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WESTERN HEMISPHERE TRADE CORPORATIONS AND BASE COMPANIES

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INTRODUCTION

As THE TITLE of this study implies, the following discussion will concern itself mainly with the use of Western Hemisphere trade corporations and foreign base companies in international trade.

The approach which I have taken to the legal concepts that comprise the subject matter of this discussion may be characterized as an historical one. There is justification for such an approach since, in this area, history is in the making. The concepts are constantly changing or being clarified by interpretation.

FOREIGN TRADE HISTORICALLY

When our present federal income tax was enacted in October 1913 under the Sixteenth Amendment to the Constitution, the United States was not a capital exporting country. Businessmen gave little consideration to such matters as the taxation of foreign source income; however, it was not many years later that the United States Supreme Court decided the case of *Cook v. Tait.*[1] It then became clearly established that federal income taxes were to be applied to the world-wide income of United States citizens and United States corporations.

It is interesting to note that under the 1913 Income Tax Act, the rate for individuals was one percent (1%) on net income up to fifty thousand dollars ($50,000) and six percent (6%) on income exceed-

[1] 265 U.S. 47 (1924). This case held that United States income tax was not restricted to income of a United States citizen derived from sources within the United States. The same principle was later applied to United States corporations.

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ing five hundred thousand dollars ($500,000). Corporations were taxed at the flat rate of one percent (1%) on net income.

During the early period of our country's economic and industrial development, income from tariffs constituted the major portion of federal tax collections. Today, of course, the Income Tax produces by far the largest amount of revenue. With the advent of the First World War, income taxes rose as did wages and living standards, but the United States still was not an exporter of finished goods or capital.

It was not until after the close of the First World War that the United States took on any of the characteristics of a major exporting country. Later, whatever economic penetration was made into Europe prior to Hitler's march on Poland was soon brought to an end or at least postponed. With the coming of the Second World War, wage rates, consumers' costs and tax rates continued to soar but the only available markets for American products were located in the countries of the Western Hemisphere.

FOREIGN TRADE VEHICLES

The Western Hemisphere Trade Corporation Act of 1942 provided for an approximate reduction of fourteen percentage points (14%) in the domestic tax rate for U.S. corporations operating in the Western Hemisphere and meeting other specific requirements.[2] Because the Second World War was in full swing and American manufacturing firms were turning their full attention toward the manufacture of implements of war, Western Hemisphere trade corporations were not fully utilized for the exportation of consumer goods to Latin America or Canada during the period from its enactment to the end of the War. Roughly speaking, it was 1947 before the full measure of its utility was recognized.[3] From that time forward, such companies were widely used by American firms trading in the Western Hemisphere.

More recently, however, the full extent of the benefits accruing from the utilization of foreign corporations or "base companies" as they are sometimes called, has become apparent and the trend of far-seeing American management has been toward the use of foreign

[2] Section 141, Revenue Act of 1942, 26 U.S.C.A. §§ 921, 922 (Supp., 1959).

[3] Baker and Hightower, Western Hemisphere Trade Corporations, 22 Tul. L. Rev. 229 (1947).

base companies rather than the domestic Western Hemisphere trade corporations. Both of these classes of corporations have advantages and disadvantages. It will be the endeavor of this paper to discuss each. In addition, to complete the historical picture, mention will be made of the "Boggs Bill," sometimes referred to as H.R. 5, which provides for the establishment of a domestic corporation having many of the advantages of a foreign base company and some additional ones. Perhaps, without more ado, we should discuss some of the features of Western Hemisphere trade corporations and foreign base companies.

WESTERN HEMISPHERE TRADE CORPORATIONS

Needless to say, it was the intention of Congress to provide a means by which domestic corporations could trade in foreign countries within the Western Hemisphere on a more competitively advantageous basis when it passed the Act providing for Western Hemisphere trade corporations. The following oft-quoted passage from the Report of the Senate Finance Committee illustrates that point:

> American corporations trading in foreign countries within the Western Hemisphere are placed at a considerable competitive disadvantage with foreign corporations under the tax rate provided by the Bill. To alleviate this competitive inequality, the Committee Bill relieves such corporations from surtax liability.[4]

It was not the first time nor will it be, we hope, the last time that Congress has provided tax benefits for American firms and United States citizens doing business outside of the United States. The China Trade Act of 1922 provided for a special type of corporation to which a special deduction was granted on income derived from sources within China, Formosa, and Hong Kong.

ADVANTAGES OF THE WESTERN HEMISPHERE TRADE CORPORATION

In essence, the provisions of the Internal Revenue Code of 1954[5] which concern themselves with Western Hemisphere trade corporations provide a special tax deduction to domestic corporations which meet certain specific requirements.

Briefly, a Western Hemisphere trade corporation must be a domestic corporation: (1) doing all of its business in countries of the

[4] Sen. Rep. 1631, 77th Cong. 2d Sess. (1946).

[5] Int. Rev. Code §§ 921, 922, 26 U.S.C.A. §§ 921, 922 (Supp., 1959).

Western Hemisphere (other than incidental purchases); (2) have 95% or more of its gross income derived from sources outside of the United States; and (3) have 90% or more of its gross income derived from the active conduct of a trade or business.

Domestic corporations meeting the above requirements are entitled to a special deduction in computing taxable income of an amount corresponding to fourteen fifty seconds (14/52) of the net taxable income.[6] This results in an approximate net reduction of fourteen percentage points in tax rate. If a Western Hemisphere trade corporation is formed as a subsidiary of a domestic corporation, any dividends paid by the subsidiary would be subject to taxation in the hands of the domestic parent. By computing the so-called dividends received credit, the effective rate of tax on the dividend income is 7.8% which added to the tax paid by the Western Hemisphere trade corporation produces a net effective tax rate of 42.8%.

It is, of course, true that the wholly-owned domestic subsidiary operating as a Western Hemisphere trade corporation may be liquidated on a tax free basis,[7] but that would end the operation. Obviously, the business could not be carried on again by a new subsidiary immediately afterward without the Revenue Service taking the position that the transaction produced an ordinary dividend subject to tax.

In the overall view, however, it is apparent that a definite tax incentive program was established for companies engaged in foreign trade in the Western Hemisphere. Recognizing the competitive inequalities which exist in foreign markets of the world, it is perfectly logical for American firms to take whatever steps are legally appropriate to reduce the cost of their operation. This is not tax avoidance. The Treasury Department has ruled[8] that the creation of a new corporation to carry on the business in the Western Hemisphere (other than the United States) of an existing domestic corporation does not constitute tax avoidance within the meaning of Section 129 of the Internal Revenue Code of 1939.[9]

It cannot be doubted that a taxpayer has a right to arrange his affairs in any manner he chooses. This concept is inherent not only

[6] Int. Rev. Code § 922, 26 U.S.C.A. § 922 (Supp., 1959); 26 C.F.R. § 1.922-1.

[7] Int. Rev. Code §§ 331, 332, 26 U.S.C.A. §§ 331, 332 (Supp., 1959).

[8] I.T. 3757, C.B. 200 to 202 (1945).

[9] Int. Rev. Code § 269, 26 U.S.C.A. § 269 (Supp., 1959).

in our tax law, but is fundamental to our American way of life. The courts have repeatedly affirmed this principle.

Thus it was so held by the Circuit Court of Appeals for the Second Circuit in *Helvering v. Gregory*.[10] That case involved a corporate reorganization and the court said:

> We agree with the Board and the taxpayer that a transaction, otherwise within an exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one choose, to evade, taxation. Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes.[11]

That decision was affirmed by the United States Supreme Court in these words: "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether to avoid them, by means which the law permits, cannot be doubted."[12]

On the basis of the foregoing, it seems hardly contestable that conducting one's international business through the medium of a Western Hemisphere trade corporation and thereby obtaining an approximate tax reduction of nine percent (9%) is a valid and appropriate method of doing business.[13]

DISADVANTAGES OF WESTERN HEMISPHERE TRADE CORPORATION

What then are the disadvantages, if any, resulting from the use of a Western Hemisphere trade corporation?

In order to state adequately the disadvantages inherent in the use of the Western Hemisphere trade corporation, it would perhaps be well to start with the proposition that it is a domestic corporation. Under the present scheme of taxation in the United States, domestic corporations are taxed each year on the income which they earn. Western Hemisphere trade corporations, it is true, are granted a rate reduction, but nevertheless they must pay tax every year. Furthermore, the tax on unreasonable accumulations of earnings is applicable to these companies.[14]

This means that the foreign source income of the Western Hemi-

[10] 69 F.2d 809 (C.C.A.2d, 1934).

[11] Ibid., at 810; Bullen v. Wisconsin, 240 U.S. 625 (1916); United States v. Isham, 17 Wall. (U.S.) 496 (1897).

[12] Gregory v. Helvering, 293 U.S. 465, 469 (1935).

[13] American Food Prod. v. Comm., 28 T.C. 14 (1957).

[14] Int. Rev. Code § 531, 26 U.S.C.A. § 531 (Supp., 1959).

sphere trade corporation is not available for re-investment in the foreign operations of the American parent company until they are reduced by 38%. Of course, that need not always be a disadvantage, since in many cases it may be the desire of the United States parent to bring profits home on a current basis. More and more each day, however, American firms find that the key to successful competition in Latin America involves real and permanent economic penetration.

Another limiting feature of the Western Hemisphere trade corporation is the fact that its use is restricted to the Western Hemisphere. Experience has taught American management that one of the factors which contribute to the growth of a foreign operation is the pride and enthusiasm which employees specialized in that field demonstrate where the international operation is centered or coordinated through a single corporate vehicle. This is similar in principle to the utilization of a domestic subsidiary for a particular phase of a company's business as opposed to a division of the company used for the same purpose.

As with all creatures of statute, the operation of a Western Hemisphere trade corporation is limited to the precise words of the Act which created it. For instance, Section 921 provides that 90% or more of the gross income of such companies must be derived from the active conduct of a trade or business. The Regulations specifically state that dividends received by a corporation do not represent income derived from the active conduct of a trade or business.[15] A Western Hemisphere trade corporation may not, therefore, act as a holding company. In some countries a local wholly-owned subsidiary presents a more advantageous method of conducting business, but to the extent used, the sales territory of the Western Hemisphere trade corporation is reduced.

Interest income is likewise not deemed to be derived from the active conduct of a trade or business.[16] This means that the Western Hemisphere trade corporation is not free to carry the paper of its foreign customers even though it may wish to do so, at least to the extent that the interest earned on such paper exceeds 10% of the gross income of the company.

An area which has not received a great deal of consideration, but

[15] 26 C.F.R. § 1.921-1(b).

[16] I.T. 1785, II-2 C.B. 258; Towne Securities Corp. v. Pedrick, 53-2 U.S.T.C. 48, 597 (S.D. N.Y., 1953).

which should be of substantial interest, involves the use of a Western Hemisphere trade corporation in foreign licensing operations. A question is immediately presented as to whether or not royalties or technical service fees earned by a company purporting to qualify as a Western Hemisphere trade corporation will be deemed to be income derived from the active conduct of a trade or business. The Regulations are silent on this point, and no cases have been decided to date.

By process of analogy, the Commissioner might look to the cases interpreting the provisions of the Code relating to Personal Holding Companies to determine what constitutes passive income as opposed to income derived from the active conduct of a trade or business. Under those cases, it has been held that where a license contract involved only the right to manufacture under a trademark or patent, the income derived therefrom was royalty income and therefore personal holding company income.[17] Where such a contract provided only for the rendition of personal services, the remuneration paid therefor was ordinary income and could not be deemed to be passive in nature.[18] Where the contract involved both the right to manufacture under a trademark or patent and also provided for the rendition of services (and such services were in fact rendered) the Court has apportioned the payments made into royalties on the one hand and technical service fees, or ordinary income, on the other.[19]

That the Treasury would adopt such a position in the case of Western Hemisphere trade corporations is merely a supposition on my part and, indeed, it may logically be argued that companies engaged in the business, among other things, of licensing the manufacture of a given product are, in fact, engaged in the active conduct of a trade or business by so doing.

These, then, are some of the disadvantages attendant upon the use of a Western Hemisphere trade corporation in international business. The advantages are obvious. It would be logical to ask in what manner a foreign base company compares with a Western Hemisphere trade corporation and whether it too contains some disadvantages.

It is of course true that there are problems involved in the use of

[17] Portable Industries Inc. v. Comm., 24 T.C. 571 (1955) (acquiescence); Puritan Mills v. Comm., 43 B.T.A. 191 (1940).

[18] Affiliated Enterprises, Inc. v. Comm., 140 F.2d 647 (C.C.A.10th, 1944). But see Comm. v. Affiliated Enterprises, Inc., 123 F.2d 665 (C.A. 10th, 1941) reversing 42 B.T.A. 390 (1940), cert. den. 315 U.S. 812 (1942).

[19] United States Universal Joint Co. v. Comm., 46 B.T.A. 111 (1942) (acquiescence).

a foreign base company in international trade. In fact, two very important problems which have not previously been mentioned apply equally well to Western Hemisphere trade corporations and foreign base companies. These involve "source of income" and "inter-company transactions." Before discussing them, however, we should examine some of the outstanding features of the base company.

FOREIGN BASE COMPANIES

I once defined the terms "base company" and "base country" as ones which have for their purpose the conceptual denomination of the use of the corporate and commercial laws of a foreign country as a base upon which to predicate the international business of American companies operating abroad.[20] Perhaps it is too simple—at least it is concise. The term "base company" as it is used in international trade means a foreign corporation, but not any foreign corporation. It must be one which is formed under the laws of a country having implicit in its law certain prerequisites. Foremost among those is the requirement that the tax laws of the foreign country have limited extra-territorial application. Similarly, the labor laws and social security laws should not reach beyond the borders of that foreign country.

What an American firm does, then, when it forms a foreign corporation through which to conduct its international business, is to substitute for the United States' principle of world-wide taxation the laws of a foreign country in which is inherent the principle of limited taxation. Perhaps the earlier definition was not too far off.

ADVANTAGES OF THE FOREIGN BASE COMPANY

Since we are concerned here with the relative advantages of a Western Hemisphere trade corporation, as opposed to a foreign base company, we will confine ourselves to considerations involving Federal taxation, although there are many other factors involved in the use of a foreign base company.[21] With respect to a Western Hemisphere trade corporation, we said that the maximum rate applicable was 38% but that it was payable each year. A foreign corporation

[20] Meek, Organization and Operation of a Base Company in Foreign Trade, 39 Chicago Bar Record 403 (1958).

[21] An example is the competitive advantage arising from the use of a local company in a country where nationalistic tendencies prevail; insulation of domestic assets from the hazards of foreign commerce, etc.

deriving income solely from foreign sources pays no United States tax on its income earned abroad and none is payable until the earnings are brought home to the shareholders in the form of a dividend. Then it is the shareholders who are taxed and not the foreign corporation. To state the principle conversely, a foreign corporation is taxed in the United States only on income derived from sources within the United States. Furthermore, if the foreign corporation is not resident within the United States it will be taxed only on its gross income from sources within the United States which is deemed to be "fixed or determinable, annual or periodical."[22] This means that a foreign corporation which is not resident within the United States may, conceivably, earn income of a trading nature from sources within the United States and still not be subject to United States taxation. The question of what constitutes "residence" is a difficult one.

The Internal Revenue Code[23] provides that a foreign corporation engaged in trade or business within the United States shall be taxable as provided in Section 11 of the Code, but it also states that gross income in the case of a foreign corporation includes only gross income from sources within the United States.[24] Being engaged in trade or business within the United States is therefore the keynote of "residence" for United States tax purposes.

While a foreign base company may be engaged in any one or more of several kinds of foreign operations, such as foreign licensing, rendering personal services, or acting as a holding company, let us assume that a foreign corporation has a trading operation. Let us assume further that the base company, a Panamanian subsidiary of a U.S. parent, either purchases the goods in the United States and resells them abroad or conducts its trading activities on a commission basis. The fact that some of its officers and directors are located within the United States does not necessarily mean that the foreign corporation is engaged in trade or business within the United States.[25]

[22] Int. Rev. Code § 881(a), 26 U.S.C.A. § 881(a) (Supp., 1959). A non-resident foreign corporation is taxed at the rate of 30% of its gross income from sources within the United States which is fixed or determinable, annual or periodical.

[23] Int. Rev. Code § 882(a), 26 U.S.C.A. § 882(a) (Supp., 1959).

[24] Int. Rev. Code § 882(b), 26 U.S.C.A. § 882(b) (Supp., 1959).

[25] Scottish American Investment Co. v. Comm., 12 T.C. 49 (1949). Accord: Continental Trading Inc. v. Comm., 265 F.2d 40 (C.A.9th, 1959); Comm. v. Consolidated Premium Ore, Ltd., 265 F.2d 320 (C.A.6th, 1959); Spermacet Whaling & Shipping Co. v. Comm., 30 T.C. 618 (1958).

Nor does the fact that the company purchases the goods within the United States make it resident here.[26] On the other hand, should the foreign corporation not only purchase the goods here but sell them within the United States by passing title to them at the port of exit and other activities are present, the company will be deemed to be engaged in trade or business within the United States and will be taxable under Section 11 in the same manner as any domestic corporation.[27]

The purpose of the foregoing is to point out that it is advantageous for a foreign corporation to maintain itself on a non-resident basis so that should it under some extraordinary circumstances earn U.S. source trading income, it will not be taxed thereon unless it is deemed to be engaged in trade or business within the United States.

The benefits accruing from the accumulation of taxfree earnings need hardly be enumerated, suffice it to say that such funds may freely be invested in any foreign country and thereby produce additional earnings.

Another factor which is important is that the foreign base company may engage in business activities throughout the world and may engage in any business it chooses. Of course, if the stock of the American parent is closely held, that is to say, if more than 50% in value of the outstanding stock of the parent company is owned by less than five individuals, cognizance must be taken of the Foreign Personal Holding Company sections of the Internal Revenue Code.[28] Otherwise, the foreign base company may act as a holding company, enter into license agreements or technical service agreements without any U.S. restrictions whatsoever.

It may be formed under the laws of any one of several countries whose corporate and tax laws lend themselves to a base company operation. Switzerland, Venezuela, Panama, and many others have beneficial laws. Luxembourg is a country whose laws lend themselves particularly well to a holding company operation.

26 Amalgamated Dental Supply Co. v. Comm., 6 T.C. 1009 (1946).

27 United States v. Balanovski, 131 F. Supp. 898 (S.D.N.Y., 1955), rev'd 236 F.2d 298 (C.A.2d, 1956).

28 Int. Rev. Code §§ 551 to 557, 26 U.S.C.A. §§ 551 to 557. Where more than 60% of the income of a foreign corporation is of a Personal Holding Company nature (including dividends, interest, royalties, rents, etc.) and more than 50% in value of its stock is owned by or for not more than five individuals who are United States citizens. All of the Personal Holding Company income will be included in the United States tax returns of the United States shareholders.

Of course, the nature of the operation of the base company will, for the most part, determine the place of its incorporation. If foreign licensing will constitute a major portion of the company's activities, it would be well to consider incorporating that company in a country which has a relatively great number of treaties for the prevention of double taxation. If it is purely a trading operation, a minimum of tax liability and freedom of corporate action will be of primary concern.

Another factor worth considering is that a foreign corporation, so long as it does not earn income from U.S. sources, is not subject to the tax on unreasonable accumulation of earnings provided for in the Code.[29]

We have mentioned some of the advantages of utilizing a foreign base company, perhaps we should mention the problems which are encountered in their use.

DISADVANTAGES OF THE FOREIGN BASE COMPANY

The first disadvantage is the treatment which is accorded foreign corporations that are subsidiaries or affiliates of the United States shareholders. There are several sections in the Code which have specific application to such companies.

The first difficulty that arises involves the transfer of appreciated property or securities to a foreign corporation. Under the reorganization sections of the Code, a transfer of appreciated property to a newly organized domestic corporation may be made without recognition of gain or loss, where a foreign corporation is involved. Section 367 of the Code provides that in determining the extent to which gain will be recognized in such a case (or in the case of any of the exchanges described in the reorganization sections), a foreign corporation will not be considered as a corporation unless the Commissioner has been satisfied that the exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes. The effect of this is that a transaction which would otherwise have been non-taxable, will be taxable if a foreign corporation is involved and if a prior Treasury ruling has not been obtained.[30]

Section 1491 provides that where a transfer of stock or securities is made to a foreign corporation as paid-in surplus or a contribution to capital, there will be assessed an excise tax equaled to 27½% of

29 Int. Rev. Code § 531, 26 U.S.C.A. § 531 (Supp., 1959).

30 Texas-Canadian Oil Corp., Ltd. v. Comm., 44 B.T.A. 913 (1941).

the excess of the value of the stock or securities so transferred over its adjusted basis in the hands of the transferor.

Consideration should also be given to the fact that there may be circumstances when the use of a foreign base company is not economically practical. Such a case might exist where a stock participation in a foreign corporation operating locally in a given country is contemplated on less than a 50% basis. If a base company held the stock, the U.S. parent corporation would not be allowed a tax credit for the foreign taxes paid by the local operating company.[31] It would then be advisable for the parent company to hold the stock of the second foreign corporation directly, unless the income accumulated in the foreign base company from that particular operation would produce sufficient income by re-investment to offset the amount of foreign tax credit lost.

On the whole, however, it will be found that substantial tax benefits may be obtained by operating through a foreign base company, as opposed to a Western Hemisphere trade corporation or a branch operation of the parent company, simply by virtue of the relative freedom of action which is gained and the possibilities for re-investment of foreign source income.

PROBLEMS ENCOUNTERED IN FOREIGN TRADE GENERALLY

Earlier in this paper, we mentioned two problems which apply both to Western Hemisphere trade corporations and to foreign base companies. The first of these is the problem encountered in determining "source of income."

Source of income problem

As was stated, in order for a Western Hemisphere trade corporation to obtain the special deduction allowed by the Code, and in order for the foreign base company to maintain its earnings free of tax, it is necessary that such income be earned from sources outside of the United States.

Under U.S. tax concepts, the source of a given item of income will depend upon an analysis of the rules which relate to that particular kind of income. For instance, in the case of income which is earned from the rendition of personal services, it is clear in the law that such income is deemed to arise at the place where the services are rendered

[31] Int. Rev. Code § 902(b), 26 U.S.C.A. § 902(b) (Supp., 1959).

and, hence, is taxable there.[32] Thus, if a foreign base company or a Western Hemisphere trade corporation conducts sales activities outside of the United States and receives a commission as compensation for such efforts, the commission will be deemed to arise from sources outside of the United States.

This would also include services rendered outside of the United States in connection with a technical service agreement. Likewise, the use outside the United States of patents, copyrights, trademarks and other such property will be deemed to be income from sources without the United States.[33]

The real problem arises in connection with the income derived from the sale of goods. The Code provides that gains, profits and income derived from the purchase of personal property within the United States and its sale without the United States will be deemed to be income derived from sources without the United States. However, great difficulty is experienced in connection with whether the "sale" was made within or without the United States.

It seems clearly settled in the cases that the "sale" will be deemed to have been made at the place where the seller relinquishes all its right, title and interest in and to the property.[34] However, the Treasury Department has not accepted this general principle in its entirety. In 1947 it issued GCM 25131[35] wherein it is stated that in any case in which the sale transaction is arranged in a particular manner for the primary purpose of tax avoidance, the general rule will not be applied. In such cases, all factors of the transaction such as negotiations, the execution of the agreement, the location of the property and the place of payment, will be considered, and the sale will be treated as having been consummated at the place where the substance of the sale occurred. The Regulations have adopted the principles announced in GCM 25131 in their entirety.[36]

There has been a great deal of litigation involving source income in the sale of goods. The *American Food Products*[37] case involved a do-

[32] Int. Rev. Code § 862(a)(3), 26 U.S.C.A. § 862(a)(3) (Supp., 1959).

[33] Int. Rev. Code § 862(a)(4), 26 U.S.C.A. § 862(a)(4) (Supp., 1959).

[34] East Coast Oil Co. v. Comm., 31 B.T.A. 558 (1934), aff'd 85 F.2d 322 (C.C.A.5th, 1936), cert. den. 229 U.S. 608 (1936), acq. C.B. 1947-2,2; United States v. Balanovski, 236 F.2d 298 (C.A.2d, 1956); American Food Products v. Comm., 28 T.C. 14 (1957).

[35] C.B. 1947-2, 85.

[36] 26 C.F.R. § 1.861-7(c).

[37] 28 T.C. 14 (1957).

mestic corporation which contended that it was a Western Hemisphere trade corporation, but most of the earlier cases involved foreign corporations. There are several cases which have been recently docketed with the Tax Court and which have been filed with the District Courts involving Western Hemisphere trade corporations. The real test in these cases will be whether the Courts will interpret a desire to reduce one's taxes by qualifying under the Western Hemisphere trade corporation provisions as "tax avoidance." It would seem to be a contest between the intent of Congress and the desire of the Treasury to collect more revenue. The United States Supreme Court has stated that anyone may so arrange his affairs that his taxes shall be as low as possible, but apparently the Commissioner has not read that case.

Inter-company transactions

The second problem involves, for the most part, an application of the so-called "reallocation sections" of the Internal Revenue Code.[38] It also involves general principles of United States taxation which, in effect, state that income is taxable to the person that earns it.

Section 482 provides that where two or more organizations or businesses are owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution or allocation is necessary in order to prevent the evasion of taxes or clearly to reflect the income of such organizations.

This means not only the price at which a U.S. parent company sells products to its subsidiary operating in the foreign field may be apportioned but also any sales commission paid to such subsidiary. Further, the bona-fides of any transaction between such companies involving the sale transfer or use of property may be examined.

CONCLUSION

We have glanced briefly at some of the history of American investment abroad and have noted some of the relevant statutory provisions relating to the conduct of such international business.

We have reviewed the advantages and disadvantages of the Western Hemisphere trade corporation and, similarly, of the use of a

[38] Int. Rev. Code § 482, 26 U.S.C.A. § 482 (Supp., 1959).

foreign base company in international trade. The fact that American firms must resort to the use of a foreign corporation in order to maintain their foreign investment on a competitively advantageous basis is indeed unfortunate. In recent years legislation has been introduced in Congress to alleviate this situation by providing for a domestic foreign business corporation which would have some of the characteristics of the Western Hemisphere trade corporation and some of the benefits obtained in using a foreign base company.

The latest of these is known as the "Boggs Bill" and was introduced in the House as H.R. 5. Its eventual fate in Congress cannot be ascertained at this time, but it is hoped that within the next year or two, it will be passed in a form favorable to American business.