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REPORT TO THE CONGRESS

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Progress To Strengthen
U.S. Government Foreign
Tax Relief On Defense
Expenditures Overseas

B-133267

Department of Defense
Department of State

BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

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JAN. 6, 1972



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

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To the President of the Senate and the
Speaker of the House of Representatives

This is our follow-up report on our report to the Congress entitled "Questionable Payment of Taxes to Other Governments on U.S. Defense Activities Overseas" (B-133267, dated January 1970) for the purpose of informing the Congress of the progress being made to strengthen the U.S. Government foreign tax relief program on defense expenditures overseas.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Subsequent to our January report, we received and evaluated the joint comments of the Departments of State and Defense which generally agreed with the recommendations contained in the report. We examined documents and reports relative to the foreign tax relief program and discussed them with responsible agency officials in Washington. The substance of this report has been reviewed with the Chairman of the Interdepartmental Committee on Foreign Tax Relief, who was in general agreement with it.

We are pleased to report that the Departments of State and Defense have taken commendable initial steps to strengthen the management and administrative procedures concerning the U.S. foreign tax relief program and are currently pursuing a unified course of action to minimize the payment of foreign taxes on U.S. defense expenditures overseas.

The General Accounting Office report issued in January 1970 presented a wide variety of problems associated with the administration of foreign tax matters and cited examples of millions of dollars of direct and indirect tax payments made over several years by the U.S. Government on defense expenditures overseas. We reported that taxes were being paid by the U.S. Government in several countries in connection with leases of property, rentals of family housing, local procurements, and imports of supplies and equipment. The taxes identified were: real property taxes, local or municipal taxes, business and trade taxes, excise taxes, and import taxes. We took the position that it is inappropriate for the financial burden of a

foreign tax to be passed on to the U.S. Government in connection with its defense activities overseas. We made a number of recommendations to the Secretary of State and to the Secretary of Defense addressed to:

- defining the U.S. policy regarding relief from foreign taxes,
- establishing clear responsibilities for appropriate U.S. agencies,
- providing adequate administrative machinery to operate an effective tax relief program,
- studying host country tax laws,
- negotiating tax relief agreements with the Governments of Vietnam and Thailand,
- reviewing the adequacy of NATO infrastructure tax rebate rates, and
- having more periodic internal management reviews.

We recognize that the elimination of foreign taxes on U.S. defense expenditures overseas is a very complex problem area; and a satisfactory solution to some of the problems will involve negotiations with foreign governments. In our opinion, the Departments of State and Defense are moving in the right direction and if their efforts continue with the same vigor and determination, we believe conditions will improve. Following are some of the specific actions taken since the issuance of our report.

- (1) In June 1970, the State/Defense Interdepartmental Committee on Foreign Tax Relief was established to:
 - (a) investigate and study the existing tax relief agreements with foreign governments; and
 - (b) report, advise, and recommend to the Departments of State and Defense ways of obtaining the maximum tax relief including, as necessary, negotiating tax relief problems and tax relief agreements with foreign governments.

In October 1970 a representative of the Treasury Department was appointed a member of the Inter-departmental Committee.

- (2) The Department of Defense and Department of State issued internal directives in August and November 1970 which (a) restated U.S. policy on payment of foreign taxes and established a definitive course of action for obtaining the maximum tax relief on United States defense expenditures overseas; (b) defined responsibility within the State Department and the Defense Department for the foreign tax relief program; and (c) prescribed policies and procedures for preparation and maintenance of tax studies.
- (3) In January 1971 members of the Interdepartmental Committee visited selected U.S. military commands and U.S. embassies overseas for the purpose of getting firsthand information about tax problems and tax exemption administrative practices used in different countries. They visited the following countries: Vietnam, Thailand, Taiwan, Italy, Belgium, and the United Kingdom.

Representatives had discussions in Brussels with the U.S. Mission to the North Atlantic Treaty Organization (NATO) about problems involved in the NATO infrastructure tax rebate rates. In November 1971 we were informed that the U.S. Mission to NATO was preparing a study and report, and upon its completion the Interdepartmental Committee will decide at that time if the U.S. Mission should make a general request for an overall revision in the NATO infrastructure tax rebate rates.

- (4) The Department of Defense has called for greater emphasis by its internal audit agencies on foreign tax relief matters in their audits of procurements and general contract administration. The Army and the Navy internal audit staffs have increased coverage in their audits of foreign

tax relief matters. The Air Force is increasing their audit efforts in this area. The Defense Contract Audit Agency issued instructions to their field offices alerting them to give this matter attention in their contract audits.

- (5) As of November 1971, 24 of 30 country tax studies undertaken had been completed and the Interdepartmental Committee was reviewing these studies to determine the necessity of negotiating new tax agreements or amendments to existing agreements.

With respect to negotiating tax relief agreements with the Government of Vietnam and Thailand, the situation as of November 1971 was as follows:

Thailand -- A satisfactory tax relief agreement had not been reached, but the State Department - after the Interdepartmental Committee conducted a special study in Thailand - has concurred that a formalized arrangement on tax relief should be negotiated. The Committee anticipates that negotiations will begin early in 1972.

Vietnam -- The United States did not have an adequate tax relief agreement with the Government of Vietnam. The United States has been relying on an ineffective, but nevertheless active, agreement and on the unilateral actions by the Vietnamese Government. In November 1971 the Interdepartmental Committee informed us that, until the future pattern of United States Government expenditures has been assessed, any effort to enter into negotiations would be counterproductive.

In our January 1970 report we discussed instances where contractors had excluded taxes from their contract prices but had been unable to obtain tax relief from the Italian Government because of a breakdown in administrative procedures, despite the fact that the United States has an agreement with the Italian Government (Dunn-Vanoni Agreement) which stipulates that the Italian Government would assume the burden of taxes on U.S. defense expenditures in Italy.

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Recently, two contractors filed appeals with the Armed Services Contract Appeal Board for reimbursement of the foreign taxes paid by them. These actions are based on provisions of the contracts. In the event of an adverse judgment by the Board, these contractors will be free to bring a suit against the U.S. Government. The exact amount of all potential contractors claims is unknown, but it has been estimated in excess of \$1,000,000.

We consider the elimination of payment of foreign taxes on U.S. defense expenditures important in view of U.S. Government policy, the balance-of-payment problems confronting the United States, and the current budgetary expenditure picture. We believe that the Departments of State and Defense share our view in this regard as evidenced by the actions taken and planned to bring about management improvements in this complex field.

We also believe that efforts to reach satisfactory tax agreements and administrative arrangements with foreign governments should be intensified to eliminate as rapidly as possible the continuing U.S. payment of foreign taxes on defense activities overseas.

We intend to keep informed of the progress being made by the Departments of State and Defense in the area of administration of foreign tax exemptions and report additional actions when appropriate.

Copies of this report are being sent to the Secretary of State; the Secretary of Defense; the Secretary of the Treasury; and the Director, Office of Management and Budget.



Comptroller General
of the United States

Copies of this report are available from the U. S. General Accounting Office, Room 6417, 441 G Street, N W., Washington, D.C., 20548.

Copies are provided without charge to Members of Congress, congressional committee staff members, Government officials, members of the press, college libraries, faculty members and students. The price to the general public is \$1.00 a copy. Orders should be accompanied by cash or check.