

(The summary referred to above follows:)

[From the report "Analysis of Proposed U.S. Taxation of Foreign-Source Income of Foreign Corporations" by the Committee on International Taxation of the New York State Bar Association Tax Section]

SUMMARY OF REPORT AND MAJOR RECOMMENDATIONS

The principal features of our Committee's Report are presented below in capsulated form.

A. INTRODUCTION

Under existing law, foreign business corporations are taxable by the United States only on income from U.S. sources. Relatively objective tests have evolved for determining the "source" of specific categories of income (see pp. 2-3).

The Bill would also tax three categories of foreign-source income: (1) rents or royalties for the use abroad of patents, copyrights and other intangibles; (2) certain banking and financing income received from foreign issuers and obligors; and (3) income from certain sales of goods, title to which passed outside the United States. The test in each case is whether the particular item of foreign-source income was "attributable" to a U.S. office. However, in the case of non-import sales of goods, no U.S. tax would be imposed if a foreign office "participated materially in such sale".

No additional revenue is expected to result from the proposed tax on foreign-source income.

B. POLICY QUESTIONS PRESENTED

The Report of the House Ways and Means Committee* gives two policy reasons for the proposed tax on foreign-source income: (1) to prevent the United States from being used as a "tax haven" by foreign corporations which avoid both all U.S. tax and most foreign tax, and (2) to impose a U.S. tax on "income generated from U.S. business activities".

Our analysis of the Bill in relation to these policy objectives raises doubts as to whether they have been consistently applied in the Bill in the form enacted by the House on June 15, 1966. In particular, there are no exceptions in the Bill to assure that its application would be limited solely to those foreign corporations which are substantially availed of to reduce foreign taxes. Our Committee believes that consistency with the Bill's "tax haven" theory would require provisions equivalent to various exceptions contained in Subpart F (see pp. 13-14).

The Bill also fails to implement in consistent fashion its theory that, for tax purposes, income is "generated" by office activities. If the theory is valid, it would seem to require changing the source-of-income rules to treat as foreign-source income the portion which is "generated" by foreign office activities. The Bill does not do this, and our Committee urges that further consideration be given this question (see pp. 14-17, 65-6).

There is also a question as to whether, under the Bill, the income taxed by the United States would be limited to the portion fairly allocable to the services rendered by the U.S. office. Our Committee recommends that for this purpose the equivalent of a Section 482 type of allocation be employed, in order to allocate to the U.S. office an amount equal to the fee or commission for the services rendered in the United States which it would have earned at arm's length if it had been a separate entity (see pp. 18, 55-7, 61, 65, 84-5).

Serious policy questions are also raised by conflicting U.S. income tax treaties with eighteen countries, which would bar the proposed tax on foreign-source income (see pp. 19-20). Treaties with other countries would allow the tax, but only if a Section 482 type of allocation was employed to determine the amount of income subject to the tax (see pp. 20, 57-9). Our Committee recommends further study of these treaty problems in order to assure that the proposed new tax would not operate in a disparate manner among different countries (see pp. 21, 63).

C. PRACTICAL PROBLEMS

Of special importance are the difficult problems of proof raised by the Bill (see pp. 22-8, 49-51, 73-4, 77). Tracing the "activities" of offices in the United States and abroad could be interpreted to require detailed records of negotiations and

*H. Rep. No. 1450, 89 Cong., 2d Sess. (April 26, 1966).