

office furnish a valid reason for not imposing U.S. tax, it would be anomalous to impose U.S. tax where the activities of the foreign office (although not a sales office) are *more substantial* than those of the typical sales office, e.g., where the foreign activities are as extensive as the Philippine activities of the Philippine corporation described above.

It is believed that the foregoing analysis also leads to the conclusion that, where a foreign corporation engages in the manufacture, extraction, growth, or production of goods outside the United States, it should not be subject to any U.S. tax merely because it uses a U.S. office to arrange for sales of those goods to foreign customers.

It is clear, therefore, that an office or other place of business outside the United States should be considered to have "participated materially in the sale" of goods in all cases where those goods have been procured by substantial purchasing or productive activities conducted by the foreign corporation at its office or other place of business outside the United States.

U.S. Export Sales

Different policy considerations lead to a similar conclusion where the goods sold to foreign customers are either produced by the foreign corporation within the United States or purchased from suppliers within the United States. Here the imposition of any U.S. income tax by reason of selling activities of a U.S. office would clearly run counter to our national policy of encouraging U.S. exports, a policy essential to the strengthening of the U.S. balance of payments.

The Council believes that the selling of goods to foreign customers through a U.S. office should not give rise to any U.S. tax on the sale by a foreign corporation which either produces those goods within the United States or purchases them from suppliers within the United States. As under existing law, the sale of such goods, if produced by the foreign corporation, would give rise to U.S. tax on the portion of the total profit treated as U.S.-source income from production (as distinguished from selling) activities. (See Regulation 1.863-3(b)).

Sales to U.S. Customers

The bill fails to specify any method for determining the portion of the total profit taxable by the United States with respect to sales made through a U.S. office to customers located within the United States. Thus it may not give effect to the intention expressed in the Report of the Ways and Means Committee at P. 16:

"In the case of foreign source income where the products are destined for the United States, the income will be treated as effectively connected with a U.S. business *to the extent* the sales activity is carried on by the U.S. office.