

EFFECTIVELY CONNECTED CONCEPT

Foreign Source Income

H.R. 13103 as passed by the House of Representatives would amend the Internal Revenue Code to broaden the present rules for U.S. taxation of foreign corporations to include not only income from sources within the United States but also certain types of foreign source income "effectively connected" with the conduct of a trade or business in the United States. These are:

- (i) Rents and royalties derived from the active conduct of a licensing business;
- (ii) Dividends, interest, or gain from stock or bond or debt obligations derived in the active conduct of a banking, financing, or similar business; and
- (iii) Certain income from sales of goods made through a U.S. office.

The purpose of this feature of the bill is described in the Ways and Means Committee's Report primarily as prevention of the use of the United States as a "tax haven" with respect to certain types of transactions which might escape tax in other countries if certain activities are carried on in the United States. The Report states further (at P. 15) that "it is believed that foreign corporations should pay a U.S. tax on the income generated from U.S. business activities."

"Tax Haven" Purpose

The National Foreign Trade Council believes that the "tax haven" aspect of these purposes is specious in that: (a) any abuses which exist could more appropriately be corrected by other countries; (b) the scope of the bill goes beyond "tax haven" situations; and (c) legislation by the United States would only drive the activities affected to countries which impose no taxes.

The Report of the Ways and Means Committee describes the "tax haven" purpose as relating to cases in which international sales, licensing and financial activities can be carried on with an office in the United States without payment of income taxes to any country because (1) the foreign corporation is organized in a country which does not tax its corporations on income derived from the conduct of business outside the country; (2) the income may not be taxed where the goods are sold because the corporation does not have a permanent establishment there; and (3) the United States will not tax the income because under United States rules the income is not derived from sources within the United States. The Report