

eign country and transport them to another country for sale there. If part of its profit is fairly attributable to its transportation activities or other factors, it should be subject to U.S. tax only on the portion of its profit attributable to the selling functions performed at its U.S. office.

Credit For Foreign Income Taxes

A major defect of the House version of H.R. 13103 is its failure to provide adequate relief from international double taxation of income "effectively connected" with a U.S. office or other fixed place of business.

This problem may also be illustrated by the example (set forth above) of the Philippine corporation purchasing hand-embroidered linens in the Philippines and selling them through a U.S. office to both U.S. and Canadian customers.

In this typical case, the country of purchase (the Philippines) will impose its tax on the entire profit either: (i) because the corporation is domiciled or has its seat of management in that country or (ii) because the corporation passes title to the goods within the country of purchase. In addition, H.R. 13103 would cause the United States to tax the same profit.

The resultant double taxation should be alleviated by allowing the foreign corporation a credit against its U.S. tax for the foreign tax on the double-taxed income.

Under H.R. 13103, such a credit would be allowed, however, only where the foreign tax is imposed by the country in which the income has its "source", i.e., the country in which title to the goods passes,⁷ but not where the foreign tax is imposed by the country in which the foreign corporation has its domicile or seat of management, i.e., by its home country.⁸

The apparent rationale of this distinction is that the right of the United States to tax income "effectively connected" with a U.S. office should take precedence over the right of the foreign corporation's home country to tax such income. Under this theory, double taxation would be averted by allowance by the home country of a credit against its tax for the U.S. tax (rather than by allowance by the United States of a credit against the U.S. tax for the home country's tax).

While this new theory may at first appear plausible, there are several reasons why it is not likely, in practice, to avert double taxation.

⁷ As mentioned above, the proposed statute may fail to allow a credit where the country imposing the foreign income tax is both the country of "source" and the country of domicile, unless a similar tax would have been imposed by that country if the corporation had been domiciled in another country.

⁸ Thus, for example, no credit would be allowed for the Philippine tax if the United States were to tax the Philippine corporation on sales to Canadian customers negotiated by its U.S. office and if those customers were to take title to the goods upon their arrival in Canada rather than upon their shipment from the Philippines. On those facts, credit would be denied because the foreign tax would be imposed by the country of domicile (the Philippines) rather than the country of "source" (Canada).