision and certification of any award to the Secretary of the Treasury, who has sole jurisdiction to make such payments.

Funds can become available for payment of claims through (1) payments made pursuant to the terms of agreements and understandings concluded with the foreign governments and (2) liquidation of assets situated in the United States of such foreign governments and foreign nationals. Where funds become available to pay claims, each of the enabling statutes contain specific instructions authorizing payments on awards out of special funds established by Treasury for that purpose.

Treasury's Bureau of Government Financial Operations receives, accounts for, and authorizes disbursement of all funds received. A separate claims fund and payment register is established for each country. Payments to claimants are disbursed from the separate funds in the manner stipulated in the enabling statutes. These statutes also authorize Treasury to deduct 5 percent from all funds received as reimbursement for expenses incurred by the Commission and Treasury in administering the programs. The amount deducted is credited to the Treasury account for miscellaneous receipts.

Generally, Treasury makes payments out of the separate claims funds as follows.

1. Payment in the amount of $1,000 or the principal amount of the award, whichever is less.

2. Periodic payments thereafter on the unpaid principal balance of each remaining award in proportion to the total amount available for distribution.

3. Pro rata payments of interest after principal payments have been made in full on all awards, in proportion to the total amount available for distribution.

Under this payment procedure all claimants--individuals, religious and nonprofit organizations, and corporations--participate equally in the distribution of available funds and no one group has priority.

Consideration should be given to raising the initial payment

The legislative history on establishment of the $1,000 initial payment indicates that it was largely an arbitrary amount, influenced by the fact the earliest programs (Yugoslavia and Panama) contained a large number of claims close to this amount. The amount of the initial payment has not changed over the years even though its real value has diminished and the size of awards granted by the Commission has increased.

The $1,000 initial payment is no longer a sufficient amount to discharge many of the smaller awards. For example, awards made under the Cuba program were about one and a half times more frequent in the $1,001 to $5,000 range than those of $1,000 or less and accounted for over half the total number of awards. However, they represented less than 1 percent of the total dollar value of awards.

Therefore, we believe that raising the amount of the initial payment would be a convenient way of discharging more small claims--thereby reducing administrative cost--with only a minimal adverse effect on ultimate settlement of the larger claims.

STATUS OF CLAIMS PROGRAMS

Claims programs have been established against 12 foreign governments. The Commission has completed its determinations except for the new East German program, and it will complete a followup Hungarian program in May 1977. Awards made under the 1949 Act total about $2.5 billion in principal amount. Losses certified under the Cuban program, $1.85 billion, and the People's Republic of China program, $197 million, account for about 82 percent of all awards.

Claims settlement agreements have been reached with Yugoslavia, Panama, Poland, Bulgaria, Hungary, Romania, and Italy which provide for compensation of $87.7 million, in addition to proceeds from the sale of blocked assets of $25.1 million. Total awards for these programs of $258 million were anticipated, so the average payoff rate was approximately 44 percent before administrative expenses, or a net average principal return of about 42 percent.

APPENDIX I

Settlement agreements have not yet been made with the Governments of Czechoslovakia, the Soviet Union, Cuba, the People's Republic of China or East Germany. The magnitude of claims against East Germany remains to be determined, but negotiations with the other governments have been either suspended or deferred.

Payments on claims awarded against Czechoslovakia and the Soviet Union have been limited to the proceeds obtained from the sale of blocked or assigned assets in the United States. No funds have been made available to pay any portion of the claims awarded against the Governments of Cuba and the People's Republic of China.

Funds available for payment to claimants have often been considerably less than the aggregate value of awards granted by the Commission. Only under the Italian program were funds sufficient to satisfy all awards in full, including interest. For programs where settlement agreements have been concluded with foreign governments, payoff rates have ranged from 33 to 91 percent of the aggregate award. For programs where no settlement agreement has been concluded, payoff rates range from zero to 11 percent using funds derived from asset liquidations.

The Treasury has made most of the disbursements for the Yugoslavia, Panama, Bulgaria, Romania, and Italy programs. The small balances remaining are primarily the result of lost addresses of payees or refusal of claimants to accept the part payment in satisfaction of their claim. The Polish payments are being made in 20 equal annual installments, scheduled to end in 1980. Hungarian payments are complete for the first of two program phases and initial payments up to $1,000 are being made as the Commission certifies awards on the followup program. Subsequent Hungarian program payments will be prorated to claimants as annual installments, scheduled to end no later than 1992, are received.

APPENDIX I

Below is a brief summary of the status of each claims fund at December 31, 1975.

Claims fund	Number of awards	Amount of awards	Compensation received (or due)	Amount paid to date to claimants (note a)
		(millions)		
Yugoslavia	1,395	$ 28.1	$ 20.5	$ 19.8
Panama	62	.4	.4	.4
Poland	5,022	100.7	40.0	30.3
Bulgaria	230	4.8	3.2	3.1
Hungary	1,176 b/	58.6 b/	21.1	2.2
Romania	583	61.1	23.7	22.5
Italy	572	3.5	5.0	4.2 c/
Soviet Union	1,925	70.5	9.1 d/	8.7
Czechoslovakia	2,630	113.6	9.0 d/	8.5
Cuba	5,911	1,851.1	0 d/	N/A
People's Republic of China	384	196.9	0 d/	N/A
East Germany	N/A	N/A	0 d/	N/A

a/Net amount actually paid after deducting administrative expense.
b/Adjudication of claims substantially completed.
c/Includes interest of $873,000.
d/Claims settlement agreement not yet concluded; compensation, if any, derived from sale of liquidated assets.

APPENDIX II

RELATIONSHIP OF TAX WRITEOFFS TO FOREIGN CLAIMS SETTLEMENT PAYMENTS

Tax benefits resulting from expropriation-loss deductions are not considered in determining the amount of compensation a claimant receives. The Foreign Claims Settlement Commission, in determining the amount of awards, does not consider tax savings as a form of compensation for the loss. Also the Treasury, in making payments, does not adjust them to recognize tax benefits received by or due to the claimants on account of their losses.

Previous consideration has been given to making such adjustments and they have been made in a similar program under the War Claims Act of 1948. 50 U.S.C. App. SS 2001, et seq. (1970 & Supp. IV 1974).

APPLICATION OF PROVISION PREVENTING DOUBLE BENEFITS

The Commission, in determining awards, is authorized to deduct amounts equivalent to those received by the claimant from other sources on account of the loss. The authority was enacted in 1958 by amending the International Claims Settlement Act of 1949 for the Czechoslovakian claims program and has been further incorporated into the legislation through amendments authorizing subsequent claims programs.

The objective of the authority was to prevent claimants from receiving double benefits. During congressional hearings, it was pointed out that claimants would receive windfall profits if loss deductions were taken in years when higher tax rates were in effect than when subsequent recoveries were made. The deduction provision was not intended to correct inequities which may occur between claimants because of the internal revenue laws.

The deduction provision has undergone various interpretations. The Senate Committee on Foreign Relations, in its report on a bill to provide for claims determinations against Cuba in 1964 (Senate Rept. No. 1521, 88th Cong., 2nd sess.), suggested that the deduction provision be applied to tax benefits realized by a claimant. In discussing the provision, the Committee report states

that "* * * if (the) claimant has already taken a tax writeoff on his claim, the amount of the writeoff would be deducted from the amount determined to be due on the claim." However, the reference was made amid concern that Treasury funds in such instances, even indirectly, might be used to fund some part of the claim. To preclude this possibility, the Committee added a subrogation provision to the effect that, if a claimant had his claim reduced because of a tax writeoff, any amount so deducted "shall not be construed as divesting the United States of any rights against the Government of Cuba for the amounts so deducted."

However, in the following year, the subrogation provision was deleted as being unnecessary to protect the total claim of the United States. It was recognized that there was nothing in international law, the Internal Revenue Code, or previous practice under the International Claims Settlement Act that would affect or reduce the total U.S. claim against Cuba by the amount of any writeoffs allowed under U.S. tax legislation. (Senate Rept. No. 701, 89th Cong., 1st sess.).

The Committee also took up the question of whether the deduction provision was intended to cover tax benefits. It was suggested that tax benefit considerations should be eliminated entirely from the purview of the act authorizing the Cuban claims program since it would only serve to confuse and unduly complicate the program. In support of this contention, it was pointed out that (1) there appeared to be no valid reason to depart from the recovery rules established under the Internal Revenue Code, (2) because of the liberal tax benefit provisions that applied to Cuban claimants, the claimants themselves might not know what benefits they would derive for many years, and (3) the Commission had never construed the deduction provision to refer to tax writeoffs inasmuch this factor was covered by the Internal Revenue Code.

The House Committee on Foreign Affairs also took the position that deductions for amounts received by claimants did not apply to tax benefits (House Rept. No. 706, 89th Cong., 1st sess.). During hearings, a Treasury official testified and Committee members agreed that tax

benefits were not really amounts received, such as insurance proceeds, and the internal revenue laws operated to prevent double recovery by imposing a tax on any compensation received by a claimant to the extent he had previously derived a tax benefit from the loss.

The latter position has continued to prevail. Thus, claims awards are not reduced for tax benefits a claimant may have derived from a loss deduction nor have subsequent claims payments been adjusted between awardees to "equalize" compensation through the combined value of direct claims payments plus tax savings.

TAX SAVINGS RECOGNIZED IN ANOTHER CLAIMS PROGRAM

A 1962 amendment to the War Claims Act of 1948 required that corporate awards for claims in excess of $10,000 be reduced by the aggregate amount of Federal tax savings realized by the claimant on account of losses deducted in prior years. This program is also administered by the Foreign Claims Settlement Commission.

The requirement applied only to claims of U.S. corporations and was intended to prevent windfall recoveries to claimants. Without the provision, it would have been possible for a corporate claimant to recover more than 100 cents on the dollar. High wartime excess-profits tax rates applicable in prior years, when the loss deduction had been taken, made possible tax savings which far exceeded the subsequent tax payments due on recoveries included in gross income and taxable at lower peacetime rates. The provision was limited to awards in excess of $10,000 in order to eliminate the administrative burden that otherwise would have been involved in processing numerous small claims.

Therefore, the concern in this case was similar to that in the preceding section, that changing tax rates can allow the claimant to achieve a windfall profit.

EFFECTS OF ADJUSTING CLAIMS PAYMENTS FOR TAX-LOSS DEDUCTIONS

Adjustment of claims payments for the value received through tax benefits related to expropriation losses would have a number of important consequences. First, it would

shift available proceeds from those claimants who received more tax loss benefits to those who received less, regardless of the reason. Second, Treasury tax revenues would decline, since payments would be directed more to claimants with unexhausted tax-loss deductions and would be subject to lower tax rates. Third, administrative expenses would increase as a result of having to determine the value of claimant tax benefits and to recompute awards. Fourth, the Commission and the Internal Revenue Service employ different criteria in classifying and valuing awards, thereby further magnifying the administrative problems of attempting to achieve overall equity.

--Available proceeds would be distributed to claimants on the basis of unrecovered economic loss after, rather than before taxes. This would reduce the total amount of uncompensated loss and give claimants who obtained no tax benefits a proportionately larger share than they would be entitled to under present procedures. Since corporate awards constitute by far the major portion of awards (for Cuba, they represented 87 percent of the total dollar value), and we determined that the large corporate claimants received substantial tax benefits, it seems clear that the prime beneficiaries would be tax-exempt claimants and those who, for one reason or another, were unable to offset the loss, in whole or in part, against taxable income.

--Treasury tax revenues generated by payments to claimants would be adversely affected. Payments to claimants (other than tax-exempt organizations) are taxable if the full amount of the loss has previously been deducted from income. Thus, to the extent that payments are directed away from corporate claimants who have made full tax recoveries to other claimants (i.e., tax-exempt organizations and those with unexhausted loss deductions) lesser amounts of the payments are subject to tax. Also, to the extent that corporate taxpayers pay a higher average tax rate than individual claimants, any shift of payments away from corporations to individuals would also reduce tax revenues. However, we lacked data on type,

income level, and status of taxpayers claiming the expropriation loss deductions or on actual tax savings realized, so we could not determine the extent of any impact on the Treasury.

--A mechanism would have to devised for determining tax savings realized by claimants and deducting these amounts from the Commission-certified awards prior to payment by Treasury. Presently, no requirement exists for claimants to report tax savings. It should be pointed out that, since any reported tax savings would work to the claimant's detriment in any payment adjustment, the reliability of the reported data may need to be verified, adding to the administrative burden.

--The Commission and the Internal Revenue Service use different criteria in establishing the value of losses and apply different rules to determine who has suffered a foreign expropriation loss. The Commission ordinarily bases awards on the value of the item at the time of loss whereas the Internal Revenue Service uses the adjusted cost basis or fair market value, whichever is lower, for deduction purposes. Also, classification of the claimants varies. For example, the Commission treats stockholder interests in corporations owned or controlled at least 50 percent by U.S. nationals as corporate claims whereas the Internal Revenue Service may classify such claimants as individuals or partnerships. Given such built-in differences in rules and procedures, it would appear to be difficult to ease existing after-tax inequities.