

U.S. tax payable by the local corporation. The net result would be particularly harmful for corporations exporting goods from the many "less developed" areas which offer such tax incentives, e.g., Ireland, Peru, Puerto Rico, Southern Italy, Trinidad, etc.

These inadequacies of the credit approach thus furnish further support for the need: (1) to eliminate the proposed U.S. tax on profits from sales to foreign customers by foreign corporations conducting substantial operations through a local place of business in a foreign country, and (2) to restrict any U.S. tax on profits from sales to U.S. customers to the amount which an independent sales agent would earn by performing services similar to those performed by the U.S. branch office of the foreign corporation.

Rental and Royalty Income

The bill includes as one of the types of income from sources without the United States which will be treated as "effectively connected" income, if attributable to a U.S. office of a foreign corporation or nonresident alien individual, rents or royalties for the use of intangible property outside the United States. While the bill itself is silent as to the criteria to be used in determining whether such rents or royalties are to be attributed to a U.S. office, the Ways and Means Report indicates that the test is whether the lease or license is "made by or through" such office. This, in turn, is said to depend upon whether a U.S. office actively participates in soliciting, negotiating or performing other activities required to arrange the license. The place where the invention was developed is immaterial under this test.

The Council firmly believes that it is unrealistic to regard the royalties paid for the use of a valuable right as being generated entirely by the making of the contract. It is either the making of the invention or its use in manufacturing which generates the income; salesmanship or the mere negotiation of the lease or license is generally of minor importance.

If the approach of the proposed statute is to tax rental and royalty income merely because of the presence of negotiating or related activities in the United States, the Council believes that modification of the bill is necessary to bring the rental and royalty provision into line with analogous portions of the bill and to avoid substantial inequity.

As presently formulated, under the test indicated in the Ways and Means Report, rental or royalty income would be attributed to a U.S. office if activities (other than general supervision) incident to the lease or license are performed by or through such office, irrespective of the extent to which a foreign office also participates or where the activities are performed. Thus, for example, royalty income might conceivably be attributed to a U.S. office even though: (1) the intangible property being licensed was developed or acquired entirely outside the United States, (2) the license is negotiated principally by a foreign office, but a tech-