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American Banking in the Channel Islands and the United Kingdom in the 1970s—Membership in the EEC and the Finance Act 1972

I. Introduction—The EEC and the Finance Act 1972

In 1967 the European Economic Community adopted indirect tax harmonization directives (the Value Added Tax), under the explicit authorization of Article 99 of the Treaty of Rome. No explicit provision authorizes the adoption of a harmonized direct taxation system.

The Treaty of Rome, under Article 100, implicitly authorizes harmonization of national provisions concerning direct taxation of corporations and, to an extent, of shareholders. Article 100 authorizes the harmonization of any provisions that might affect the equal conditions of competition, and the functioning of the Common Market.

The type of corporate tax system which is to be approved by the Community is open to speculation. The proposal is to be made in the near future in accordance with a 1971 decision of the Council. It is to include withholding taxes as they are related to the corporate tax systems. A harmonized corporate tax structure is to emerge in the near future in the Community.[1]

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[1] 12 EUROPEAN TAXATION (nos. 5 and 6) (May-June 1972) 112 at 112-113. *See generally,* Clive Schmitthoff, "The First Five Steps to Harmony," THE FINANCIAL TIMES, January 31, 1973 at 17:1 & John Chown, "April Will Bring Major Tax Changes," THE FINANCIAL TIMES, January 29, 1973 at 13:1. For recent material on the Law of the European Economic Communities, *see,* PENNINGTON, COMPANIES IN THE COMMON MARKET (2ed. 1970); P. MATHIJSEN, A GUIDE TO EUROPEAN COMMUNITY LAW (1972); D. LASOK & J. W. BRIDGE, INTRODUCTION TO THE LAW AND INSTITUTIONS OF THE EUROPEAN COMMUNITIES (1973); A. H. ROBERTSON, EUROPEAN INSTITUTIONS (3ed. 1973) and as to the British accession to the Treaty of Rome, U. KITZINGER, DIPLOMACY AND PERSUASION (1973).

Taxation in the United Kingdom of a corporation was substantially revised in 1972, to create a structure more similar to that existing in some of the Common Market countries. At this point it appears that the new tax system is at least no more disadvantageous to foreign corporations doing business through subsidiaries in the United Kingdom, than the prior system. Possibly it is quite more attractive, since the Advance Corporation Tax has replaced the withholding tax, thus increasing the net dividends, at least marginally to a foreign parent corporation.[2]

This essay reviews the tax and non-tax environment with which an American bank is confronted, when determining whether or not to enter the world of 'foreign banking in London' in the 1970s.

II. Emerging Tax Havens—The Channel Islands (Jersey & Guernsey)

The Commission of the European Communities, *THE ENLARGED COMMUNITY—OUTCOME of the NEGOTIATIONS WITH the APPLICANT STATES*, 51-52 (Supplement 1/72, 22 January 1972), summarizes the position of the Channel Islands as a result of the 1972 Treaty of Accession.

The provisions of the Accession Treaty apply in order to ensure free movements of goods (industrial and agricultural) between them and the Community. This means that they will apply as to third countries the Common Customs Tariff and protective measures as to agricultural products. The islands will not benefit from Community provisions, with regard to movement of persons and services, except with their rights with the United Kingdom. Essentially, the Islands were included only in the customs union. They are not subject to Community fiscal provisions, including the future harmonization or unification of the corporate tax system and structure.

There is a safeguard clause, under Article 5 of the Protocol, which provides that if, in applying these particular rules, difficulties of one kind or another shall arise as between the Community and these territories, the Council shall, acting by qualified majority vote on a proposal from the Commission as to conditions and methods of application, adopt the measures necessary.[3]

For many reasons it seems very unlikely that the United Kingdom would allow the Community to violate the special relationship that exists between the Channel Islands and the United Kingdom, including the fiscal tax measures that are passed by either Guernsey or Jersey. It is not likely

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[2]Absent the impact of international taxation agreements that might have excluded the receipt of dividends of a foreign subsidiary from computable income.

[3]*See* appendix.

that other Community Members would advocate such an action, since they too have European dependencies. They might very well consider the arrangement beneficial to the existence of a uniform tax structure, that aids in the development of a common market.

THE BANKER (1972) considers the parliament of Jersey (States of Jersey), as wanting to further the development of Jersey as an international financial center.[4] The new Commercial Relations Department wants to develop Jersey as an international financial center of high responsibility. Prior to the signing in 1972 of the Accession Treaty by the United Kingdom, a special committee of Jersey made known in 1967, its position toward the United Kingdom concerning their desire of being excluded from the operation of Community fiscal measures.[5]

At the end of the negotiation session of November 10th, 1971, the British negotiator indicated that the fiscal harmonization and value added tax are not to apply to the Channel Islands, and more importantly, the Island's constitutional relationship with Britain and their ancient Charter rights were not to be affected.[6] Mitchell, Kuipers and Gall analyze the arrangement resulting from the United Kingdom's membership in the European Economic Community, and discuss the significance of the Channel Islands as being included in the customs union, but excluded from the tax union and the common agricultural policy:[7]

> To apply full tax provisions to these territories would, for the time being, be for them an economic disaster. If there emerge abuses of these 'tax havens' the arrangements are made in the Protocol to take appropriate measures. Meanwhile, on this small scale, but importantly in human terms, the random results of history are allowed to survive. Thus the unevenness of the constitution of the United Kingdom has found tolerable solutions.[8]

III. Background and Fiscal Structure of Jersey and Guernsey

The United Kingdom does not, in law, include the Channel Islands.[9] As colonies, being held by the Crown and subject to the British Parliament at

[4]T. Doggart, *Tax Havens—The Landscape Changes,* 122 THE BANKER 537 (1972).

[5]*REPORT and RECOMMENDATION of the SPECIAL COMMITTEE of STATES of JERSEY AS to the UNITED KINGDOM'S APPLICATION to the EUROPEAN ECONOMIC COMMUNITY* (Island of Jersey, 1967).

[6]*Current Information on the Negotiations for Expansion of the European Communities,* 9 COMMON MARKET L. REV. 179, 181-82 (1972).

[7]Mitchell, Kuipers and Gall, *Constitutional Aspects of the Treaty and Legislation Relating to British Membership,* 9 COMMON MARKET L. REV. 134. *See generally,* SUPREAN COMMUNITY TREATIES (Sweet & Maxwell, 1972).

[8]*Id.* 148-49.

[9]*See generally,* GUERNSEY, CONSTITUTIONAL RELATIONSHIPS WITH THE UNITED KINGDOM (States of Guernsey, January 12th, 1970); *Billet d'Etat* (XI-1971), *Report of the States Advisory and Finance Committee Survey in Commerce and Light Industry,* (September 29th, 1971).

Westminster, the Channel Islands have nevertheless enjoyed, for many years, a special position. They are neither part of the United Kingdom nor are they colonies. The two main islands are Jersey and Guernsey. "Freedom from United Kingdom taxation is a fundamental right and privilege of the islands."[10]

THE 1967 JERSEY REPORT and RECOMMENDATIONS considered that in the field of taxation, those provisions of the Treaty of Rome which would have the most impact upon the economy of the Island, were the provisions relating to direct taxation and the value-added tax.[11] Under arrangements completed under the Accession Treaty and the European Communities Act 1972, Jersey is not subject to the Common Market's fiscal provisions.

11 *EUROPEAN TAXATION* I/84 (April 1971) discussed corporate taxation, unit trusts and investment trusts in the Channel Islands.[12] In both Jersey and Guernsey, a company registered in the Islands but which is neither "controlled and managed" nor "carrying on business within" those Islands pays a flat annual "corporation tax" of £200, and an annual filing fee of £25. "Such companies can be considered as an alternative to corporations in other tax-free jurisdictions."[13] As of 1972 there was no capital gains tax,[14] and the standard rate of tax on dividends from United Kingdom companies and foreign companies was 20 percent.

However, where a company is registered but not managed or controlled in the Islands, it is not normally subject to income tax, but to the corporation tax. Such companies may opt to pay income tax rather than corporation tax. A company is held to be resident in the country in which its central management and control is located, not in the location of its incorporation.

A double taxation agreement exists between the United Kingdom and Jersey and Guernsey. However, they need to be modified in light of the United Kingdom's revision of its corporation tax structure and system of 1972, pursuant to the Finance Act 1972.[15]

When a Channel Islands resident individual or company receives United

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[10]K. R. Simmonds, *The British Islands and the Community: I—Jersey,* 6 COMMON MARKET L. REV. 156 (1969) at 159.

[11]*Jersey Report,* 1967, at pp. 6–7, 55, 111–124.

[12]*The Channel Islands, The Isle of Man and the Republic of Ireland—Unit Trusts and Investment Trusts,* 11 EUROPEAN TAXATION I/84 (April 1971). *See also,* Spitz, INTERNATIONAL TAX PLANNING (1972).

[13]*Id.* at I/86. *See generally,* THE CORPORATION TAX (Guernsey) LAW 1950.

[14]*Id.* at I/87.

[15]The Islands do not have such agreements with any of the Community Member States, *See* (Jersey) Order in Council, June 24, 1952, SI 1952 No. 1216, Supp. Ser. § of ERUOPEAN TAXATION; IV UN 133. (Guernsey), June 24, 1952, SI 1952 No. 1215, Supp. Ser. § C of IV UN 128.

Kingdom interest on which tax has been deducted at source, there is a full credit relief against local tax and no reclaim from the United Kingdom. Untaxed United Kingdom interest is subject to Channel Islands tax at 20 percent.[16] In case of income from a foreign (non-U.K.) source, Jersey has no provisions for credit relief. The net receipt, after withholding tax is subject to Jersey tax at 20 percent.

Guernsey does give unilateral relief at half the Guernsey rate or the foreign rate, whichever is less. If this relief is claimed, the gross dividend must be declared for tax purposes.[17] Management expenses are deductible. Most Channel Islands investment companies are closed-end investment trusts incorporated under the Companies Laws. There are no particular restrictions except that there is no provision for unlimited companies and no practical procedure for creating an incorporated open-ended structure.[18]

The observation made by the Director of the British Institute of International and Comparative Law in 1971, is quite informative: "It is obvious that the low rates of personal and company taxation which at present apply in Guernsey may attract, within certain limits, both new residents and new business interests."[19]

IV. Emerging Community Harmonization of Corporate Taxation

In January 1969 the Commission submitted two draft directives[20] to the Council of Ministers, concerning the harmonization of tax treatment of

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U.K. Gross Dividend		100
Withholding Tax*		30
Received in Jersey		70
Less Jersey Tax at 20%		14
Net Receipt		56

*Pre-1972 revision.

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U.K. Gross Dividend		100
Withholding Tax*		30
Received in Guernsey		70
20%of 100	20	
Less half relief	10	
		10
Net Receipt		60

[18] 11 EUROPEAN TAXATION 1/84 at 1/87 (1971).

[19] K. R. Simmonds, *The British Islands and the Community III*, 8 COMMON MARKET L. REV. 475, 469 (1971).

[20] *See generally*, Anschutz, *Harmonization of Direct Taxes in the European Economic Community*, 13 HARVARD INT'L L. J. 1 (1972); Musgrave, *Harmonization of Direct Business*

merger-type transactions and parent-subsidiary relationships.[21] These are still before the Council. They indicate the areas in the near future that the Community will be legislating upon. It may very well require a harmonized or uniformed corporate tax system in or among the Member States. If the Community seeks to raise much of its operating revenues in the future from this source, as has been suggested, the level of taxation of corporate income may be considerably greater than the 20 percent level currently existing in the Channel Islands.

An enlarged Eurobudget is bound to occur. The new Eurobudget revenues must come from taxation. While VAT custom and agricultural levies are currently favored, there are strong arguments for preferring the corporation tax. "The corporation tax should be made uniform and the revenue paid to Brussels. This provides an impetus to Europeanization where the atmosphere is ripe for it, namely in business. . . . Short–run, and more urgent, policy should pin-point the corporation tax as being an economically desirable and politically acceptable Community tax, in the present stage of European integration, with the value-added tax held in reserve if and when member-states are prepared to go much farther. . . ."[22]

Two drafts of double taxation conventions exist (the OECD and the EEC). The Community considers this an integral area ripe, at least, for harmonization and, perhaps, as a part of a common fiscal policy of the Community.[23] Also to be noted is the question of freedom of establishment for banks, and the related question of liberalization of banking services, both of which have raised certain difficulties which are being examined by a working group of the Council.[24] The essential link is with Article 61, which provides for the liberalization of the movement of capital.[25]

Taxes—A Case Study, 2 FISCAL HARMONIZATION IN COMMON MARKETS 207 (Shoup, ed., 1967); Council Decision, 21 April 1970, 70/243, JO 1970, L94.

[21]*European Communities—Proposed Directives,* 9 EUROPEAN TAXATION 147 (1969).

[22]*European Corporation Tax,* TIMES, October 9th, 1972, pp. 25 at 4.

[23]The United Kingdom has double taxation agreements with all of the Common Market Member States, 12 EUROPEAN TAXATION I/10 (January 1972); "Tax Treaty Charts," 12 EUROPEAN TAXATION I/75 (March 1972).

[24]*See,* Campbell, COMMON MARKET LAW SUPPLEMENT (No. 2, 1971, Volume II) at p. 33. *See generally,* JO No. 43, 11 May 1960 (JO 1960); JO No. 9, 18 December 1962 (JO 1963).

[25]*European Law Problem for the Bank of England,* TIMES November 8th, 1972, pp. 24 at 4. The Council decided to extend the freedom of establishment to the banking sector, as bank operations relate to the liberalization of the movement of capital. This was decided November 1972.

V. United Kingdom Corporation Taxation Reform—The Finance Act-1972

1. Income, Gains and Holding Companies[26]

The company (corporation) tax system and structure was substantially changed in 1972. The United Kingdom adopted an imputation system in line with France and the proposed reform in Germany.[27] It is to take effect as of April 1973. The corporation tax rate for the fiscal year 1971 is 40 percent (but it is indicated to be raised in the future to 50 percent). It will be applied to *all* corporate profits, whether retained or distributed. Shareholders will receive a credit for part of the corporation tax paid on the distributed profits. The corporation tax is payable nine months or so, after the end of the company's accounting period. There is no withholding tax on distribution of profits at source. But companies are required to deduct income tax from interest paid and other charges.

When paying dividends, the company is required to make a payment of corporation tax measured by reference to the amount of the profits then distributed. The advanced corporation tax for 1973 is 3/7's (s.84 of the Finance Act 1972)[28] During the year, as distributions are made, the company accounts for the ACT. The individual is considered as receiving the dividend and the tax credit, the amount of the ACT. (s.86.) Any excess ACT may be carried by the company either back for two years or forward to future years. (s.85.)

It is considered by some that this new system is disadvantageous for United Kingdom companies with a large proportion of overseas income. The ACT will represent the minimum tax payable on their income, only the remaining corporation tax being available for foreign tax credit.[29] Some measure of relief might be granted by the so-called overspill relief, or by the companies considering the dividend distributions as being payable in the first place out of domestic profits, if they have a sufficient amount of domestic profits.

Under the Finance Act 1972 chargeable gains in a company's total profits, are reduced in cases of unit trusts and investment trusts, by 5/8's

[26] *See generally, United Kingdom—Tax Reform,* 12 EUROPEAN TAXATION 1/57 (March 1972).

[27] *Id.* at 1/58.

[28] *See generally,* WHITE PAPER (Cmnd 4955)—*Reform of Corporation Tax. See,* s. 91 for Group of Companies. *See also,* GREEN PAPER (Cmnd 4630)—The latter suggested that it did not think that it would be appropriate for the rate of tax on companies' capital gains to rise in line with the increase in the rate of tax on retained profit.

[29] *See,* 12 EUROPEAN TAXATION 164 (1972) and Clause 80(2) of Finance Bill 1972.

(s.93.) Thus, if they have 40 percent income tax, they will have 15 percent tax as chargeable gains. (s.112, s.119.)

As to holding companies see section 154 of the Companies Act 1948.[30] The true investment trust or holding company has no power to distribute by way of dividends, any profits arising from the realization of investments. The profits can be credited to capital reserve or used to write down the book value of its investments. The principal distinctions in taxing of investment companies and dealing companies, are significant, even since the introduction of capital gains tax in the mid-1960s. The principal characteristics in the taxation of investment holding companies are the following:[31]

1. Chargeable gains are not taken into account in calculating the distributable income of a close company, but dealing profits are included for that purpose. (Tax Act 1970, s.291 para. 2.)
2. Capital gains provisions do not apply to the sale of dealing investments.
3. An investment company will obtain relief for administrative expenses of a dealing company, since they qualify as management expenses. When expenses exceed the profits of the year, relief will be available against subsequent profits but not against profits of an earlier year. (Tax Act 1970, s.304.)

The following is an observation of a leading international tax authority: "The question as to whether the activities of a company or companies should be carried on by one company alone or by a group and, if a group is appropriate, as to the most suitable division of activities between the group companies and the shareholding relationship with each other, should be determined on commercial principles. However, the high taxation advantages and disadvantages of a particular group structure should always be kept under review.'[32]

Observers have analyzed the significance of a foreign firm utilizing either a subsidiary or branch operations in the United Kingdom, and have generally concluded that branch operations are to be preferred.

"Where a non-resident company contemplates extending its trading activities to the United Kingdom, tax considerations prima facie favor operating through a branch or agency rather than through a subsidiary in this (U.K.) country.'[33] A subsidiary is subject to the corporation tax, withholding tax on its distributions (pre-1973) and would be a close company subject, *inter alia,* to the shortfall provisions, if its parent itself in the

[30]*See generally,* PALMER'S COMPANY LAW (ed., Schmitthoff and Thompson, 21 ed., 1968). Chapter 63.

[31]*See generally,* SIMON'S TAXES (7 ed, 1972).

[32]*Id.* at p. 363.

[33]Talbot and Wheatcroft, CORPORATION TAX 311 (1968). *See also, Id.* 289.

United Kingdom be a close company. A United Kingdom branch or agency would suffer corporation tax but no tax on the transfer of funds.

Illustration # 1 (Pre – 1973)

Subsidiary	Branch	
100.0	100.0	Trading Income
42.5	42.5	corporation tax (42.5%)
57.5	57.5	
23.7*	----	Income Tax (Assume 8s3d in –)
33.7	57.5	Receivable by Overseas Parent.

*Subject to tax treaties.

The following is an illustration of the corporate taxation under the Finance Act of 1972, on the distribution of a United Kingdom subsidiary of its profits to a foreign parent. See generally, 12 *EUROPEAN TAXATION I*/167 (June 1972).

Illustration 2 – Resident United Kingdom Corporation Distributes All Profits to Non-Resident Parent Corporation (New Approach)

(A) Taxable Profit: 100
(B) Taxes on Resident Subsidiary:
– Corporation Tax 40%
(for fiscal year 1971; s. 64)
– ACT need not be paid with respect to a distribution to a non-resident.

(1) United Kingdom Corporation Tax: 40% of 100 =	40
(2) Net Dividend Going to Non-Resident Parent: 100 – 40 =	60
*(3) Net Dividend after all taxes (assuming dividend is exempt from foreign tax): 100 – 40 =	60
*(4) Net Dividend Assuming Dividend is Subject to Foreign Corporation Tax of 40%. 40% of 60 =	24
100 – 40 – 24 =	36

**See* United Kingdom – U.S.A. Tax Treaty (1945), and three supplementary Protocols of 1946, 1954 and 1957. *EUROPEAN TAXATION* (Section C).

The White Paper on the Reform of Corporate Taxation (Cmnd 4955, 1972) discusses double taxation relief under the new tax structure[34] and close companies.[35]

For double-taxation relief purposes any deductions for corporation tax profits will be set against domestic profits in priority to overseas profits. The advance corporation tax will be apportioned against the corporation tax as domestic income in priority to that of overseas income. A company with both domestic and foreign income will be able, in effect, to assume that distributions are made out of its domestic sources, so that its undistributed profit (50 percent tax without abatement for ACT) will be regarded as coming from its income from foreign sources. As much United Kingdom tax as possible will be attributed to the foreign profits, and the scope of tax credit relief maximized. Likewise a group which includes companies some of which have domestic income, and other with overseas income, will be able to attribute so far as possible any surplus ACT of the parent company to its subsidiaries with domestic income.

The new corporation tax offers one important simplification. At present, when a "shortfall assessment" is made, the company is charged to income tax on the dividends which it could have paid. Now that tax income is no longer to be deducted at source from distributions, the shortfall assessment to basic income tax will disappear. The part of the company's income which would have gone into paying a dividend will be apportioned to the shareholder, liability to income tax will be only at rates in excess of the basic rate and to investment surcharge.

The new tax seems, at the least, no more disadvantageous to the foreign subsidiary, and quite possibly more beneficial, since the withholding tax no longer exists. The impact of the new tax on the operations of a branch of a foreign corporation, does not seem to worsen its position.

2. *Tax Avoidance Legislation*

The United Kingdom has had as a part of its tax legislation[36] for a number of years, several provisions aimed at the use of foreign base companies and holding companies for the purpose of avoiding its taxes. See Section 478, Income and Corporation Taxes Act 1970, as to individuals. Section 482 prevents to a large extent migration of companies. (The United Kingdom first introduced capital gains taxation in 1965.) The anti-avoidance provisions apply to non-resident companies and non-resident

[34] *Id.* 10.

[35] *Id.* 11.

[36] *United Kingdom— Legislation for the Prevention of International Tax Avoidance,* 11 EUROPEAN TAXATION 93 (April 1971).

trusts. Section 41 of the Finance Act of 1965, relates to United Kingdom shareholders of closely held non-resident companies. Section 42 provides that certain United Kingdom beneficiaries of a non-resident trust are taxable for capital gains realized by the non-resident trust.

3. Near-Banking Operations

Since the early 1960s banks in the United Kingdom have dramatically been diversifying their activities,[37] and other organizations are seeking and obtaining banking status. Only in January 1972 was banking status granted to four groups specializing in hire-purchase finance.[38]

COMPETITION and CREDIT CONTROL, The Bank of England's basic paper initiating the new era of free competition in banking, holds major implications for the fundamental developments of the British banking system. *COMPETITION and CREDIT CONTROL* initiated the new policy of the Bank of England, and introduced a new freedom of action. It allows clearing banks the opportunity to engage in a much greater range of commercial transaction. Their activities have already brought them into direct competition with specialists in various types of finance and with each other.[39]

For companies, such as the hire-purchase and instalment credit houses, the situation offers a direct challenge to compete on equal terms for both lending business, and for funds to support it. It is open for merchant banks to take whatever business they can from the commercial giants. It is likely that trustee savings banks and building societies may find themselves increasingly overlapping with the banks. The current conflict between specialist banks and the big ones, are in hire-purchase and instalment credit business, and particularly in the area of consumer finance.

The secondary banks, *e.g.*, the British Bank of Commerce, Cedar Holdings, London and Country Securities, have grown phenomenally over recent years. Small builders and property developers have been the worst sufferers from the physical lending controls on 'mainstream' banking. The new banks have been willing to respond to this need—with equity participation. Secondary banks in light of the new credit era are seeking associations with financial institutions outside of banking. Observers think that the second mortgage phenomenon will not long exist.[40]

Finance houses were the only major group of lenders whose principal activity was forced into decline between 1965-1970. While more complex

[37]*Near-Banking—A Survey* 122 THE BANKER 635 (1972).

[38]P. Smart, "So What is a Bank?" *Id.* 639; and as to consortium banking as a means of international banking, "Consortium Banking," THE TIMES, Feburary 6, 1973, at I:1.

[39]Blanden, *The Big Banks Spread Their Wings, Id.*

[40]O'Shea, *Secondary Banks, Id.* at 651.

proposals for the overhaul of consumer credit legislation are still a long way from the statute books, term controls have been abolished and the new system of regulation through use of 'reserve assets' have been introduced (Crouther Report).

The evolution of banking-type business by the finance houses dates back to the early 1960s, when a number of houses began to feel the need to diversify out of the highly cyclical motor-hire-purchase business, which they depended upon. Generally, their diversification led the finance houses into more profitable areas. Competition by the clearing banks were very limited during the 1960s. In the last year, several houses have concluded that the benefits of remaining classified as finance houses are too small.[41]

The finance houses are interested in preparing to battle for the consumer market. A number of houses are beginning to deal directly with the public for both savings and loan business. This is clearly an area of great growth potential. The finance houses' commercial side is less hopeful. The clearing banks have landed a major challenge that may be difficult to meet. Finance houses should be able to hold their own position in specialized areas, such as leasing and property finance, but on a more general basis, they may find it more difficult to maintain their position.

All five major clearing banks have taken a positive interest in factoring within the last five years. Several major American banks have entered the field in the United Kingdom and there are, of course, indications that more may follow. Why the sudden interest? British banks are looking for further services to attract and to hold their customers. The American banks were looking for expansion of their range of services through Britian.

Factoring provides substantial administrative assistance to expanding companies and, at the same time, better secure them against many credit risks and collection problems.[42] Factors in the case of bank-related operations are creating substantial benefits for their own user clients. A great deal of the new business is currently being handled on a 'maturity basis' (one receives money from a factor on a guaranteed average collection date, rather than at time of invoicing). This has created an increase of about 15 percent cash flow and slow down, in the requirement of additional funds for the companies.

Services of the factors are not confined to home markets. Finance companies are currently starting to offer export services of real value to domestic manufacturers selling abroad on short-term. Such a service was not even in existence ten years ago. With the British government attempting to induce domestic concerns to enter the newly available markets in the

[41]Redman, *Finance Houses as Banks, Id.* at 671.

[42]Pilcher, *Factoring—A New Banking Service, Id.* at 675.

European Communities, this seems to be a very valuable role that United States banks with experience and facilities on the continent can perform for manufacturers based in the United Kingdom.

The banks are able to offer practical support to their customers in the United Kingdom, and in the development of their overseas trade. The average British company needs all the help that it can get, both in terms of improving its own administrative efficency, and on competing as keenly as possible in the expanding European market place.[43] American banks located in London could participate advantageously in this area of near-banking services.

4. London—Leading Financial Center of an Expanding Common Market

In the 1960s, the city was successful, because it was the only center capable of taking advantage of the unprecedented expansion of trade and investment, and the Euro-dollar market. It had the service skills required by international trade. By contrast, other centers remained relatively underdeveloped in terms of these markets and trading skills. The value of securities quoted on the London stock exchange dwarfs that of "the Six EEC bourses combined."[44]

What does London Offer? London has over 213 different banks located or represented in London. New York has 170. The City of London's overseas earnings have risen sharply in recent years, from £210m. in 1965 to £540m. in 1970. While it is impossible to forecast accurately the likely competitive impact of British banks on Europe, and the impact of the expanded Common Market on London banking and foreign banking in London, it is is quite likely that London will emerge as a financial center, in the Common Market of prime importance, and the role of American banks will expand.

VI. Note on United States Taxation of Foreign Subsidiaries and Branches[45]

The principal tax advantage of the foreign corporation as a vehicle for foreign business and investment, is that it pays no United States tax on its foreign income, unless it is "effectively connected" with the conduct of a United States trade or business. The shareholders of the foreign subsidiary

[43] *Id.* at 679.

[44] "London's Foreign Business (Survey of London)," 122 THE BANKER 197 (1972), esp., "The City in a New Era," *Id.* As to possible changes in stock exchange operations, *see generally*, A.H. Hermann, "A Desirable Initiative," THE FINANCIAL TIMES, November 30th, 1972 at 7:6 and M. Westlake, "EEC Drive to Harmonize Stock Market Regulations," THE TIMES, December 11, 1972 at 19:8.

[45] Bittker and Ebb, UNITED STATES TAXATION OF FOREIGN INCOME AND FOREIGN PERSONS (2 ed., 1968) at pp. 210, 274-75, 279, 329 and 338.

are not taxed until the income is "repatriated" in the form of dividends or similar payments.

Two limited exceptions to the above are the "foreign personal holding companies" (the need to report undistributed income as realized by the corporation), and "controlled foreign companies" (to report its undistributed Subpart F income), and some provisions of the Foreign Direct Investment Regulations (investors holding more than ten percent of the voting stock of a foreign corporation to repatriate a portion of its earnings at a minimum level). Also of concern is the favorable reception in many sectors of the United States, of the proposed Hartke-Burke Bill, or the Foreign Trade and Investment Bill of 1972. This is to be considered further by the United States Congress next year.

By contrast the earnings of a foreign branch are taxed when they arise. However, losses incurred in branch operations offset the enterprise's domestic income in computing taxable income. The possibility of offsetting foreign losses against domestic income is especially attractive in the early years of foreign operations. This may tip the scale in favor of using a foreign branch rather than a foreign corporation. A domestic corporation conducting its foreign operations through a domestic subsidiary may, by filing consolidated returns, lay the basis for a tax result comparable to that achieved by using a foreign branch.

VII. Conclusion

It is quite clear that the Accession Treaty and the European Communities Act 1972 preclude Jersey and Guernsey from the operation of most of the provisions of the Treaty of Rome. They are not to be subject to the developing harmonization of corporate tax law in the Community. The government of Jersey wants to develop as a responsible international financial center. While the Community has a reserved legal right to correct any 'difficulties', for many reasons this will not be done, at least not for a considerable period of time. The history of this British European dependency is of foremost consequence. It is by no means clear that the development of a tax haven may not in fact be in furtherance of the development of a common market.

The fiscal and commercial environment of London lend that city to be a banking center, very attractive for operations of foreign banks. With the entry of the United Kingdom into the Common Market, London, as a location of banking headquarters for American banks is further enhanced.[46]

[46]The position of London will gain greater attractiveness once the proposed reform of both company law and bank law is undertaken in the near future. *See, Major Company Law*

It is expected that a number of foreign banks will reorganize their corporate structure to take advantage of the recent developments, and to locate in London.

Reform Coming Soon, THE TIMES, November 10, 1972, 20:1; *European Law Problem for the Bank of England*, THE TIMES, November 8th, 1972, 24:4; *The Future Role of London in International Bond Market*, THE TIMES, November 13th, 1972, 21:4.

APPENDIX

Protocol No. 3 on the Channel Islands and the Isle of Man*

ARTICLE 1

1. The Community rules on customs matters and quantitative restrictions, in particular those of the Act of Accession, shall apply to the Channel Islands and the Isle of Man under the same conditions as they apply to the United Kingdom. In particular customs duties and charges having equivalent effect between those territories and the Community as originally constituted and between those territories and the new Member States shall be progressively reduced in accordance with the timetable laid down in Articles 32 and 36 of the Act of Accession. The Common Customs Tariff and the ECSC unified tariff shall be progressively applied in accordance with the timetable laid down in Articles 39 and 59 of the Act of Accession, and account being taken of Articles 109, 110 and 119 of that Act.

2. In respect of agricultural products and products processed therefrom which are the subject of a special trade regime, the levies and other import measures laid down in Community rules and applicable by the United Kingdom shall be applied to third countries.

Such provisions of Community rules, in particular those of the Act of Accession, as are necessary to allow free movement and observance of normal conditions of competition in trade in these products shall also be applicable.

The Council, acting by a qualified majority on a proposal from the Commission, shall determine the conditions under which the provisions referred to in the preceding subparagraphs shall be applicable to these territories.

ARTICLE 2

The rights enjoyed by Channel Islanders or Manxmen in the United Kingdom shall not be affected by the Act of Accession. However, such persons shall not benefit from Community provisions relating to the free movement of persons and services.

ARTICLE 3

The provisions of the Euratom Treaty applicable to persons or undertakings within the meaning of Article 196 of that Treaty shall apply to

*This is the official English language translation by the British Government, pending the official text from the Communities.

those persons or undertakings when they are established in the aforementioned territories.

ARTICLE 4

The authorities of these territories shall apply the same treatment to all natural and legal persons of the Community.

ARTICLE 5

If, during the application of the arrangements defined in this Protocol, difficulties appear on either side in relations between the Community and these territories, the Commission shall without delay propose to the Council such safeguard measures as it believes necessary, specifying their terms and conditions of application.

The Council shall act by a qualified majority within one month.

ARTICLE 6

In this Protocol, Channel Islander or Manxman shall mean any citizen of the United Kingdom and Colonies who holds that citizenship by virtue of the fact that he, a parent or grandparent was born, adopted, naturalised or registered in the island in question; but such a person shall not for this purpose be regarded as a Channel Islander or Manxman if he, a parent or a grandparent was born, adopted, naturalised or registered in the United Kingdom. Nor shall he be so regarded if he has at any time been ordinarily resident in the United Kingdom for five years.

The administrative arrangements necessary to identify these persons will be notified to the Commission.