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PSDED 374/88

TO: 1. PS/MR VIGGERS (B&L)
2. PS/SECRETARY OF STATE (B&L)

FROM: D FELL, DED

cc PS/PUS (B&L)
PS/Sir K Bloomfield
Mr Burns
Mr McAllister
Mr Chesterton
Mr Gowdy
Mr Wilson
Mr Bell
Mr Bohill
Mr Cowper-Coles,
Washington
Mr McAleer

DONNELLY BILL

PURPOSE OF SUBMISSION

1. Officials have now studied the legislative proposals put before Congress by Congressman Donnelly and have consulted with colleagues in HMT and FCO. This submission records the results of that research and makes recommendations on the response by Government.

BACKGROUND

2. Congressman Donnelly is Chairman of the House Friends of Ireland in the US Congress and has taken a strong interest in Northern Ireland affairs, and in particular the issue of fair employment. He introduced his Bill into Congress on 20 April and his aim appears to have been to wrest the initiative from the MacBride proponents and to construct legislation which would embrace both incentive and penalty provisions as a means of encouraging US investment in Northern Ireland but punishing those companies failing to meet satisfactory fair employment standards. It is understood that the SDLP have been heavily involved in the preparation of this Bill, particularly its incentive provisions. The Bill is currently stalled in Congress and has shown little signs of making any headway at present.

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CONTENT OF BILL

3. A summary of the Bill as presented to the House of Representatives on 20 April is at Annex 1. In brief the Bill:
 - (a) provides tax incentives in the form of removal of limitation on foreign tax credits on Northern Ireland income for US companies who are located in certain areas of high unemployment and whose workforce numbers at least 40% Catholic; and
 - (b) provides a sanction in the form of withdrawal of foreign tax credits on Northern Ireland income for US companies who are in breach of fair employment standards which Mr Donnelly regards as in line with those in our own proposed legislation.

ANALYSIS

4. After careful study of the Bill, the conclusion is that though it has a number of flaws (such as imprecise definitions of terms such as "area of high unemployment") and possible contradictions between provisions, it could be made to work, particularly with advice from HMG. However, the assessment of Inland Revenue is that the Bill offers very little real incentive to companies. The main UK rate of corporation tax (35%) is only slightly in excess of the US rate (34%) and the removal of the limitation on foreign tax credits is therefore likely to provide very limited benefit; in any case, it is probable that US companies will have already tried to arrange their income to avoid the additional tax liability arising.
5. The Bill is unlikely, therefore, to provide the sort of incentive which Congressman Donnelly hopes to achieve and thus is unlikely to meet its objective of encouraging investment in areas of high unemployment in Northern Ireland. (It is understood that Congressman Donnelly now recognises this and is trying to find some alternative incentive provision.) It will also impose additional burdens on the US companies operating in Northern Ireland, through the need to maintain separate accounting records specifying the tax liability attributable to the companies' operations in Northern Ireland, which

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- will necessitate some disaggregation for those companies incurring tax liabilities in other parts of the UK as well. The net effect, together with the potential penalties for those companies which fail to match up to the required standards, is that the Bill will do little to add to the attractiveness of Northern Ireland as an investment location.
6. A further factor is that there is a pre-condition for earning the tax benefit of 40% Catholic employment in the workforce. This is considered to be potentially capable of lawful implementation in most of the areas specified by Mr Donnelly (the population of which is at least 40% Catholic) but it conveys the impression of a quota and makes no allowance for the availability of suitably qualified and experienced labour. Indeed Belfast has an overall Catholic population of some 36.6% and this could cause difficulties for companies in that area trying to meet the 40% figure. No penalty is attached, however, to failure to meet the 40% level.

ASSESSMENT

7. As regards the desirability of the Bill, and HMG's attitude to it, we would clearly prefer not to have the unnecessary complication of US legislation seeking to enforce fair employment standards in Northern Ireland. Whilst the standards in the Bill appear consistent with our own legislative proposals they will be subject to interpretation by the Courts in the US and this could lead to companies who seek to benefit from the incentives or to avoid the penalties, being required to operate within the framework of US affirmative action (including, for example, preferential treatment). Moreover although we believe that Congressman Donnelly's aims can be viewed as constructive, the Bill, as indicated above, is unlikely to be significantly investment orientated and it involves a further reporting layer for US companies (in addition to the FEA/FEC, State legislatures and pro-MacBride shareholders).
8. The US companies themselves have not reacted, as yet, to the Bill, but it is believed that they are monitoring the developments on it and are keeping a low profile so long as it is making little headway. The longer term assessment must be that US investors will attach more weight to the negative, rather than the marginally positive, aspects.

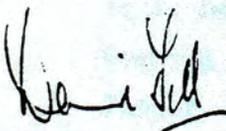
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9. It has been suggested that the Bill might provide a buffer against MacBride legislation in Congress and might negate the need for MacBride legislation at State level. The initial signs, however, do not support this view and we have no confidence that the Donnelly proposals will in any way deflect the MacBride campaign.

US/US DOUBLE TAXATION DIMENSION

10. It is understood that the US Treasury is strongly opposed on tax policy grounds to the Bill. Similarly, Inland Revenue have suggested that there might be an argument that the penalty provisions of the Bill cut across the US/UK Double Taxation Convention but the case is not conclusive and it is considered that Congress is unlikely to be impressed by the point. The US State Department has also been consulted and it is opposed as well, but has taken the view that the Bill seems unlikely to make much progress and that there is no need for lobbying on the issue at present.

CONCLUSION

11. The Donnelly Bill is an issue which needs careful political handling in view of the SDLP involvement in and support for, the incentive provisions of the measure. There is also the possibility of an adverse reaction from Donnelly, and more generally in Congress, if HMG were to launch an all out attack on the proposals. Indeed, as there has been criticism of the Bill from the pro-MacBride lobby for recognising the fair employment standards of HMG's new proposals it seems unlikely that there will be any unity of support in the US for the Bill. Politically therefore, there is little case for any strong statement from Government against the Bill and official advice is that Government should distance itself from it for the present. Reaction may be sought at some point, however, and a proposed draft response to be held ready is attached at Annex II.
12. Ministers are invited to note the assessment of the Donnelly Bill and to approve the draft line to take at Annex II.


DAVID FELL
25 May 1988

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ANNEX I

SUMMARY OF DONNELLY BILL

1. US companies which have operations in NI are required to make an annual report to the Secretary of the Treasury on the extent of their compliance with the fair employment standards set out in the Bill. Penalties are provided (\$25,000 fine and/or one year in jail) for failing to report. "Operation" is not defined as manufacturing or otherwise.
2. Failure to satisfy the Secretary that the fair employment standards have been complied with will result in a reduction of foreign tax credit by an amount calculated under regulations prescribed by the Secretary. The reduction would apparently be determined by reference to the company's Northern Ireland operation in relation to the company's total non-US operations eg as a percentage of sales, output, employment etc. "Operation" is not defined as manufacturing or otherwise.
3. In order to take advantage of the incentive package of the Bill ie the removal of the limitations on foreign tax credits, a company would have to be locate it's manufacturing operation in an area of high unemployment and ensure that at least 40 per cent of its employees were Roman Catholics. No definition of an area of high unemployment is given although Donnelly in his speech referred to parliamentary constituencies with unemployment rates of 20% or higher and to specific areas such as Belfast, Cookstown, Strabane etc all of which with the exception of Belfast, are over 40% Roman Catholic.
4. The Bill does not address the possible situation of a company satisfying the requirements of the tax credit incentives ie greater than 40% RC and in an area of high unemployment and yet failing to meet the fair employment standards and thus being liable to the penalty provisions.
5. The Bill would require those companies that wish to take advantage of the incentive provisions to set up separate limited companies in Northern Ireland and file audited tax returns here. There would be no need for companies to take such steps if they were not in a position to claim the tax benefits. The penalty provision provides for a way of calculating the loss of tax credit for Northern Ireland operations by reference to the size of the NI operation in the context of total non-US operations. Thus companies would not be required to file separate audited returns for their NI operations unless they wished to take advantage of the incentives.
6. In practical terms the Bill would not apparently impact negatively on any US company whose employment practices complied with those laid down in the Bill. These hopefully could be satisfied by a certificate of compliance from the FEA. We would like to think that no US company would be unable to meet the fair employment standards which are clearly in line with our own current thinking. If the situation were to arise where the penalty provision was being enforced, in all probability the company would be the subject of penalties under our own new proposals, if not under the existing law.

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LINE TO TAKE ON DONNELLY BILL

1. The British Government fully shares Congressman Donnelly's desire to contribute positively to promoting equality of opportunity in employment, and new investment, in Northern Ireland.
2. The British Government believes that equality of opportunity in employment is best addressed through Northern Ireland law and effective Government action. The Prime Minister, Mrs Margaret Thatcher, has already committed her Government to such action. Strong new legislative proposals have been described in detail in the White Paper published on 25 May. They will be enacted with all possible speed.
3. The British Government's experience of US companies is that they are fully aware of, and seek to fulfil, their responsibilities as equal opportunity employers. For any companies which default on their responsibilities the British Government's own legislative proposals will involve severe penalties for failing to reach the same fair employment standards which are embraced by Congressman Donnelly's proposals.
4. The legislative initiative undertaken by Congressman Donnelly is clearly well intentioned, including as it does, a tax incentive provision for US companies locating in Northern Ireland, provided they meet certain conditions. Having looked at the provisions in some details, however, the British Government is of the opinion (which it is understood the Congressman shares) that the benefits are likely to be modest and that the Bill would not offer any significant additional benefit for US companies locating in Northern Ireland. Moreover, the additional burdens of accounting and reporting which the Bill could impose on those companies are unlikely to enhance the attractiveness of Northern Ireland as an investment location.