

United States Senate Committee on Finance

For Immediate Release

Thursday, March 13, 2008

Baucus, Grassley Seek JCT Analysis of U.S. Taxation of Sovereign Wealth Funds

WASHINGTON – Sen. Max Baucus, chairman of the Committee on Finance, and Sen. Chuck Grassley, ranking member, today asked the non-partisan Joint Committee on Taxation to describe and analyze the history, current rules, and policy underpinnings of the U.S. tax rules applicable to U.S. investment by foreign governments, including investments made by Sovereign Wealth Funds.

“Sovereign Wealth Funds have been around a long time, but they have increased in size and prominence lately. Treasury, the IMF, the OECD and the banking committees on both sides of the Capitol have been examining the regulatory aspects of these investments,” Baucus and Grassley said. “With increasing U.S. investments being made by these funds, we decided we ought to make sure we have a clear understanding of the U.S. tax rules that apply to these investments, how those rules compare to those that apply to non-governmental foreign investors, and how other countries tax these investments.”

The senators said the United States has long exempted from taxation passive income from U.S. investments made by foreign governments. There are two reasons for this: (1) sovereign immunity; and (2) to keep the U.S. economy open to foreign investment. The United States does not exempt a foreign government’s income earned from commercial activities in the U.S. market, because to do so would give them a competitive advantage over non-governmental market participants.

“There are issues related to transparency of Sovereign Wealth Funds and the political concerns that might develop without such transparency,” Baucus and Grassley said. “This research request will help us understand the role of tax policy in the Sovereign Wealth Fund puzzle.”

The text of the Baucus-Grassley letter to the Joint Committee on Taxation follows here.

March 13, 2008

Mr. Edward Kleinbard
Chief of Staff
Joint Committee on Taxation
Longworth House Office Building
Room 1015
Washington, DC 20515

Dear Mr. Kleinbard

The rapid expansion and prominence of Sovereign Wealth Funds (“SWFs”) have raised significant questions and concerns about their investment in U.S. assets. According to Treasury testimony before the House Committee on Financial Services, SWF managed assets are estimated to be \$1.9 to \$2.9 trillion, and some forecasts predict growth to \$10 to \$15 trillion by 2015.

The recent acquisitions of minority stakes in U.S. financial services firms by SWFs has raised the profile of these funds. According to the Federal Reserve Board, SWFs have made direct investments of over \$24 billion in U.S. financial services firms in recent months. These investments provided much needed capital and liquidity to U.S. firms faced with significant asset write-downs related to the market decline driven by the subprime mortgage situation.

Treasury, along with the OECD and the IMF, has been pursuing ways to enhance transparency of SWFs and the investments they make, each stressing the importance of a coordinated international approach. Transparency is important to assess any potential political and market risks associated with SWF investments. Congress has also taken note of these potential concerns, holding hearings in the Senate Banking Committee in November 2007 and in a Subcommittee of the House Financial Services Committee earlier this month.

One area that has not been discussed recently is the U.S. tax policy regarding U.S. investment by foreign governments. The U.S. has long exempted passive investment income of foreign governments on sovereign immunity grounds. Under current law, section 892 of the Internal Revenue Code exempts U.S. source passive investment income of foreign governments. This rule is consistent with the important goal of keeping the U.S. economy open to foreign investment. Income from commercial activities is not exempt, however, because such an exemption would grant a competitive advantage over non-governmental market participants.

In light of the rapid increase in the size and number of SWFs, their U.S. investments, and their expected continued growth, it is appropriate to examine the tax regime applicable to their U.S. investments and its policy underpinnings. To help us examine this tax policy, please provide us with the following information and analysis:

1. Trends in the level and types of U.S. investment by foreign governments, in absolute terms and relative to non-governmental pools of capital, and factors contributing to these trends.
2. Trends in the level and types of investments (U.S. and foreign) by domestic public funds, such as state pension funds and other investment funds controlled by federal or state governments.
3. Techniques used by SWFs to invest in U.S. corporations (see, e.g., Rev. Rul. 2003-97; Sovereign Wealth Fund Deals Take Advantage of IRS Ruling, 2008 TNT 41-5).
4. Present law and background regarding the federal taxation of U.S. income derived by foreign governments, including (but not limited to):
 - a. History of the federal income taxation of U.S. income derived by foreign governments;
 - b. Scope of the section 892 exemption;
 - c. Application of section 892 to recent SWF investments in U.S. financial institutions

and how income from those investments would be taxed in the absence of section 892;

- d. Comparison with federal tax treatment of U.S. investment by non-governmental foreign residents;
 - e. Comparison with federal tax treatment of U.S. investment by tax-exempt entities;
 - f. Any filing, third party tax reporting and withholding requirements associated with U.S. income derived by foreign governments; and
 - g. Applicability of income tax treaties or other international agreements to U.S. income derived by foreign governments.
5. Policy considerations regarding the current tax treatment of U.S. investment by foreign governments.
 6. Tax treatment in other major OECD countries of investment by foreign governments.

Please provide us with this information and analysis by June 16, 2008.

Sincerely,

Max Baucus
Chairman

Chuck Grassley
Ranking Member