

September 2004

TAX POLICY

Historical Tax  
Treatment of  
INTELSAT and  
Current Tax Rules for  
Satellite Corporations



G A O

Accountability \* Integrity \* Reliability

Highlights of [GAO-04-994](#), a report to congressional requesters

## Why GAO Did This Study

The International Telecommunications Satellite Organization (INTELSAT)—an intergovernmental organization launched in 1964 to design, develop, and operate a commercial telecommunications satellite system—enjoyed certain privileges that domestic companies do not, including some related to taxation. Each member nation designated a Signatory to participate as an investor. The U.S. Signatory was COMSAT, a private corporation. Intelsat privatized in 2001, and its tax situation changed. In response to congressional requests for information on whether Intelsat could continue to enjoy any preferential tax treatment as a foreign corporation, GAO did this study to describe how INTELSAT and COMSAT were treated for U.S. tax purposes prior to INTELSAT's privatization and to describe how current U.S. tax treatment for a domestically incorporated satellite company in the United States compares to current U.S. tax treatment for a foreign corporation with operations, services, and revenue in the United States.

[www.gao.gov/cgi-bin/getrpt?GAO-04-994](http://www.gao.gov/cgi-bin/getrpt?GAO-04-994).

To view the full product, including the scope and methodology, click on the link above. For more information, contact James R. White at (202) 512-9110 or [whitej@gao.gov](mailto:whitej@gao.gov).

## TAX POLICY

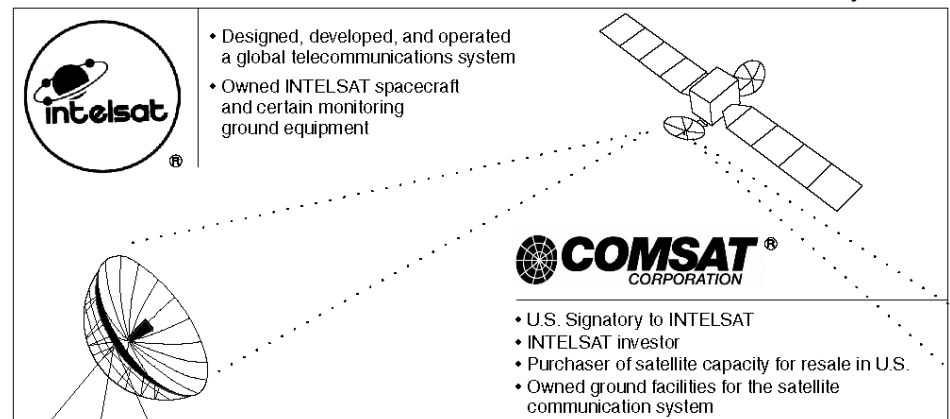
# Historical Tax Treatment of INTELSAT and Current Tax Rules for Satellite Corporations

## What GAO Found

As an international organization, INTELSAT was exempt from all U.S. federal income taxes, communications taxes with respect to activities under INTELSAT agreements, and customs duties on imports of communications satellite equipment. INTELSAT and its property, income, operations, and other transactions were also exempt from all taxes in the District of Columbia, except for those not used for, or related to, the purposes of INTELSAT. In contrast, COMSAT was subject to all applicable U.S. taxes.

Currently, U.S. income tax treatment of satellite corporations, like other corporations, depends, in part, on whether the corporation is incorporated domestically or is a foreign corporation. The United States taxes the worldwide income of U.S. domestic corporations, regardless of where the income is earned. However, when the tax is due depends on several factors, including whether the income is from a U.S. or foreign source and, if it is from a foreign source, whether it is earned through direct operations or through a subsidiary. Tax on income from a subsidiary may be deferred. The United States generally taxes foreign corporations on any U.S.-source income they earn, but taxes them only on certain types of foreign-source income (and generally only if the latter income is attributable to an office or fixed place of business in the United States). In order to avoid double taxation of income earned in a foreign country, the United States allows corporations to claim a credit for foreign taxes they paid on foreign-source income. Specific income-sourcing rules exist for determining the U.S. taxation of income that domestic and foreign corporations earn from space, ocean, or international communications activities. The rules differ depending on the type of activity and whether the corporation is domestic or foreign.

### Roles of INTELSAT and COMSAT in the Worldwide Telecommunications Satellite System



Source: Intelsat Global Service Corporation; COMSAT Corporation, used with permission; GAO.



September 13, 2004

Congressional Requesters

The Communications Satellite Act of 1962<sup>1</sup> (Satellite Act) provided a framework for building a commercial satellite system for telecommunications services that would serve countries throughout the world. In August 1964, the United States joined with other nations to launch such a system through an interim agreement signed by the government of each participating nation, including the United States. This agreement provided for the establishment of the intergovernmental organization INTELSAT to develop such a system. INTELSAT enjoyed certain privileges that domestic companies do not, including some related to taxation. Each participating nation named a Signatory to act as an investor in INTELSAT. COMSAT Corporation (COMSAT) was created to serve as the United States' Signatory. INTELSAT's role was to design, develop, implement, and operate the global commercial communications satellite system and COMSAT was responsible for purchasing satellite capacity directly from INTELSAT for resale in the U.S. market.

During the 1990s, there was considerable criticism from new commercial satellite companies focused on the difficulty of competing against an organization with INTELSAT's advantages. The Open-Market Reorganization for the Betterment of International Telecommunications (ORBIT) Act,<sup>2</sup> which was enacted in 2000, provided for sanctions to be imposed upon Intelsat if it did not privatize in a manner consistent with the terms of the act. On July 18, 2001, INTELSAT transferred substantially all of its assets and liabilities to Intelsat, Ltd.—a holding company incorporated by INTELSAT under the laws of Bermuda—and its wholly owned subsidiaries.<sup>3</sup> By so doing, INTELSAT lost its tax-exempt status, along with other privileges it had been granted as an international organization and under international agreements.

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<sup>1</sup>Pub. L. No. 87-624, 76 Stat. 419 (1962).

<sup>2</sup>Pub. L. No. 106-180, 114 Stat. 48 (2000). This law amended the Satellite Act.

<sup>3</sup>The official name of the intergovernmental organization was INTELSAT—all capital letters. After privatization, the privatized company is known as Intelsat. As such, we make this distinction throughout this report.

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Given INTELSAT's advantages relating to taxation while it was an international organization, you expressed an interest in obtaining information on whether Intelsat, Ltd. could continue to enjoy any preferential tax treatment over its competitors. Specifically, you asked us to describe how (1) INTELSAT and COMSAT were treated for U.S. tax purposes prior to INTELSAT's privatization and (2) current U.S. tax treatment for a domestically incorporated satellite company in the United States compares to current U.S. tax treatment for an offshore-incorporated company with operations, services, and revenue in the United States.<sup>4</sup> In addition, you asked us to provide information related to the implementation of the ORBIT Act and the status of market access for global satellite companies in countries around the world. Thus, as agreed, we are also concurrently issuing a separate report to you on these issues.<sup>5</sup>

To address both of these objectives, we reviewed relevant provisions of the Satellite Act, the ORBIT Act, U.S. tax laws, and other relevant laws; relevant Internal Revenue Service (IRS) regulations and tax rulings; relevant court cases; relevant Joint Committee on Taxation summaries; relevant Securities and Exchange Commission filings and Federal Communications Commission (FCC) filings and orders; relevant executive orders; relevant international agreements; and other relevant documents and reports. In addition, we interviewed cognizant Intelsat, Ltd., IRS, and Treasury officials. We did not determine the taxes that INTELSAT and COMSAT actually paid prior to INTELSAT's privatization or that Intelsat, Ltd. or any other specific company or companies would have to pay.

We conducted our review from March 2004 through June 2004 in accordance with generally accepted government auditing standards.

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## Results in Brief

While it was an international organization, INTELSAT was exempt from all U.S. federal income taxes, as well as from federal communications taxes with respect to activities authorized by INTELSAT agreements. INTELSAT

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<sup>4</sup>The Internal Revenue Code (I.R.C.) section 7701(a)(4) provides that the term "domestic," when applied to a corporation, means that the corporation is created or organized in the United States or under the law of the United States or of any state. I.R.C. section 7701(a)(5) provides that the term "foreign," when applied to a corporation, means that the corporation is not domestic. As such, we use these terms throughout the report.

<sup>5</sup>GAO, *Telecommunications: Intelsat Privatization and the Implementation of the ORBIT Act*, GAO-04-891 (Washington, D.C.: Sept. 13, 2004).

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was also exempt from customs duties on imports of communications satellite equipment. In addition, INTELSAT and its property, income, operations, and other transactions were exempt from all taxes imposed by the District of Columbia—where it was headquartered—except for those not used for, or related to, the purposes of INTELSAT. Moreover, the wages and salaries of INTELSAT employees who were not U.S. nationals or permanent residents were exempt from federal and District income taxes. In contrast, COMSAT was subject to applicable U.S. federal, state, and local taxes, even with respect to income that it received through its participation in INTELSAT.

Currently, U.S. income tax treatment of satellite corporations, like other corporations, depends, in part, on whether the corporation is incorporated domestically or is a foreign corporation. The United States taxes the worldwide income of domestic corporations, regardless of where the income is earned. However, when the tax is due depends on several factors, including whether the income is from a U.S. or foreign source and, if it is from a foreign source, whether it is earned through direct operations or through a subsidiary. A domestic corporation may be able to defer U.S. tax on a foreign subsidiary's income. The United States generally taxes foreign corporations on any U.S.-source income they earn, but taxes them only on certain types of foreign-source income (and generally only if the latter income is attributable to an office or fixed place of business in the United States). The U.S.-source income is taxed in one of two ways. If such income is "effectively connected" with a U.S. trade or business, it is generally subject to the corporate income tax; however, certain types of U.S.-source investment income that are not effectively connected are subject, instead, to a flat rate tax known as the 30 percent withholding tax. Specific income-sourcing rules exist for determining the U.S. taxation of income that domestic and foreign corporations earn from space, ocean, or international communications activities. In order to avoid double taxation of income earned in a foreign country, the United States allows corporations to claim a credit for foreign taxes they paid on foreign-source income.

We provided a draft of this report in August 2004 to the Secretary of the Treasury and the Commissioner of Internal Revenue for their review and comment. We also provided Intelsat, Ltd. with the opportunity to review our draft report and provide comments or observations. We received technical and editorial comments via e-mail from IRS and Intelsat, Ltd. and oral technical and editorial comments from Treasury. Where appropriate, we made changes in our report in response to these comments.

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## Background

With the enactment of the Satellite Act, the United States began building a framework for a commercial satellite system that would provide telecommunications services throughout the world. The United States joined with other nations through an interim agreement<sup>6</sup> to form an international organization<sup>7</sup>—the International Telecommunications Satellite Organization (INTELSAT)—to provide such a system. This agreement established an Interim Communications Satellite Committee to be responsible for the design, development, construction, establishment, maintenance, and operation of the satellite system. Pursuant to the interim agreement, INTELSAT was subsequently established under a formal international agreement (definitive agreement) among the United States and other nations in February 1973. Under the definitive agreement, INTELSAT’s purpose was to design, develop, implement, and operate a global commercial communications satellite system that would provide international commercial satellite communications on a nondiscriminatory basis to all areas of the world.

Each member nation that was a party<sup>8</sup> to the INTELSAT agreements designated a single Signatory, usually a telecommunications entity, to participate as an investor in the system. The Signatory for the United States was COMSAT, created as a private, profit-seeking, government-regulated corporation to provide for the United States’ participation in such a system, as authorized by the Satellite Act. COMSAT also was the only entity authorized to purchase satellite capacity directly from INTELSAT for resale in the U.S. market. (See fig. 1.)

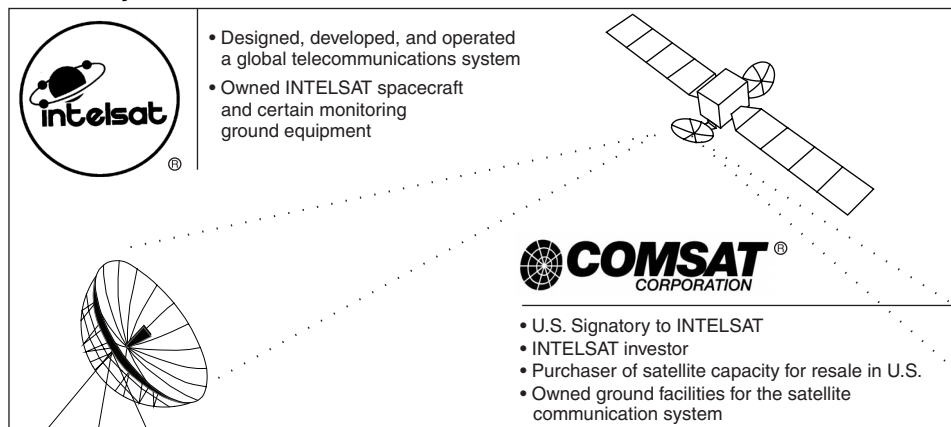
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<sup>6</sup>Agreement Establishing Interim Arrangements for the Global Commercial Communications Satellite System, August 20, 1964, 15 U.S.T. 1705, T.I.A.S. 5646 (entered into force August 20, 1964). A formal INTELSAT agreement was agreed to in Washington on August 20, 1971, and entered fully into force on February 12, 1973: Agreement Relating to the International Telecommunications Satellite Organization “Intelsat”, August 20, 1971, 23 U.S.T. 3813, T.I.A.S. 7532 (entered into force February 12, 1973).

<sup>7</sup>The ORBIT Act and other sources, including Intelsat, Ltd. itself, refer to INTELSAT as an *intergovernmental* organization. However, it was INTELSAT’s status as an *international* organization that was responsible for its exemptions from federal taxes discussed in this report. Throughout this report, the terms *intergovernmental* and *international* are both used in reference to INTELSAT.

<sup>8</sup>According to the definitive agreement, a party was “a State for which the Agreement has entered into force or been provisionally applied.”

**Figure 1: Roles of INTELSAT and COMSAT in the Worldwide Telecommunications Satellite System**



Source: Intelsat Global Service Corporation; COMSAT Corporation, used with permission; GAO.

During the 1970s and early 1980s, INTELSAT was the only wholesale provider of certain types of global satellite communications services.<sup>9</sup> This changed, however, by the mid-1980s, when the United States began encouraging the development of commercial satellite communications systems to provide for competition in the market.<sup>10</sup> By the mid- to late-1990s, INTELSAT faced global satellite competitors and commercial satellite companies were contending that, if the satellite marketplace were to become fully competitive, INTELSAT needed to be privatized so that it would operate like commercial companies in the market. In particular, these companies noted that INTELSAT enjoyed immunity from legal liability and was often not taxed in the various countries that it served—advantages that stemmed from its status as an international intergovernmental organization. By the mid-1990s, INTELSAT began to recognize that it would be best for the organization to privatize and, in 1999, INTELSAT announced its intention to do so.

<sup>9</sup>While INTELSAT was the only provider at that time of what is called global fixed satellite services—that is, services provided between fixed points on land—another global satellite organization that was also formed, based on amendments to the Satellite Act, provided global maritime satellite communications. This organization is commonly known as Inmarsat. However, a discussion of Inmarsat is outside the scope of this report.

<sup>10</sup>See Presidential Determination Number 85-2 (1984).

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The ORBIT Act, which became law in March 2000, provided for sanctions to be imposed upon Intelsat if it did not privatize in a manner consistent with the terms of the act, so as to promote a competitive global satellite communication services market. On July 18, 2001, INTELSAT transferred substantially all of its assets and liabilities to Intelsat, Ltd.—a holding company incorporated by INTELSAT under the laws of Bermuda—and its wholly owned subsidiaries.<sup>11</sup> Intelsat, Ltd. remains incorporated in Bermuda and its subsidiaries were incorporated in several countries, including the United States. The FCC has determined that INTELSAT's 2001 privatization was in accordance with the ORBIT Act, but FCC conditioned the licenses it has granted to Intelsat LLC<sup>12</sup> on the company's holding an initial public offering (IPO) of securities, as required under the ORBIT Act.

In May 2004, the deadline for Intelsat, Ltd.'s IPO was extended until June 30, 2005,<sup>13</sup> by an amendment to the ORBIT Act.<sup>14</sup> On August 16, 2004, Intelsat, Ltd. announced that its Board of Directors approved the sale of the company to a consortium of four private investors; the sale requires the approval of shareholders holding 60 percent of Intelsat's outstanding shares as well as regulatory approval. Intelsat's announcement stated that Intelsat and a subsidiary owned by the consortium would be amalgamated under Bermuda law (in a manner similar to a merger in the United States) and that the deal could be closed as early as the end of 2004.

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<sup>11</sup>INTELSAT agreed to leave in place a residual intergovernmental organization, the International Telecommunications Satellite Organization (ITSO), that would monitor the performance of Intelsat, Ltd.'s remaining public service obligations. In particular, after the privatization, Intelsat, Ltd. was tasked with maintaining global connectivity and honoring connectivity obligations that had been made by INTELSAT to customers in countries with low levels of telephone service and low income, having a high degree of dependence on Intelsat for their communications needs.

<sup>12</sup>Intelsat LLC is an indirect subsidiary of Intelsat, Ltd. It is a limited liability company organized under the laws of Delaware and holding Intelsat, Ltd.'s satellites, satellite licenses, rights to use orbital locations, and other related assets.

<sup>13</sup>The FCC is authorized to extend the deadline to December 31, 2005.

<sup>14</sup>Pub. L. No. 108-228, 118 Stat. 644 (2004).



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## Prior to Privatization, INTELSAT Was Exempt from Most U.S. Taxes, but COMSAT Was Subject to Tax

While it was an international organization, INTELSAT was exempt from all U.S. federal income taxes, as well as from federal communications and property taxes with respect to activities authorized by INTELSAT agreements. INTELSAT was also exempt from customs duties on imports of communications satellite equipment. In addition, INTELSAT and its property, income, operations, and other transactions were exempt from all taxes imposed by the District of Columbia—where it was headquartered—except for those not used for, or related to, the purposes of INTELSAT.<sup>15</sup> Moreover, the wages and salaries of INTELSAT employees who were not U.S. nationals or permanent residents were exempt from federal and District income taxes. In contrast, COMSAT was subject to applicable U.S. federal, state, and local taxes, even with respect to income that it received through its participation in INTELSAT.

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## As an International Organization, INTELSAT Was Exempted from Most Applicable Taxes in the United States

INTELSAT's tax exemptions were based on its designation as an international organization<sup>16</sup> covered under the International Organizations Immunities Act,<sup>17</sup> its specific international agreements, and a law specifically providing for immunity from taxation in the District of Columbia. As a designated international organization, INTELSAT was entitled to certain privileges, exemptions, and immunities, including exemptions under the I.R.C. In particular, income of international

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<sup>15</sup>According to an Intelsat, Ltd. official, INTELSAT was required to pay property taxes to the District of Columbia on part of the INTELSAT headquarters building in the District because INTELSAT had renters in the building that were subject to U.S. taxes. In addition, another official said that INTELSAT was not subject to taxes in any of the 50 U.S. states.

<sup>16</sup>In 1965, Exec. Order No. 11,227, 3 C.F.R. 317 (1964-1965) designated the Interim Communications Satellite Committee as a public international organization entitled to enjoy privileges, exemptions, and immunities conferred by the International Organizations Immunities Act. Similarly, in 1966, Exec. Order No. 11,277, 3 C.F.R. 107 (1966) designated the International Telecommunications Satellite Consortium (the name by which INTELSAT was initially known) as an international organization entitled to enjoy, from and after August 20, 1964 (the date the INTELSAT interim agreement was signed and became in force), all of the privileges, exemptions, and immunities in section 4(a) of that act. Following the in-force date of the INTELSAT definitive agreement, Exec. Order No. 11,718, 3A C.F.R. 177 (1973) revoked Exec. Order Nos. 11,227 and 11,277 and designated INTELSAT as an international organization with such privileges under the act and, in 1977, Exec. Order No. 11,966, 3 C.F.R. 90 (1977) revoked Exec. Order No. 11,718 and redesignated INTELSAT as a public international organization, accompanied by the privileges, exemptions, and immunities conferred by the act.

<sup>17</sup>International Organizations Immunities Act, 22 U.S.C. section 288 et seq. (2004).

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organizations received from any source within the United States is generally exempt from taxation. Further, wages, fees, and salaries received by any employee of an international organization as compensation for official services to the organization are generally not included in gross income and are exempt from taxation if the employee is not a citizen of the United States.<sup>18</sup>

In 1970, a law to provide for the immunity from taxation in the District of Columbia for the International Telecommunications Satellite Consortium and, subsequently, INTELSAT, was enacted.<sup>19</sup> This law provided that INTELSAT and its property, income, operations, and other transactions would be exempt from all taxes imposed by the District, except for any property, income, operations, or transactions not used for, or related to, the purposes of INTELSAT.

In addition, Article XV of the 1973 definitive agreement provided that, in all nations that were parties to the INTELSAT agreement, INTELSAT and its property were to be exempt from all national income and direct national property taxation<sup>20</sup> and from customs duties on communications satellites, including components and parts for such satellites, to be launched for use in the global system. This article also provided that the United States was to conclude a Headquarters Agreement with INTELSAT as soon as possible to cover the appropriate privileges, exemptions, and immunities with respect to INTELSAT, its officers, those categories of its employees specified in the headquarters agreement, parties, representatives of parties, Signatories, representatives of Signatories, and persons participating in arbitration proceedings. Included was a requirement for a provision in the Headquarters Agreement that all Signatories acting in their capacity as such—except for COMSAT, the Signatory of the United States itself—be exempt from national taxation on income earned from INTELSAT in the territory of the United States.

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<sup>18</sup>This exemption is provided under I.R.C. section 893. However, an employee who is a permanent resident of the United States (i.e., a green card holder) must waive this exemption if he or she desires to retain his or her status as an immigrant.

<sup>19</sup>Pub. L. No. 91-494, 84 Stat. 1091 (1970).

<sup>20</sup>According to an Intelsat, Ltd. official, national property taxes referred to property taxes that existed in some countries.

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The United States and INTELSAT concluded the Headquarters Agreement and it was brought into effect as of November 24, 1976.<sup>21</sup> Most of the tax exemptions provided by this agreement duplicated those already available to INTELSAT as a designated international organization or under the 1970 law. Three additional tax benefits were (1) a federal tax exemption for income earned outside of the United States, (2) a specific exemption from all U.S. and District communications taxes, and (3) a District tax exemption for wages and salaries earned by INTELSAT employees who were not U.S. nationals or permanent residents.

The exemptions from U.S. and District taxes related to INTELSAT remained in effect until July 18, 2001, when INTELSAT transferred substantially all of its assets and liabilities to Intelsat, Ltd.—a holding company incorporated by INTELSAT under the laws of Bermuda—and its wholly owned subsidiaries. After its incorporation, Intelsat no longer qualified for the privileges and exemptions, including tax exemptions that were granted based on its status as an international organization and its international agreements.

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### As a U.S. Domestic Corporation, COMSAT Was Subject to Federal, State, and Local Taxes

As a U.S. domestic corporation, COMSAT was subject to any applicable U.S. federal, state, and local taxes, as any domestic corporation would be. COMSAT had no tax exemptions in the United States. INTELSAT Signatories, including COMSAT, had rights and obligations in INTELSAT analogous to those of a partner in a partnership. Each owned an investment share, made proportionate contributions to INTELSAT's capital costs, and received proportionate distributions of INTELSAT's net revenues after deductions for operating expenses. Thus, as such, COMSAT was taxed on its distributive share of its INTELSAT income.

The ORBIT Act ended COMSAT's role as the U.S. Signatory to INTELSAT. Prior to Intelsat, Ltd.'s incorporation in July 2001, COMSAT merged with the Lockheed Martin Corporation in August 2000.

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<sup>21</sup>Headquarters Agreement Between the Government of the United States of America and the International Telecommunications Satellite Organization, November 22 and 24, 1976, 28 U.S.T. 2248, T.I.A.S. 8542 (entered into force November 24, 1976).

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## Whether Corporations, Including Satellite Corporations, Are Domestic or Foreign Determines Their U.S. Income Taxation

The United States taxes domestic corporations (those incorporated in the United States) differently than foreign corporations. In addition, special tax rules apply to income from space, ocean, or international communications activities.

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## Domestic Corporations Pay U.S. Tax on Their Worldwide Income

The United States taxes the worldwide income of U.S. domestic corporations, regardless of where the income is earned. However, when the tax is due depends on several factors, including whether the income is U.S. or foreign source and, if it is foreign source, on the structure of the corporation's business operations. A domestic corporation that earns income by operating directly in a foreign country, e.g., not through a partially or wholly owned foreign subsidiary, is liable for tax when the income is earned. In contrast, a domestic corporation that operates in a foreign country through such a subsidiary may be able to defer tax on the domestic corporation's share of the subsidiary's income. Generally, taxes on the domestic corporation's income from foreign subsidiaries are not due until the income is repatriated to the United States in the form of dividends. However, under certain circumstances, antideferral provisions may apply, causing the income to be taxed currently. One such provision, known as subpart F, disallows deferral of certain types of income, such as interest, dividends, other passive investment income, and certain income from space or ocean activity,<sup>22</sup> earned by controlled foreign corporations.<sup>23</sup>

In order to avoid double taxation of income earned in a foreign country, the United States allows domestic corporations to claim a credit for foreign taxes they paid on foreign-source income, subject to certain limitations.

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<sup>22</sup>Legislation has been proposed to repeal the subpart F rules relating to income earned from space or ocean activity. See, e.g., The American Jobs Creation Act of 2004, H.R. 4520, 108th Cong., section 315 (2004).

<sup>23</sup>A controlled foreign corporation has more than 50 percent of its stock (by vote or value) owned by U.S. shareholders, each of which must own at least 10 percent of the stock (by vote).

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## Foreign Corporations Pay U.S. Tax on Their U.S.-Source Income, Subject to Certain Conditions

Generally, the United States taxes the U.S.-source income of foreign corporations, but not their foreign-source income. The tax paid on U.S.-source income generally depends on whether the income is “effectively connected” with the conduct of a trade or business within the United States. Foreign corporations that own and operate businesses in the United States that sell services, products, or merchandise are, with certain exceptions, engaged in a U.S. trade or business. Generally, any income from such a business is considered to be effectively connected income and is subject to the U.S. corporate income tax.

Certain types of U.S.-source investment income, such as dividends or interest other than portfolio interest, not effectively connected with the conduct of a trade or business within the United States are subject to a flat rate tax known as the 30 percent withholding tax. In addition, certain income of a foreign corporation engaged in a U.S. trade or business could be subject to the branch profits tax, which taxes foreign corporations on U.S. earnings and profits shifted out of the corporation’s U.S. branch in a manner similar to the withholding tax on dividends.

There are exceptions to these rules on the U.S. taxation of foreign corporations. For example, one general exception is that any U.S. income tax of a foreign corporation may be reduced or eliminated under an applicable tax treaty. A more specific example is that, while the United States generally does not tax the foreign-source income of foreign corporations, certain foreign-source income that is “attributable to” an office or fixed place of business in the United States is treated as effectively connected to a U.S. trade or business and is, therefore, subject to U.S. tax.<sup>24</sup> Such income includes rents and royalties for the use of certain intangible personal property.

U.S. tax rules determine whether the source of income is U.S. or foreign. Some of the rules are complex, and some apply to particular activities.

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<sup>24</sup>The foreign corporation could claim a credit for foreign taxes paid on this income, subject to certain limitations.

**Specific Sourcing Rules Exist for Determining the U.S. Taxation of Income from a Corporation’s Space, Ocean, or International Communications Activities**

Specific sourcing rules determine the U.S. tax on income from space and ocean activity and international communications activity. Table 1 summarizes the basic statutory rules. Generally, under these rules, a domestic corporation’s income from space and ocean activity is U.S. source, and a foreign corporation’s income from such activity is foreign source. A foreign corporation’s income from international communications activity generally is treated as entirely foreign source. However, if a foreign corporation has an office or fixed place of business in the United States, all of its international communications activity income attributable to such an office or business is treated as U.S.-source income. Generally, a domestic corporation’s income from international communications activity is treated as 50 percent from U.S. sources and 50 percent from foreign sources. If a domestic or foreign corporation’s income from an activity falls under both the sourcing rules governing space and ocean activity and the rules governing international communications activity, the rules governing international communications activity control, and the income is not considered space and ocean activity income.

**Table 1: Basic Statutory Rules for Determining Whether Income Is U.S. or Foreign Source**

Type of corporation	Income from space and ocean activity	Income from international communications activity
U.S. corporation	U.S. source	50 percent U.S. source, 50 percent foreign source
Foreign corporation—if income is attributable to a fixed place of business in the United States	Foreign source	U.S. source
Foreign corporation—if income is not attributable to a fixed place of business in the United States	Foreign source	Foreign source

Source: GAO.

The I.R.C. provides Treasury the authority to modify these rules in certain respects. Pursuant to this authority, IRS issued proposed regulations in 2001 that, if made final, would change some of the rules for determining whether income from space or ocean activities and international communications activities is U.S. or foreign source.<sup>25</sup> For example, the

<sup>25</sup>Prop. Treas. Reg. sections 1.863-8 and Prop Treas. Reg. sections 1.863-9.

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proposed regulations would increase the number of situations in which international communications income of a foreign corporation would be treated as U.S.-source income. A public hearing addressing the proposed regulations was held on May 23, 2001, and the public comment period specified in these proposed regulations has ended. IRS is reviewing the extensive public comments received on the proposed rules to determine whether changes to them are appropriate.

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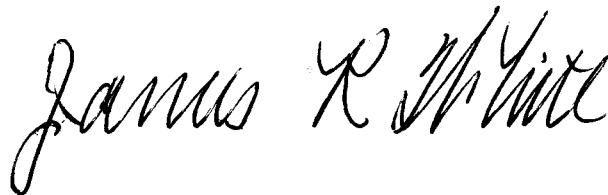
## Agency Comments

We provided a draft of this report in August 2004 to the Secretary of the Treasury and the Commissioner of Internal Revenue. We also provided Intelsat, Ltd. with the opportunity to review our draft report. We received technical and editorial comments via e-mail from IRS and Intelsat, Ltd. and oral technical and editorial comments from Treasury. Where appropriate, we made changes in our report in response to these comments.

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As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 15 days from its issuance. At that time, we will provide copies to interested congressional committees, the Secretary of the Treasury, the Commissioner of Internal Revenue, and other interested parties. We will also make copies available to others upon request. In addition, this report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you have any questions about this report, please contact me at (202) 512-9110 or James Wozny, Assistant Director, at (202) 512-9084. We can also be reached by e-mail at [whitej@gao.gov](mailto:whitej@gao.gov) or [woznyj@gao.gov](mailto:woznyj@gao.gov), respectively. Key contributors to this report were Joyce Corry, Cheryl Peterson, and Michael Rose.



James R. White  
Director, Tax Issues  
Strategic Issues Team

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*List of Congressional Requesters*

The Honorable Ernest “Fritz” Hollings  
Ranking Minority Member,  
Committee on Commerce, Science, and Transportation  
United States Senate

The Honorable Conrad Burns  
Chairman, Subcommittee on Communications  
Committee on Commerce, Science, and Transportation  
United States Senate

The Honorable Joe Barton  
Chairman, Committee on Energy and Commerce  
House of Representatives

The Honorable Edward Markey  
Ranking Minority Member,  
Subcommittee on Telecommunications and the Internet  
Committee on Energy and Commerce  
House of Representatives

The Honorable W.J. “Billy” Tauzin  
House of Representatives



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