

GLOBAL COMMUNICATIONS SATELLITE SYSTEM

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Mr. LONG of Louisiana, from the Committee on Finance,
submitted the following

REPORT

[To accompany H.R. 18486]

The Committee on Finance, to which was referred the bill (H.R. 18486) to amend the Internal Revenue Code of 1954 with respect to the treatment of income from the operation of a communications satellite system, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

I. SUMMARY

The bill provides that foreign entities participating in the global communications satellite system, in which the United States participates pursuant to the Communications Satellite Act of 1962, are not to be subject to U.S. income taxation on earnings derived from that system. This eliminates the possibility under present law that some foreign participants in the existing International Telecommunications Satellite Consortium, or participants in a successor organization, might be subject to U.S. income taxation on their share of this consortium's earnings. The taxation of the U.S. participant in the consortium, the Communications Satellite Corp., is not affected by the bill.

The enactment of this bill is favored by the administration.

II. GENERAL STATEMENT

Reasons for bill.—The International Telecommunications Satellite Consortium (Intelsat), which is an international joint venture formed to establish a global commercial communications satellite system, was created in 1964. The establishment of a global commercial communications satellite system and the participation in it by the United

States through a private corporation for profit were authorized by the Communications Satellite Act of 1962.

At the present time 62 countries are represented in Intelsat. The Communications Satellite Corp. (Comsat) is the U.S. participant in the joint venture. Most foreign countries participating in Intelsat do so through a government ministry or agency. However, some foreign countries participate through a privately owned corporation or a quasi-governmental agency.

The participants in Intelsat own the "space segment" of the satellite system, which consists of the communications satellites and the tracking, control, command, and related ground facilities required for the operation of the satellites. The participants' ownership of the space segment is in the form of undivided shares based on their respective contributions to the costs of the design, development, construction, and establishment of the space segment. The earth stations which are used to transmit communications to, and to receive communications from, the satellites are not owned by Intelsat. Rather, these stations are owned by Comsat and its counterparts in the foreign countries which participate in the joint venture.

Comsat acts as the manager for the design, establishment, operation, and maintenance of the space segment, pursuant to the policies established by the governing body of Intelsat.

Intelsat derives operating revenues from furnishing satellite capacity to the various participants (Comsat and its foreign counterparts). In other words, Intelsat's operating revenues are basically derived from renting satellite channels. The net revenues after deduction of allocable expenses are distributed pro rata to the various participants in Intelsat.

Under present law the majority of the foreign participants in Intelsat clearly are not subject to U.S. income taxation on their share of the net revenues, because these participants are foreign governments or governmental agencies which under the Internal Revenue Code (sec. 892) are exempt from U.S. income taxation.

The U.S. tax status of those foreign participants which are private corporations or quasi-governmental entities, however, is not clear under present law. The possibility exists that these participants might be subject to U.S. income taxation on their share of the net revenues derived by Intelsat. For this possibility to materialize, two conditions would have to be met. First, these foreign participants in Intelsat would have to be considered to be engaged in trade or business in the United States. They would be so considered if Intelsat is treated as engaged in a trade or business in the United States because of its contacts with the United States. Second, the revenues which are distributed to these participants, derived by Intelsat from furnishing satellite capacity, would have to be considered income from sources within the United States. Moreover, in the case of the participants which are quasi-governmental entities, it would also have to be determined that they constituted private corporations, rather than governmental agencies, for purposes of the U.S. tax law.

In view of the possibility that existing U.S. tax law might subject the nongovernmental foreign participants in Intelsat to U.S. income taxation, and thereby produce differential treatment of the foreign entities participating in this joint venture according to whether or not

they operated through government agencies, the administration has requested that the foreign participants in Intelsat be specifically exempted from U.S. income taxation on amounts that are derived from income tax only earnings from the ownership or operation of a communications satellite system. It does not exempt a foreign entity from tax on any other income derived from sources within the United States, even though that income may be derived because of information transmitted by a communications satellite system. However, this other income in some cases nevertheless might still be exempt from tax, as income earned by a foreign government.

In addition to the desirability of providing the same tax treatment for the different participants in Intelsat, there also is a real question as to whether it is appropriate for the United States to tax rental income derived by foreign entities from the space segment.

For the reasons stated above, the committee agrees with the House that it is appropriate to insure that the foreign participants in Intelsat are exempt from U.S. income taxation on amounts they derive from that participation. The effect of the bill is to remove the possibility that certain foreign participants in Intelsat, with about 10 percent of the ownership interests in the joint venture, might be subject to U.S. income taxation. The bill does not affect the U.S. income tax treatment of Comsat, the U.S. participant in Intelsat, which is fully taxable in the same manner as other domestic corporations.

Explanation of bill.—The bill amends the Internal Revenue Code of 1954 to provide an exemption from U.S. income taxation for foreign entities which are designated by foreign governments to participate in the operation or ownership of a communications satellite system in which the United States participates pursuant to the Communications Satellite Act of 1962. The exemption applies only to the earnings which the foreign participant derives from the communications satellite system.

The amendment made by the bill applies with respect to taxable years beginning after December 31, 1966.

III. CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (new matter is printed in italic, existing law in which no change is proposed is shown in roman):

SECTION 883 OF THE INTERNAL REVENUE CODE OF 1954

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 UNDER FOREIGN FLAG.*—Earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(2) AIRCRAFT OF FOREIGN REGISTRY.—Earnings derived from the operation of aircraft registered under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(b) *EARNINGS DERIVED FROM COMMUNICATIONS SATELLITE SYSTEM.*—The earnings derived from the ownership or operation of a communications satellite system by a foreign entity designated by a foreign government to participate in such ownership or operation shall be exempt from taxation under this subtitle, if the United States, through its designated entity, participates in such system pursuant to the Communications Satellite Act of 1962 (47 U.S.C. 701 and following).

