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## DEFINITIONAL PROBLEMS OF THE FOREIGN INCOME TAX CREDIT

ANTHONY J. WATERS\*

Section 901 of the Internal Revenue Code of 1954 grants a credit against United States income tax liability in

the amount of any income . . . taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States<sup>1</sup>

subject to certain rules and limitations, some founded in the regulations, the revenue rulings and the case-law, some contained in §§ 904 and 905 of the Code. This is a direct credit, by contrast with the indirect, or "deemed paid" credits available under §§ 902, 960 and 963. Section 903 supplements § 901 by offering a direct credit for taxes paid "in lieu of" income taxes. This article is concerned with the definition of "income tax" applied in granting credit under § 901.<sup>2</sup> The several decisions under § 903 afford a useful perspective on the question, and these will be discussed.<sup>3</sup> But it is the large body of law applying § 901 which testifies to the difficulty encountered in applying the term "income tax" to the many and various foreign taxes for which a § 901 credit has been sought. The Code itself offers no guidance, so it has been for the Service and the courts to develop a "common law" definition.

The starting point of any inquiry into the qualification of a foreign tax for credit is the application of the general criteria laid down in the landmark case of *Biddle v. Commissioner*:<sup>4</sup>

Section 131 [now § 901] does not say that the meaning of its words is to be determined by foreign taxing statutes and

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1. Int. Rev. Code of 1954, § 901.

2. Int. Rev. Code of 1954, §§ 901-905. The provision for income taxes is the only important part of these sections. There has never been a credit specifically for a war profits tax, and there are very few decisions construing excess profits taxes. See, e.g., Rev. Rul. 56-51, 1956-1 CUM. BULL. 320, modifying Rev. Rul. 31, 1953-1 CUM. BULL. 225 (Cuba); Rev. Rul. 68-318, 1968-1 CUM. BULL. 342 (Italy); Spec. Rul. 3-28-40 (Mexico).

3. *Infra* at 228-31.

4. *Mary Duke Biddle v. Commissioner*, 302 U.S. 573 (1938).

decisions, and there is nothing in its language to suggest that in allowing the credit for foreign tax payments, a shifting standard was adopted by reference to foreign characterizations and classifications of tax legislation. The phrase "income taxes paid," as used in our own revenue laws, has for most practical purposes a well understood meaning to be derived from an examination of the statutes which provide for the laying and collection of income taxes. It is that meaning which must be attributed to it as used in § 131.<sup>5</sup>

In other words, where the tax in question conforms to the United States concept of an income tax, determined by reference to the federal income tax in fact levied domestically, it will qualify for credit. The limitations put upon the foreign tax credit by the rule in *Biddle*, construing a term not defined by the statute, comport with a superficially attractive understanding of double taxation, the avoidance of which is the policy behind the credit. It was open to the Court in *Biddle* to define "income tax" so as to effect an alleviation of double taxation in a broader and more amorphous sense,<sup>6</sup> but it did not do so. In view of the absence of statutory guidance on point, the course it took must be regarded as reasonable. But reasonable or not, it remains the fundamental constraint upon the category of foreign income taxes which qualify for credit. As we shall see, the constraint does no more than define the question: What foreign taxes will qualify for credit, given that the term "income tax" is used to mean "taxes which come within the United States understanding of that term as applied in domestic taxation"? It does not go far toward providing any answers.

In passing on the question of credibility, the Service and the courts have sought to satisfy three criteria:

- (1) a foreign levy must be a tax
- (2) based on income
- (3) whose purpose is to reach that income.

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5. *Id.* at 578-79.

6. Short of direct dependence upon other countries' classifications, with the resultant "shifting standard," it was open to the Court to interpret the statutory provision as being aimed at double taxation of that wealth which the United States taxes as "income," rather than limiting it to a tax levied in conformity with the domestic tax pattern.

It is the requirement of a tax base consistent with the U.S. concept of "income" which has caused most problems, and it is the conformity of tax bases between this country and those whose taxes are creditable that has kept the range of such taxes relatively limited. The purpose requirement has also posed several problems, not the least of which has been to discover the purpose of a tax within a foreign system where its purpose has not been expressly declared. Had all foreign countries borne the U.S. tax credit in mind when creating their taxes, each would doubtless have a "purpose" section conveniently labeled and translated into English.

### HISTORY

Before analyzing the detailed application of the statutory scheme, it may be helpful to put the whole subject in context by looking briefly at the history of the credit for foreign income taxes.

The foreign tax credit was introduced by the Revenue Act of 1918.<sup>7</sup> Section 222 (a) and (b) applied to individuals, section 238 (a) to corporations. Previously, taxes other than the federal income tax had been deductible in computing taxable income for federal tax purposes.<sup>8</sup> The principle of deductibility of other taxes is as old as the United States income tax itself, having been contained in the Civil War tax act of 1862 and again in the acts of 1865 and 1866.<sup>9</sup> Congress had not yet addressed specifically "foreign" taxes, but this was rectified by the Revenue Act of 1913 which specified "foreign" taxes as a deductible item in computing

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7. Int. Rev. Code of 1918, §§ 222, 238 (now I.R.C. §§ 901-905).

8. Int. Rev. Code of 1917. The Internal Revenue Act of 1917, by §§ 1201(1), 1202(1), 1207(1) and 1207(2), amended the law as contained in the Internal Revenue Act of 1916, §§ 5(a), 6(a), 12(a) and 12(b), amending the Internal Revenue Act of 1913, §§ II(B) and II(G)(b). Prior to the 1917 amendments, federal income taxes were deductible in the year in which paid. For example, if the taxpayer earned \$10,000 in 1914 and paid \$500 tax on that income in 1915, then \$500 was deductible from his gross income for 1915. For a moderately hot debate on the 1917 amendments abolishing this deduction for Federal income taxes paid, see 55 CONG. REC. 6317-26 (1917). A proposed amendment to abolish deductions for all taxes was rejected. See 55 CONG. REC. 6326-27 (1917).

9. Section 49 of the Revenue Act of 1861 (effective January 1, 1862) ends with the capitalized words: PROVIDED THAT, IN ESTIMATING SAID INCOME, ALL NATIONAL, STATE OR LOCAL TAXES ASSESSED UPON THE PROPERTY, FROM WHICH THE INCOME IS DERIVED, SHALL FIRST BE DEDUCTED. Similarly, § 91 of the Revenue Act of 1862, § 117 of the Revenue Act of 1864 and the March 3, 1865 amendment to § 117 of the 1864 Act contained deductibility provisions.

corporate tax liability.<sup>10</sup> In 1916 this was extended to individual taxpayers.<sup>11</sup> Although its details have been modified somewhat in accommodating the credit, the provisions for deductibility contained in § 164 of the I.R.C. are substantially identical to those in effect once the 1916 legislation had extended the deduction for foreign taxes to individuals.

The introduction of the tax credit in 1918 was the product of two factors. First, after more than a century and a quarter as a capital-importing nation, the United States had come of age and was exporting capital on a sufficient scale to attract congressional attention.<sup>12</sup> Second, the sharp increase in income tax rates in all countries affected by World War I added greatly to the burden of international double taxation on United States taxpayers.<sup>13</sup> Although one or two countries had used the credit device in deference to taxation by their own colonies, the United States was the first to adopt it on a world-wide basis.<sup>14</sup>

United States jurisdiction to tax on a world-wide basis is not seriously doubted. *Cook v. Tait* explicitly recognized the power of the Federal Government to tax citizens on foreign-source income and this is reflected in the language of I.R.C. § 61(a) which taxes "all income from whatever source derived."<sup>15</sup> It has even been suggested that there is no constitutional limitation on the authority of the United States to tax.<sup>16</sup> In any case, jurisdictional limitations with respect to foreign countries are a matter of international law and generally this jurisdiction is asserted on two bases: citizenship and source.<sup>17</sup> There is some disagreement between international lawyers as to the need for presence

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10. § II(G)(b) of the Revenue Act of 1913 included taxes "imposed by the Government of any foreign country" (emphasis supplied).

11. § 5(a) (third) of the Revenue Act of 1916. Corresponding provisions for nonresident aliens, domestic corporations and foreign corporations were contained in §§ 6(a), 12(a) and 12(b), respectively.

12. Choate, Hurok and Klein, *Federal Tax Policy for Foreign Income and Foreign Taxpayers — History, Analysis and Prospects*, 44 TEMP. L.Q. 441, 483 (1971) [hereinafter cited as Choate].

13. E. OWENS, THE FOREIGN TAX CREDIT 20 (1961) [hereinafter cited as OWENS].

14. *Id.*

15. 265 U.S. 47, 54 (1924).

16. *Billings v. United States*, 232 U.S. 261, 282 (1914).

17. See generally Surrey, *Current Issues in the Taxation of Corporate Foreign Investment*, 56 COLUM. L. REV. 815 (1956).

or allegiance as a prerequisite for taxing aliens,<sup>18</sup> but essentially none as to jurisdiction to tax citizens and residents. It follows that the credit afforded by § 901 *et seq.* is in the nature of a concession. The result has been described as the retention of tax sovereignty based on citizenship together with a recognition of the prior claim, based on source, of the country contributing most to the production of income.<sup>19</sup>

But such a description may imply a conscious congressional policy in an area in which, from the beginning, there has been none:

In a very real sense, it is deceptive to speak of this . . . as the "tax policy" of the United States. In fact, it is quite likely that Congress gave little or no thought to the effect of the Revenue Act of 1913 on the foreign income of U.S. persons or the U.S. income of foreign persons. This is a distinction without a difference, however, since whether Congress thought about it or not, a system for the taxation of those types of income did result from the passage of the act.<sup>20</sup>

Despite the subsequent importance of the tax treatment of foreign-source income to the foreign investor, Congress has continued to deal with the question only sporadically and in response to immediate pressures.

The history of the development of these tax rules, from which the tax policy of the U.S. may be divined, has been a meager one. For the most part, new rules have been developed only when they became an obvious necessity. Congress, apparently, has never treated the taxation of foreign income or foreign taxpayers in isolation and, while there is a clear basic policy underlying all of the rules — taxation of all income of U.S. citizens and domiciliaries and taxation of only U.S.

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18. Choate, *supra* note 12, at 446, nn.16-18. The effective jurisdiction of the United States in taxing aliens was increased by the Foreign Investors Tax Act of 1966, which included for the first time certain foreign source income in the taxable income of foreign persons. Int. Rev. Code of 1954, §§ 872(a) and 882(b). This was the first explicit congressional endorsement of contract or allegiance as a basis for jurisdiction to tax.

19. Comment, *The Limitless Limits of the Foreign Tax Credit*, 45 WASH. L. REV. 347, 350 (1970).

20. Choate, *supra* note 12, at 481.

income of foreigners — that policy is nowhere explicitly laid down.<sup>21</sup>

The *ad hoc* grafting of new complexities onto old rules is no way to develop a cohesive statutory scheme. It reflects the fitful congressional approach to the subject, and what conscious policy there has been is presumably reflected in the several amendments to the 1918 credit provision.

Until amended by the Revenue Act of 1921, the credit provided by §§ 222 and 238 resulted in less than full taxation of domestic income in the case of some taxpayers whose foreign income was taxed at a higher rate than domestic. This curious result was made possible by the absence of any limit on the foreign tax credit, so that where the foreign rate exceeded the domestic, the difference simply reduced U.S. tax liability, provided only that there was sufficient domestic income to incur that liability. The act of 1921 limited the credit to the ratio of foreign income to the taxpayer's world-wide income. This had the effect of ensuring full taxation of domestic income at the prevailing domestic rates.<sup>22</sup> In 1932, Congress extended the ratio principle to create a "per-country" limitation<sup>23</sup> despite substantial opposition in the Senate.<sup>24</sup> While the 1921 amendment had limited the credit to the amount of U.S. tax liability on all foreign income, the 1932 amendment did the same thing with income from each country individually. The later provision seems to have been the vestige of a House attempt to abolish the credit altogether so as to encourage investment at home<sup>25</sup> and was itself partly motivated by that factor.<sup>26</sup> Another reason given was what was considered to be unfair discrimination in favor of those taxpayers who operated in both high- and low-tax countries and thus could average for credit purposes.<sup>27</sup>

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21. *Id.* at 442.

22. Revenue Act of 1921, §§ 22(a)(5) and 238(a). The Report of the House Ways and Means Committee speaks of ending the "abuse" of the foreign tax credit which tends to "wipe out part of our tax properly attributable to income derived from sources within the United States." H.R. REP. No. 350, 67th Cong., 13 (1921).

23. Revenue Act of 1932, § 131(b).

24. *See* H. WELLS, UNITED STATES DOUBLE TAXATION POLICIES 29 (1950).

25. *See* 75 CONG. REC. 6169-70, 6489-93, 6497-6504, 7047-54 (1932).

26. H.R. REP. No. 708, 72d Cong., 1st Sess. 11-12, 23-24 (1932); 75 CONG. REC. 6490-93 (1932).

27. *Id.*

The 1932 legislation reflects an uncharacteristic congressional attention to detail in this area, and the basic limitation on the credit has aptly been described as "perhaps [the] most stringent" modification of the foreign tax credit since its inception.<sup>28</sup> As it now stands,<sup>29</sup> the law ensures that at least the prevailing U.S. tax rate will be levied on world-wide income.

In 1934, the House Ways and Means Subcommittee renewed the attack upon the foreign tax credit *per se*.<sup>30</sup> Its report was not accepted by the Committee which did, however, recommend an amendment to the credit limitation which would have ensured revenue to the United States on at least half of any foreign income of a U.S. taxpayer.<sup>31</sup> The Senate finally rejected this proposal on the strength of its Finance Committee Report<sup>32</sup> and the foreign tax credit survived unscathed. Nevertheless, hearings on the House proposals resulted in perhaps the most thorough presentations of the case for and against the credit to date. These are worth summarizing.

There were three main lines of argument in favor of abolishing the credit. First, it was said to discriminate against domestic taxpayers, who could only deduct their non-federal taxes.<sup>33</sup> Second, it allegedly constituted an unfair advantage to corporations operating abroad in that it lowered their operating costs and, third, this rendered certain U.S.-produced exports uncompetitive. By way of response, the pro-credit lobby argued that there was no discrimination against purely domestic corporate taxpayers, at any rate, since U.S. corporations with foreign subsidiaries paid at least the domestic tax rate and, in any event, 85% of dividends received by domestic corporations from their domestic subsidiaries were exempted from tax by § 26 of the Code. Further, arguments about blocking U.S. exports were countered with evidence that many of the foreign subsidiaries in

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28. Choate, *supra* note 12, at 460.

29. The 1954 Code abolished the overall limitation, but it was restored in 1960. By the 1976 Tax Reform Act, § 1031, the per-country limitation is abolished, effective January 1, 1977.

30. H.R. REP. No. 704, 73d Cong., 2d Sess. (1934).

31. *Id.* at 15.

32. S. REP. No. 558, 73d Cong., 2d Sess. 39 (1934).

33. A Fifth Amendment challenge to the foreign tax credit on almost precisely these grounds failed in a case which was disposed of on jurisdictional grounds, but which rejected the constitutional claim by way of dictum: *George W. Helme Co. v. United States*, 87 Ct. Cl. 474, *cert. denied*, 306 U.S. 645 (1938).



question were assembly and distribution centers which actually furthered exports.

This was bolstered by the results of a survey conducted by the American Exports Manufacturers Association which indicated that 34 of the 155 corporations polled thought the abolition of the credit would certainly drive them out of business and a further 56 thought that it might have that effect. Corporate emigration was also raised as a possible result of abolition.<sup>34</sup>

The complete victory of the retentionist lobby is some indication of the importance of the credit to American corporations. The evidence of those most directly affected suggests that since its introduction in 1918 the credit has become one of the most important factors in determining patterns of corporate investment.

In 1942, the 1939 Code was amended, in the face of World War II, to effect a liberalization in the application of § 131, the predecessor of the present § 901. The option of a credit or deduction, useful to the taxpayer for whom a very high foreign rate would make the (limited) credit less attractive than the (unlimited) deduction, was introduced.<sup>35</sup> So was the new provision by which foreign taxes "in lieu" of an income tax are creditable, together with a liberalization of the rules relating to second-tier foreign subsidiaries.<sup>36</sup>

In 1954, the overall limitation on the credit was abolished, leaving only the per-country limitation, which favored that narrow class of taxpayer which incurred a loss abroad while making a profit at home.<sup>37</sup> (The per-country limitation results in this loss being offset against U.S. tax; the overall limitation does not, unless there is an overall loss.) In 1960, the overall limitation was restored as an alternative,<sup>38</sup> and by § 1031 of the 1976 Tax Reform Act the per-country method is abolished (save for income from U.S. possessions) for tax years ending after 1975, and all taxpayers are required to use the overall method.<sup>39</sup> Also in 1954,

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34. See WELLS *supra* note 24, at 31-33 and authorities cited in nn. 35-46 therein, especially *American Branch Factories Abroad*, S. Doc. No. 258, 71st Cong., 2d Sess. (1930).

35. Int. Rev. Code of 1939, § 131(a), now § 904.

36. *Id.* § 131(h).

37. *Id.* § 131(f).

38. Int. Rev. Code of 1954, § 904(a)2.

39. See H.R. 10612, 94th Cong., 1st Sess. (1976), § 1031, as amended. Congressional intent is unclear, but conversations with staffers indicate a "consensus" that the amendment is aimed at oil company abuses and will have little effect outside that industry.

§ 904(d) was enacted; unused credit could be carried over from one year to another within certain limits. This remains in force. In 1958, the five-year carryover and two-year carryback provisions were introduced<sup>40</sup> and in 1962 the "grossing up" provisions were introduced with the aim of equalizing foreign and domestic dividends received by parent corporations.<sup>41</sup> In 1969, a safeguard against double credit was brought in in the form of a greater limitation on credit where a loss in earlier years has created a tax benefit.<sup>42</sup> The 1969 Act also introduced a special limit with respect to mineral income to prevent the use of excess credit in reducing U.S. tax on other foreign income.<sup>43</sup>

These sporadic amendments may reflect changes in economic climate, balance of payments pressures, political movements for or against isolationism, and the like, but the firmly-entrenched foreign tax credit remains a focal point in the world of corporate foreign investment.

While the . . . history shows that the foreign tax credit can be used to expand or restrict foreign investment and is to this extent a viable tool for the implementation of governmental non-tax policy, the minor changes in the taxing policy over the years indicate a recognition on the part of Congress that economic double taxation is basically unfair and discriminatory against foreign investment. Thus Congress has resisted the temptation to eliminate the credit to increase revenue and has contented itself with setting up a series of limitations to safeguard against abuse.<sup>44</sup>

#### APPLICATION

Having briefly traced the fitful history of the credit, we may now turn to a detailed examination of the way in which it has been applied. Because the meaning of "income tax" is determinative of the scope and effect of § 901, that will be our central focus in asking whether the adjudicative policy in this field is more coherent than the legislative. It may be helpful to examine the decisions in terms of the three requirements suggested above:

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40. Int. Rev. Code of 1954, § 904(d).

41. *Id.* § 902(a).

42. *Id.* § 905(c).

43. *Id.* § 901(e); and see generally Rendell, *Developments in Foreign Tax Credit: How It Affects Doing Business Abroad*, 37 J. TAX. 298, 299 (1972).

44. Choate *supra* note 12, at 461-62.

(1) that there be a tax (2) based on income (3) designed to reach that income.

### I. A Tax

Only one levy has failed to qualify specifically on the grounds that it was not a tax.<sup>45</sup> This was an Ecuador levy under the Labor Code of that country. The proceeds were paid to a works council which distributed it to employees in the form of benefits. This profit-sharing element, and some suggestion in the ruling that regulation of business,<sup>46</sup> rather than the raising of revenues, was the motive behind it, combined to produce a denial of credit. It has been suggested, however, that the main ground of decision was not articulated in the ruling. This was that the monies levied never entered the general exchequer but were repaid to employees of the taxpayer.<sup>47</sup> It may be that the grounds actually given, particularly that the function of the levy was to control business ("for the purposes of enforcing the Labor Code") are less than convincing. But to suggest that the true ground of decision was one which went unmentioned is to do what the author who made that suggestion declares to be necessary in analyzing the whole area before us — "At various crucial points . . . it becomes necessary to guess what principles and lines of demarcation the Service may have had in mind."<sup>48</sup> There can be no doubt that the absence of articulated grounds for decision is the main obstacle to meaningful analysis in this area. But the particular inquiry as to what is a tax, as contrasted to other, non-creditable levies, has not raised many problems. Indeed, it often appears that if all other requirements are met — essentially that there is a levy upon net income for the purpose of revenue-raising — then for credit purposes the impost is necessarily a tax. To hold otherwise would be to make a distinction without a difference.

This is demonstrated by a 1974 ruling allowing credit for payments voluntarily made to a corporation wholly owned by the Brazilian Government.<sup>49</sup> The corporation was set up for the

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45. I.T. 3768, 1945 CUM. BULL. 204.

46. Article 374 of Presidential Decree No. 210, dated August 5, 1938, provided for contribution of five percent of net profits as the "means of raising the funds for the purpose of enforcing the Labor Code. . . ." *Id.* at 204.

47. OWENS *supra* note 13, at 32.

48. *Id.* at 31.

49. Rev. Rul. 74-58, 1974 INT. REV. BULL. No. 5, at 13.

furthering of literacy and adolescent education. Once the taxpayer had elected to make such payments, they were treated exactly like income tax so far as due dates and penalties were concerned. They were creditable against the Brazilian income tax up to a 2% ceiling. As a result, these optional donations were treated by the Service as taxes:

Amounts of taxes paid directly to a public benefit corporation rather than to a government's general revenue fund constitute "taxes" if the corporation has been created for a public purpose and is regarded as performing a governmental function for which public money may be appropriated.<sup>50</sup>

As a matter of statutory interpretation, such payments might better have qualified for credit as a tax "in lieu" of income tax under § 903, to be discussed later.<sup>51</sup> But in the light of the limitations put upon the "in lieu" provision by the Service,<sup>52</sup> and because of the way in which this contribution was calculated, with consequences of non-payment and late payment the same as for the income tax itself, the Service was evidently content to credit a voluntary, charitable contribution as an income tax.

It may fairly be concluded from the Brazilian ruling, and from others like it concerning, for example, the New York City Educational Construction Fund,<sup>53</sup> the Canadian Old Age Security Tax,<sup>54</sup> employees' contributions under the British National Insurance Act<sup>55</sup> and a West German surcharge on taxes already qualifying for credit<sup>56</sup> that the definition of "tax" has really

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50. *Id.*

51. *See* discussion, *infra* 228-31.

52. *See* Reg. 1.903-1 and Rev. Rul. 67-308, 1967-2 CUM. BULL. 254, superseding Rev. Rul. 57-153, 1957-1 CUM. BULL. 243, which revoked O. D. 253, 1 CUM. BULL. 162. The effect of these limitations (*see* note 51, *supra*) is that the category of taxes credited under § 903 is limited to those which the taxing country has applied as a matter of administrative convenience because, for some reason, computation of taxable income is difficult. Given the narrowness of this category, the main credit provision, § 901, better applied to the Brazilian levy. The statutory language, however, clearly suggests that § 903 was the more appropriate provision on these facts.

53. Rev. Rul. 71-49, 1971-1 CUM. BULL. 103.

54. Rev. Rul. 67-328, 1967-2 CUM. BULL. 257; *see and compare* Rev. Rul. 68-411, 1968-2 CUM. BULL. 306 which held creditable levies made under the Canadian Pension Plan on employed and self-employed persons.

55. Rev. Rul. 72-579, 1972-2 CUM. BULL. 441.

56. Rev. Rul. 74-90, 1974-1 CUM. BULL. 181. Once the original income tax qualifies for credit, "An additional tax imposed as a percentage . . . thereof is itself an income tax." *Id.* at 182.

looked after itself in view of the other tests applied.<sup>57</sup> Given the attention which has been focused on these other elements, it is not surprising that the separate question, "What is a tax?", has not often been raised.

There is, however, one slightly murky area of the "tax" requirement which could be described as an abuse of the tax credit system. In 1957, Representative Vanik of Ohio spoke of "a conspired avoidance of an income tax obligation on \$300 million of income per year . . ." <sup>58</sup> by the Arabian-American Oil Company (ARAMCO) pursuant to a "purported agreement" with King Saud of Saudi Arabia, resulting in a 50-50 profit-sharing between the two, at the expense of the United States Treasury. A few days later, ARAMCO replied to Mr. Vanik's written request for ". . . compliance with the spirit as well as the letter . . ." of the Code by stating that they had properly credited income taxes paid, as all U.S. taxpayers were permitted to do. The "royalties" of which Mr. Vanik had written were deducted by ARAMCO as permitted by the Code. Representative Vanik noted that there had been a "shift in emphasis" between royalties and taxes.

Because taxes are creditable, royalties only deductible, U.S. oil companies prefer — understandably enough — that the source-country raise its revenue in the form of taxes, up to the point at which further taxes would not be creditable.<sup>59</sup> Beyond that point, royalties (that is, levies based on the quantity or value of oil

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57. The common feature of the levies at issue in the Rulings cited in notes 52-55, *supra*, is that they created a fund to be used for a specific purpose. In discussing the New York City levy (for which deductibility under §§ 164, 216 was sought) the Service acknowledged that "tax" was nowhere defined in the Code and that a fund raised for a specific purpose suggested a "regulatory" or "privilege" levy rather than a "tax." This implies that a tax must have no purpose more specific than the general raising of revenue. (*See and compare* case cited in note 130, *infra*). But the Service, reaching back to an earlier Ruling, found a definition of "tax" broad enough to include the levy at issue: "An enforced contribution, exacted pursuant to legislative authority in the exercise of the taxing power, and imposed and collected for the purpose of raising revenue to be used for public or governmental purposes." Rev. Rul. 61-152, 1961-2 CUM. BULL. 42. This definition would not cover the Brazilian levy, which was not "enforced." The other Rulings ignored the issue altogether, resting content with a conformity of "tax base" to the domestic-tax base, even where the foreign "taxing" statute did not use the word "tax."

58. 103 CONG. REC. 2248 (1957).

59. *See generally, Taking the "Am" out of Aramco*, FORBES MAGAZINE, December 15, 1976, at 37, which offers an interesting insight into the history of this aspect of the tax credit.

extracted rather than on gain) are preferable. Since the form in which revenue is raised matters little to the country concerned, oil-producing countries have been happy to oblige their American customers. For the corporation, substantial savings can result — all, as Representative Vanik put it, “at the expense of the United States Treasury.” This is the “shift in emphasis” between royalties and taxes to which he referred. The shift was facilitated by the Service and the courts, who based the determination of what is and is not an “income tax” on the mechanics, never asking whether it was a subterfuge for something else. If form was to govern creditability, then the prudent course was to follow the form.

It has been suggested that the correct approach to the oil-tax cases is to separate that part of the tax which is, in reality, a royalty and deny credit for it: form should not govern creditability.<sup>60</sup> But, of course, it does. In an ironic sense, this is the consequence of decisions which derive from the *Biddle* rule in holding the category of creditable taxes tightly in line with U.S. concepts. Once that considerable requirement has been met, (and on occasion oil-company-inspired lawyers have insured that it has), it would seem churlish to deny that form governs.

## II. *The Tax Base*

The conformity of tax base between the taxing country and the United States is the major controlling influence in this area. As we have seen, *Biddle v. Commissioner* sets out the criteria to be applied.<sup>61</sup> The question before the Supreme Court in *Biddle* was whether the U.S. taxpayer claiming the credit had paid the tax, or whether the British corporation of which she was a stockholder had done so. Though the case is now cited as authority for the criteria governing creditability, it established those criteria in response to the question: whose income? That narrow question is but tangentially related to the main inquiry of this article, but since its resolution provided the occasion for the formulation of the basic rules determining qualification under § 901, a historical note seems in order.

Under Rule 20 of the Income Tax Act of 1918, the United Kingdom Corporation of which *Biddle* was a stockholder had

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60. OWENS, *supra* note 13, at 33.

61. *Supra* note 4 and accompanying text.

withheld income tax from dividends paid to her.<sup>62</sup> This was tax attributable to the surplus being distributed by the dividend. This rule had been essentially unchanged since the Income Tax Act of 1842, which itself preceded the first British Companies Act by two years. The significance of that sequence is that it resulted (indeed results) in a tax treatment of these incorporated bodies, for present purposes, as though they were the effective partnership to which the 1842 statute applied: joint-stock companies. Since the tax paid by the partnership was the tax paid by its partners, it would follow that tax withheld from a distribution of surplus could correctly be regarded as tax paid by the partner receiving it.<sup>63</sup> It was against this historical background of British tax law that *Biddle* was decided.<sup>64</sup> The word "company" as used in the 1842 statute had referred to joint-stock companies, the only companies then in existence. The passage of the Companies Acts was never met by a corresponding change in the application of the withholding rule for corporate dividends. There was, however, by section 27(1) of the Finance Act of 1920, an amendment whereby the tax withheld by the company is nevertheless to be included in the stockholder's gross income for the purposes of surtax and any possible tax refund. This feature was relied upon by *Biddle* in support of her argument that she had paid the tax. But the Court said:

Although the corporation, in the United Kingdom as here, pays the tax and is bound to pay it, the tax burden in point of substance is passed on to the stockholders in the same

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62. Withholding was unknown to the United States tax system at this time; it was not even used for wages.

63. Ironically, had the taxpayer in this case been a corporation rather than an individual, the British company having been at least half-owned by the American, then the tax paid would have been credited under the "deemed paid" rule now contained in I.R.C. § 902(a) [then § 131(f)]. (The present-day requirement is that the American corporation own at least 10% of the stock.) Is this because the U.S. tax system, having developed after the birth of the corporation, recognized that the corporate person which controls another corporate person acquires rights and duties directly, without the dissonance inherent in the natural-person-as-shareholder arrangement? Whatever the best explanation, there is some irony in the fact it was a foreign tax system's failure to comprehend fully the characteristics of the corporate person which gave rise to a tax which is usually recognized for credit to a corporate taxpayer, but not to an individual.

64. For a fuller discussion, see Mitchell, *The Credit for Foreign Income Tax and Notes on the Historical Origin of the Biddle Case*, 1 AM. U. TAX INST. 395, 412.

way that it is passed on under our own taxing acts where the tax on the corporate income is charged as an expense before any part of the resulting net profit is distributed to stockholders.<sup>65</sup>

"[I]n point of substance," this was a tax upon the company's profits before they reached the stockholder. In this analysis, it was like the tax levied by the United States on corporate profits and was not creditable to the stockholder.

For more than ten years prior to *Biddle*, the Service had accepted that the stockholder had paid the tax and was entitled to credit. As there appears to be no other country which employs the British method, it is doubtful whether the question will ever be re-examined. The *Biddle* case is significant for the fineness of the line it drew between creditable and non-creditable taxes. But central to our inquiry is the requirement of similarity with U.S. taxes for which this case is responsible.

Foremost among these similarity requirements is that the tax be aimed at, even where not directly measured by, net income as understood under the Internal Revenue Code. This in turn requires some actual income in the *Eisner v. Macomber* sense of "the gain derived from capital, from labor, or from both combined . . . provided it be understood to include profit gained through a sale or conversion of capital assets . . ." <sup>66</sup> The word "derived" has long since been taken to require realization.<sup>67</sup> It is for this reason that tax paid (by a British subsidiary of a U.S. parent) as an imputed rent tax, based on the value of the property, was denied credit; the statute did not require that any rent actually be received.<sup>68</sup> Similarly denied credit was a Mexican production tax which attached to the market value of ore produced whether sold or not,<sup>69</sup> a Peruvian tax based on the value of merchandise to be exported<sup>70</sup> and a Columbian patrimony tax based on assets minus liabilities and not on "only those increases

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65. 302 U.S. at 580 (1938).

66. 252 U.S. 189, 207 (1919).

67. See J. SNEED, THE CONFIGURATIONS OF GROSS INCOME 63-76 and authorities cited therein (1967).

68. *F. W. Woolworth v. United States*, 91 F.2d 973 (2d Cir. 1937), cert. denied, 302 U.S. 768 (1938).

69. *Commissioner v. American Metal Co.*, 221 F.2d 134 (2d Cir.), cert. denied, 350 U.S. 829 (1955).

70. Rev. Rul. 74-373, 1974-2 CUM. BULL. 203.



in value of the property which are actually realized by the owner . . . .”<sup>71</sup>

Given a broad notion of avoiding double taxation, arguments against these results might be that imputed income is a logical concept of income, even though it is not a part of U.S. tax law; that taxing ore before sale differs from U.S. practice only in the matter of timing; and that a patrimony tax is a perfectly proper way for a government to protect itself against less than the property's full potential being realized. But these three are landmark decisions which continue to control; they afford relief from double taxation only in a narrow, almost mechanical sense.

A slightly different aspect of the conformity requirement is raised by the Tax Court's refusal to credit a Canadian tax on the income from a testamentary trust.<sup>72</sup> The ground of decision was simply that, at the time, such income was not taxed domestically. There was no argument to the effect that this was not income, or that it was not taxed. In other words, because Congress did not tax such income domestically, there was no question of double taxation. Today, the type of income involved in that case is taxable, so presumably credit would be allowed.<sup>73</sup>

A German turnover tax applied to gross royalties received by non-residents for the use of patents was denied credit because of the predominant “turnover” nature of that tax,<sup>74</sup> even though an East German tax on gross royalties of non-residents has been credited by analogy with I.R.C. §§ 871 and 881.<sup>75</sup> (There may

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71. *Lanman & Kemp-Barclay & Co.*, 26 T.C. 582, 587 (1956). The same tax failed on the same grounds in *Abbott Laboratories v. United States*, 160 F. Supp. 321 (N.D. Ill. 1958), *aff'd per curiam*, 267 F.2d 940 (7th Cir. 1959).

72. *Helena L. Wilson*, 7 T.C. 1469 (1946).

73. Int. Rev. Code of 1954, §§ 652, 662, 663.

74. Rev. Rul. 56-635, 1956-2 CUM. BULL. 501. The only description of the German tax contained in the Ruling is: “The ‘turnover’ tax resembles a sales tax but is broader in scope of application.” Presumably, this is a tax on the turnover of property — a tax upon an event or transaction rather than on a gain.

75. Rev. Rul. 73-159, 1973-1 CUM. BULL. 346. The tax here was imposed by East Germany upon gross receipts from the permanent or temporary granting of patents, trademarks and the like paid to persons not resident or domiciled in East Germany. The taxpayer here was a domestic corporation whose income (royalty payments) from an East German corporation had been subjected to the East German tax at source. Although this tax would not have qualified as an income tax in the ordinary sense, it was held creditable by analogy with I.R.C. §§ 871 and 881. § 871 (a)(1)(A) imposes a tax upon “the amount received from sources within the United States by a nonresident alien individual as interest . . . , dividends, rents, salaries [etc.] . . .” where that income is not connected with United States business. § 881 is

be another rationale for crediting such gross taxes as these; the rulings concerned are discussed below.)<sup>76</sup> The basis of this denial is that the "turnover" nature of the statute under which the tax was levied required no realization of income. This realization requirement has resulted in the denial of credit for a tax on capital,<sup>77</sup> on the value of bonds held,<sup>78</sup> on farm land,<sup>79</sup> on household appliances<sup>80</sup> and on personal wealth.<sup>81</sup> On very similar grounds, that part of a Swiss tax which applied to capital and reserves was denied credit,<sup>82</sup> as was a Venezuelan tax to the extent that it was, in effect, based on an imputed dividend.<sup>83</sup> In none of these cases was taxable income realized. The limiting influence of *Eisner v. Macomber* in domestic taxation is precisely reflected here.

In most of these cases, the foreign tax is of a kind which does not require realization, indeed is conceptually inconsistent with a realization requirement — typically, a tax on capital or other property. These are direct taxes, as distinct from the indirect taxes to which *Eisner v. Macomber* effectively limited the taxing power of Congress. In such cases, the denial of credit is on two distinct grounds: first, the taxing statute has no Internal Revenue Code counterpart; second, there is no income realized, in the United States sense of realization. But there are cases in which the taxing statute conforms to the similarity requirement,

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a parallel provision which applies to foreign corporations. Since these are taxes upon gross receipts, they bring the similar East German tax within the scope of the rule in *Biddle*, namely that the credit be limited to taxes of the kind which exist within the Internal Revenue Code. The Code provisions dealing specifically with the kind of income involved here (§ 871(a)(1)(D) and § 881(a)(4) respectively deal with "gains from the sale or exchange . . . of patents, copyrights, . . . and other like property") use the term "gains" by contrast with the phrase "the amount received" (§§ 871(a)(1) and 881(a)). This suggests that the East German tax was not the mirror-image of the American; the Service had room for maneuver.

76. See text following note 86 *infra*.

77. Rev. Rul. 68-318, 1968-1 CUM. BULL. 342 (Italy).

78. Rev. Rul. 69-82, 1969-1 CUM. BULL. 193 (Italy).

79. Rev. Rul. 69-480, 1969-2 CUM. BULL. 151. The tax at issue here was based on the "cadastral" technique of taxing land on its potential value as farm land.

80. Rev. Rul. 72-235, 1972-1 CUM. BULL. 439 (Holland).

81. Rev. Rul. 70-464, 1970-2 CUM. BULL. 152; however, deductible where income-producing (Switzerland).

82. Rev. Rul. 74-82, 1974-1 CUM. BULL. No. 181, modifying Rev. Rul. 69-446, 1969-2 CUM. BULL. 150 (Switzerland).

83. Rev. Rul. 75-377, 1975-2 CUM. BULL. 294.

but the transaction to which it is applied does not. That is, only the second ground of decision applies: there has been no income realized.

In *Hugh C. Wallace*, the French taxing statute conformed to the similarity requirement, but was applied to rental property whether actual rental income was received or not.<sup>84</sup> In other words, in cases involving unlet property the tax levied, based upon rental value, was a tax on the property itself. In American terms, there was no realization. Another case in which the transaction, rather than the taxing statute, failed to qualify for credit was *Burk Brothers*.<sup>85</sup> The taxpayer had bought goat skins in Calcutta, where it had an office, and imported them to the United States where they were manufactured into leather goods by the taxpayer's own factory. Burk Brothers thus by-passed the Indian skin exporting trade. Indian exporters were taxed on the difference in value of the skins between the times they bought and sold them: their income. Burk Brothers were taxed as though this had happened because the Indian authorities viewed the transaction as involving the production of wealth within India, which wealth was subject to tax. But in American terms, there was no taxable event; credit was denied.

So far, we have discussed only two requirements which the "common law" of § 901 has produced: (1) that there be income within the U.S. understanding of that term and (2) that it be taxed broadly in the way that domestic income is taxed. Taken together, these two basic limitations on the income tax credit do no more than declare its outer limits. They serve to describe, by inference, that large area of foreign taxation which is clearly beyond the reach of the credit.

Within those outer limits, the questions which determine creditability become more numerous and more refined. Even after the two basic criteria have been met, the Service and the courts have generally required a showing that what is being taxed is a net gain corresponding to the federal tax concept of taxable income. Numerous decisions deal with taxes levied on gross income, rather than net, and we shall consider them next. Then we shall examine the decisions concerning formulary taxes, that is, taxes levied according to a formula designed to reach net gain, rather than upon net gain itself.

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84. 17 B.T.A. 406 (1929).

85. 20 B.T.A. 657 (1930).

## A. Taxes on Gross Income

Given the existence of income, as we understand it, and given a method of reaching it which satisfies the *Biddle* rule of conformity, the next stage in the confining process is to satisfy the requirement that the tax reach net gain. Where the taxing country's concept of taxable income coincides with our own there is, of course, no problem. But where the income tax is levied on gross income, a denial of credit solely on the grounds that the tax base differs from the U.S. concept of taxable income would not serve to minimize double taxation. That is to say that a tax levied on gross income may very well reach net gain. Where it does in fact reach net gain — that is, where some net gain is included within the gross income being taxed — then the purpose of the foreign tax credit is served by allowing credit, not by denying it. The problem, of course, is to distinguish those taxes on gross income which do reach net gain from those which do not.

The recent case of *Bank of America N.T. & S.A. v. United States*<sup>86</sup> provides an excellent vehicle for examining this distinction. Judge Davis's Court of Claims Opinion, by which he purports to reconcile all the law on point, is as good a summary of the problem as may be found in the case law.

In the *Bank of America* case, the taxpayer sought to credit Thai, Philippine and Buenos Aires taxes levied on the gross income of its banking operations. The foreign statutes involved permitted no deductions for expenses incurred for the production of that income. The Court of Claims held, for the Service, that these were not "income taxes" within the meaning of § 901. Certiorari to the Supreme Court of the United States was denied.

Judge Davis's Opinion rests firmly on the proposition that "in addition to the rule that the United States notion of income taxes furnishes the controlling guide," there is the basic principle that "gain is a necessary ingredient of income."<sup>87</sup> In principle, a levy on gross income could be directed at net gain; where it is clear that "the costs, expenses, or losses incurred . . . would . . . be the lesser part of the gross income"<sup>88</sup> such a tax qualifies for credit. For example, an employee's foreign income tax paid on gross income would be creditable because "it is almost universally

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86. 459 F.2d 513 (Ct. Cl. 1972).

87. *Id.* at 517.

88. *Id.* at 519.

true that a wage or salary employee does not spend more on expenses incident to his job than he earns in pay.”<sup>89</sup> In *Bank of America*, there was no assurance that the gross income in question would include any net gain. For that reason, the taxes did not qualify for credit.

In analyzing the law on point, Judge Davis organizes the rulings and the Code provisions around the determinative criterion of the existence, or “very likely” existence, of net gain.

Two cases relied on by the taxpayer, each holding a tax on gross income creditable, are examined. In *Seatrains*,<sup>90</sup> the Cuban government replaced a 6% tax on taxpayer’s net income from a transportation business with a 3% tax on gross income. The Board of Tax Appeals, in upholding the taxpayer’s claim, emphasized that the change had been made as a matter of administrative convenience, the 3% reduction in tax rate being intended to approximate the value of the deductions which had been permitted under the former statute. There had been some difficulty in administering the old law with respect to permissible deductions, but the new was just as clearly intended to tax net gain. Thus, the determinative criterion of “seeking out net gain”<sup>91</sup> was satisfied.

As far as it goes, Judge Davis’s analysis of *Seatrains* seems to support his central thesis. The case is dealt with more fully below,<sup>92</sup> but it is enough to say here that it represented an expansion of the category of taxes qualifying for credit. This expansion was explicitly recognized, prior to the decision in *Bank of America*, by the passage of the “in lieu” provision, now § 903, under which the identical Cuban tax has since been held to qualify.<sup>93</sup> In other words, the tax in question was arguably not a true income tax at all, and the enactment of the “in lieu” provision took it out of the category of “income taxes” qualifying under § 901. It was, for this reason, an inappropriate authority on which to rely.

But even Judge Davis’s limited analysis of the case raises one difficulty. If, as he puts it later in his opinion, “the key is the effect of the foreign tax on net gain,”<sup>94</sup> then the ultimate

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89. *Id.*

90. *Seatrains Lines, Inc.*, 46 B.T.A. 1076 (1942) *nonacq.*

91. 459 F.2d at 518.

92. See text accompanying note 115, *infra*.

93. I.T. 3903, 1948-1 CUM. BULL. 70. See also Reg. 1.903-1 (1964), apparently describing this very tax.

94. 459 F.2d at 521.

test must be the actual effect of the tax, irrespective of the thinking behind its enactment. Of course, some insight into what the statute was designed to achieve is helpful, but determination of creditability must turn on actual effect. A tax which "seeks out" net gain does not result in double taxation unless it actually reaches net gain. The *Seatrains* case nowhere dealt with effect, but only with purpose. It did not directly address the narrow question in issue here and for this reason, as well as that already discussed, is best disregarded.

The second case relied on by the taxpayer also involved a tax on gross income which was held to qualify for credit. In *Santa Eulalia*,<sup>95</sup> a Mexican tax was levied on gross mining royalties. Judge Davis explains the result this way: "[T]he taxpayer did not operate the mine, retaining only the royalty right . . . and it seems very clear that no costs or expenses of the taxpayer in obtaining the royalties were likely to out-balance those gains . . ."<sup>96</sup> (Emphasis original). According to this characterization, a net gain was virtually certain, so that a tax on gross income in fact reached net gain and thereby qualified for credit. Be that as it may, the Tax Court's analysis in *Santa Eulalia* offers only a modicum of support for Judge Davis's characterization.

The government had argued that the tax did not qualify for credit, precisely because no expense deductions were permitted. That is, the government argued, as they were to argue in *Bank of America* itself, that a tax on gross income is *per se* disqualified from creditability under § 901. Rather than discuss the likelihood of reaching net gain, the Tax Court in *Santa Eulalia* stated that "the allowance of deductions from gross income in computing income tax is a matter of legislative grace. . ."<sup>97</sup> In other words, the computation of taxable income need not be wholly according to U.S. concepts in order that the tax qualify for credit. There is no mention of the factor which Judge Davis singles out — the virtual certainty that a net gain will occur.

The government, in *Bank of America*, relied on three cases in which credit was denied. Judge Davis explains each of them as dealing with situations in which there was no assurance of net gain. In *Keasbey & Mattison Co. v. Rothensies*,<sup>98</sup> a Quebec

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95. 2 T.C. 241 (1943).

96. 459 F.2d at 520.

97. 2 T.C. at 245.

98. 133 F.2d 894 (3d Cir. 1943).

mining tax was held not creditable, on the grounds that it was a privilege tax rather than an income tax, even though it was computed on gross income. But Judge Davis terms it "significant" that no general business deductions were permitted, saying that such expenses "could easily have made the difference between a net profit and a loss."<sup>99</sup> The second case was *American Metal*,<sup>100</sup> also decided on the grounds that the tax in issue was "on the privilege of mining." The Second Circuit Court of Appeals in that case did not assert the proposition for which the government relied on it, namely that no tax on gross income could qualify for credit. Judge Davis noted that the court there had emphasized that the tax was payable "even if the individual miner makes no profits — even if, having severed the ore, he makes no sales."<sup>101</sup> The third case cited by the government, *Allstate Insurance Co.*,<sup>102</sup> involved a Canadian tax on insurance premiums, levied irrespective of profit.

Each of these cases offers some support for the desirable consistency which Judge Davis attempts to impose on this area, but only the *Allstate* case was actually decided in terms of a requirement of "some relation to the gain, profit or loss of the taxpayer."<sup>103</sup> The other two cases were decided purely on the basis that a tax on an event or privilege is something other than an "income tax" and therefore does not qualify for credit.

In the *Keasbey & Mattison Co.* case, Judge Smith, speaking for the Third Circuit Court of Appeals, offered virtually no guidance as to how to distinguish a "privilege tax" from an income tax. He held that the Quebec statute did not conform "to the recognized criteria of an income tax" and emphasized that only the expenses of operating the mine, and not those incident to the general conduct of the business, were deductible. In the view of the court, this singled out the activity, rather than the production of income, as the taxable event. There was also the possibility of tax liability despite an overall loss, and it was this which Judge Davis took to be the principle of decision.

In *American Metal*, Judge Hincks's opinion for the Second Circuit deals very thoroughly indeed with the nature of a privilege

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99. 459 F.2d at 520.

100. 221 F.2d 134 (2d Cir. 1955).

101. *Id.* at 139.

102. 419 F.2d 409 (Ct. Cl. 1969).

103. *Id.* at 415.

tax. His holding depends largely on the fact that the Mexican Production Tax applied "forthwith upon the extraction of the ore" and is levied "irrespective of the realization of cash proceeds."<sup>104</sup> The taxpayer's unsuccessful argument was that the "exclusive badge" of a privilege tax was forfeiture of the right to continue the activity upon failure to pay the tax. Terming this argument "specious," Judge Hincks said that all depended on "the nature and effect of the tax." He referred to Mexican laws, which made clear that only the state could own mineral deposits prior to actual mining, and referred to expert testimony that putting the ore "into the economic current of things" was the "creation of wealth [which] is subject to tax."<sup>105</sup> Rebutting the taxpayer's argument that the variation of tax rate, according to the value of the particular metal in the world market, indicated a tax aimed at the ultimate gain, Judge Hincks said, "But these . . . are factors which affect the value of the privilege." Finally, he emphasized that the tax attaches even if the individual miner makes no profits — indeed, even if he makes no sales. Taken together, these factors distinguish a tax on the privilege of mining from a tax on the income from the activity.

This is one of the very few judicial attempts really to distinguish a privilege tax from an income tax. Since the distinction has been determinative in a few cases, it seems worth paying attention to the factors emphasized by Judge Hincks. It was the last of these — the irrelevance of net gain — which Judge Davis emphasizes to the exclusion of the others.

Having dealt with the cases, Judge Davis turns to the rulings and the Code. Of the four rulings involved, two were "summary rulings [which] do not detail their reasoning" but, says Judge Davis, the Service "must have assumed" that the income involved is "rarely, if ever, wholly offset by the taxpayer's costs or expenses. . . ."<sup>106</sup> The third ruling was decided by analogy with domestic Code provisions with which Judge Davis deals separately and the fourth, he admits, is "without any satisfactory explanation."<sup>107</sup>

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104. 221 F.2d at 138.

105. *Id.* at 137.

106. 459 F.2d at 522. The rulings concerned were Rev. Rul. 73-118, 1973-1 CUM. BULL. 345; Rev. Rul. 73-159, 1973-1 CUM. BULL. 346; Rev. Rul. 74-31, 1974-1 CUM. BULL. 179; Rev. Rul. 75-164, 1975-1 CUM. BULL. 233.

107. *Id.*



The Code provisions on which the plaintiff bank relied levy tax on gross income<sup>108</sup> and so afford an analogy to satisfy the *Biddle* rule of conformity. But Judge Davis, in discussing the pertinent provisions, says that "The assumption is, as we understand it, that such . . . taxpayers . . . are very unlikely to have expenses which will reduce to zero their net gains from the taxed items."<sup>109</sup> These are taxes on the non-business gross income of non-resident aliens<sup>110</sup> and on income "not effectively connected" with trade or business within the United States and received by a foreign corporation.<sup>111</sup>

Judge Davis succeeds in offering a unifying principle in an area in which too little careful analysis has been done. Although the body of law which he purports to reconcile is less consistent than he would have us believe, his careful discussion affords at least a starting point for future controversies and perhaps more than that — a determinative criterion by which tribunals will abide in future.

Before leaving this problem, it must be said that determining creditability of taxes on gross income according to whether or not a net gain is likely to be "caught," does raise one possible problem. In a situation in which the net gain is small relative to the gross income, it is conceivable that the tax levied would exceed the gain. Yet according to Judge Davis's test, the tax would be creditable. If so, the taxpayer would be doing better than avoiding double taxation, for that part of the tax which exceeds net gain should not, in theory, qualify.<sup>112</sup> This curious possibility derives from the willingness of the courts, the Service and Congress to rest content, under certain circumstances, with an assurance that there is some net gain, rather than demand a precise computation in line with United States concepts of taxable income, consistent with the government's repeated urgings.

## B. Formulary Taxes

We have discussed decisions concerning the creditability of taxes on gross income before discussing those concerning taxes

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108. See notes 110, 111, *infra*.

109. 459 F.2d at 523.

110. I.R.C. §§ 871, 1441.

111. I.R.C. § 881.

112. That is to say, in circumstances in which the taxpayer's net gain is, let us say, 2% of gross income, a tax of 3% would nevertheless qualify for credit if Judge Davis's criteria were satisfied.

for which the income tax credit is clearly intended — those on net income — because these exceptions go far toward proving the rule. The rule has already been stated, if not proven, and those taxes which come clearly within it do not generally make any contribution to the decisions on qualification.<sup>113</sup> These will qualify for credit even where the permissible deductions do not conform exactly with U.S. permitted deductions, but “the fundamental issue,”<sup>114</sup> as plainly indicated by the series of decisions already discussed, is the tax base. The creditability of taxes using gross means to a net end also indicates that the precise formulation of that net gain is unimportant. This general trend is equally evident from the decisions concerning a category very closely related to that of taxes on gross income; that is, formulary or estimated income taxes.

To the extent that there is actually a gap between taxes on gross income, discussed above, and formulary or estimated taxes, discussed below, that gap is nicely bridged by the *Seatrains* case.

In *Seatrains*, the Cuban government had brought in a 3% tax on gross income as the direct successor to a 6% tax on net. That lineage obviously aided the Board by pointing clearly to an intention to tax net income; furthermore, the reason for the change was known. This was, then, the paradigm tax of the category last examined. Yet, was it not also a formulary tax, a tax which employed a formula to estimate net income? In *Commissioner v. American Metal Co.*,<sup>115</sup> the Court of Appeals for the Second Circuit referred to the *Seatrains* case and impliedly acquiesced in the taxpayer's characterization of it as crediting a formulary tax. The reason is not hard to find since the adjustment between 3% and 6% in order to allow for a different base is itself a fairly simple formula. But other, more complex formulations have been considered and credited.

Two decisions on formulary income taxes dealt with tax systems which offered them as an option to tax on net income. In 1926, the Service allowed credit for such a Brazilian tax, computed as a fixed percentage of gross receipts, the percentage

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113. For uninformative decisions which allow credit without adding to the body of reasoning on the subject, see Rev. Rul. 55-296, 1955-1 CUM. BULL. 386; I.T. 4100, 1952-2 CUM. BULL. 140; I.T. 4023, 1950-2 CUM. BULL. 49; I.T. 4014, 1950-1 CUM. BULL. 67; I.T. 3837, 1947-1 CUM. BULL. 56, and others.

114. OWENS, *supra* note 13, at 36.

115. 221 F.2d 134.

having been fixed by a technical committee.<sup>116</sup> The other,<sup>117</sup> in which the alternative of a true tax on net income was offered only if proof of that net gain were offered to the government, imposed a percentage tax on the gross amounts of freight from passenger fares and cargo on non-resident corporations engaged in transportation between the Dominican Republic and other countries. This, too, was held creditable, but the way in which the alternative, net tax was made available seems to speak of administrative convenience. The fact that this was a tax imposed specifically on nonresident corporations also allows the likelihood-of-net-gain rationale into the picture, so that there is a range of possible reasons for allowing the credit. However, the ground on which the credit was in fact allowed was that this was a formulary tax designed to reach net income.

Another type of formulation, even further removed from any measure of net gain, was held to qualify in the case of *Herbert Ide Keen*<sup>118</sup> which concerned a French tax levied upon estimated income, the estimate being based on the amount of rental payments made by the taxpayer. This was a minimum tax, imposed only when the income tax otherwise payable fell below the amount thus computed. That factor alone would seem to disqualify the tax, applying any of the discernible first principles, but the Board of Tax Appeals held otherwise. It may be doubted whether the same tax would qualify today if challenged, particularly in view of certain language of the decision:

Whatever may be the nature of the tax, it is imposed upon what the French Government determines to be income. . . . The fact that under the law the taxable income is determined in a manner different from the taxable income under the Revenue Act of 1921 does not change the nature of the tax. The fact that the net income of the petitioner as computed under the Revenue Act of 1921 was much in excess of the income of the petitioner determined for the purposes of the French tax does not change the character of the tax paid.<sup>119</sup>

This statement is very much in line with certain dicta of the Supreme Court almost twenty years before, to the effect that "much weight" should be given to the characterizations of the

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116. G.C.M. 800, V-1 CUM. BULL. 75 (1926).

117. I.T. 3997, 1950-1 CUM. BULL. 63.

118. 6 B.T.A. 275 (1927), *nonacq.*

119. 15 B.T.A. 1243, 1246 (1929), *acq.*, IX-1 CUM. BULL. 28 (1930).

lawmaking power.<sup>120</sup> But it appears to be contrary to the rule in *Biddle*, decided nine years later. Indeed, against this background the *Biddle* case has been described as "an abrupt turn-about." Part of the holding in *Keasbey & Mattison* also seem to conflict with *Keen*:

It seems logical to conclude that any tax, if it is to qualify as a tax on income, . . . is subject to the same basic restrictions . . .<sup>121</sup>

as are income taxes under federal law. Further, it seems to have been relevant to the Board in *Keen* that petitioner's liability under U.S. law exceeded its liability under French. Had this not been so, it may be that even in the halcyon days before *Biddle*, that "extra" part of the French tax would have been fatal to the whole. And yet, despite this apparent conflict with more recent decisions — *Biddle*, *Keasbey & Mattison* — as recently as 1953, a Haitian tax which contained almost identical provisions for assessment based on rental payments was credited by the Service with specific qualification of that element of the tax. *Keen* was expressly followed.<sup>122</sup>

In response to the Commissioner's withdrawing his non-acquiescence in the *Santa Eulalia* case,<sup>123</sup> the Service revoked two rulings,<sup>124</sup> one of which had denied credit for a Mexican tax which required an advance payment of 3% of the value of the merchandise exported. This payment was refundable to the extent that it exceeded 35% of gross annual receipts, the burden being on the taxpayer to show that it did. The court in *Santa Eulalia* (which concerned a royalty tax levied on gross receipts) used very broad language to suggest that an intention to tax net gain, coupled with a great likelihood of reaching it, should satisfy § 901 even where the method of computation "does not conform strictly to that by which income taxes are computed under our own laws."<sup>125</sup> It was this language that the Service evidently thought "broad enough to warrant the application of [*Santa Eulalia*] to the provisions of the Mexican law. . . ."<sup>126</sup>

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120. *Flint v. Stone Tracy Co.*, 220 U.S. 107, 145 (1910).

121. 133 F.2d at 897.

122. Rev. Rul. 53-272, 1953-2 CUM. BULL. 56.

123. *Supra* note 95.

124. I.T. 3787, 1946-1 CUM. BULL. 232.

125. 2 T.C. 241, 245 (1943).

126. I.T. 3787, 1946-1 CUM. BULL. 232.

The persistent problem in dealing with these formulary, or estimated, taxes upon net income is exactly parallel with the fundamental problem in dealing with taxes on gross income: how can they be distinguished from other formulary taxes? The answer may be that they cannot; that where the rationale behind the taxing country's choice of formula happens to be clear, as in *Seatrans*, or where the tax is levied under a general income tax statute, then the Service and the courts will allow credit. As with the decisions concerning taxes on gross income, it seems that the element of purpose, or intent, is better fitted for the role of supporting justification than for determination of creditability. After all, if the purpose of the credit is the alleviation of some measure of double taxation, the only relevant test is of the result in the particular case. Of course, when American tribunals work their way through the unknown territory of a strange tax system, the intentions of its creator are useful signposts to ultimate result. But since the taxpayer seeking credit knows the American world of taxation, and of accounting, the tribunal and the taxpayer between them should be able to discern the actual result in American terms. Conceptually, if not practically, the purpose or intention of the taxing country can be no more than a helpful pointer.

### C. Nature of the Income

Almost all decisions on the foreign income tax credit have concerned corporate income. This may reasonably be divided into general revenue from the conduct of business abroad and specific revenue from those activities of a U.S. corporation which, for one reason or another, take place in a foreign country. Most of the decisions discussed so far, that is those construing income taxes other than those laid directly upon net income, have been concerned with specific rather than general revenue. Given that a substantial part of the business conducted by American corporations in other countries is conducted there because natural resources, expertise and other factors militate in favor of the particular venue, it is not surprising that much of the income which has been subject to these taxes has been of the specific type. Neither is it surprising, even where the imposition is made under a general income tax law, that the method of computation is either formulary or on gross income. It does not make much sense to isolate that part of a series of operations which happens to occur in a

particular country, and then to attempt computation of net income. Taxing authorities interested in revenue attempt to levy it as effectively as they can from operations occurring within their domain.

Administrative convenience may indeed be the determinative factor in the design of these taxes. In response to the general pattern, the U.S. tribunals, consciously or otherwise, have developed a series of rationalizations which take account of the facts of commercial life and succeed in allowing credit, despite the absence of detailed computation on the lines of domestic income under the Internal Revenue Code. In a real sense, this has been done in spite of the statutory provisions; at least once they were construed as applying only to U.S.-type income. This aspect of the development of the credit for foreign income taxes should give food for thought to those who consider its objectives worthy of continued effort.

It has already been noted that taxes which are clearly within the "net" category have largely looked after themselves and have not contributed to the definitional question under examination.<sup>127</sup> These taxes have usually involved general rather than specific revenue and so have presented no computation problem for the authorities immediately concerned. However, a few such general revenue situations have resulted in a denial of credit, and brief mention of these will complete the picture.

In 1929, a Peruvian tax on the export of sugar was denied credit simply on the grounds that an export tax is not an income tax.<sup>128</sup> Two decisions denied credit for French turnover taxes because, in taxing the general revenue of businesses, they did not take account of the deductions for business expenses permitted under U.S. law.<sup>129</sup> Similarly, in the *Mallouk* case,<sup>130</sup> a Philippine tax on the value of goods exported failed to qualify because not "imposed upon income or profits, either gross or net. . ."<sup>131</sup> So, too, did a tax imposed under the Cuban Gross Receipts and Sales Tax Law, because it was not levied upon net profits.<sup>132</sup>

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127. *Supra* note 113.

128. I.T. 2499, VIII-2 CUM. BULL. 325 (1929).

129. G.C.M. 8478, IX-2 CUM. BULL. 224 (1930); Eittington-Schild, 21 B.T.A. 1163 (1931).

130. 34 B.T.A. 269 (1936).

131. *Id.* at 273.

132. I.T. 3249, 1940-2 CUM. BULL. 136.

The contours of the credit for income taxes are by now familiar enough. It is a curiosity of the area that few decisions wrestle with the minutiae of permissible deductions, making that the determinant of creditability. This indicates either a basic similarity between net taxes the world over (or at least where U.S. taxpayers have found their way), or a lack of concern, among the courts and the Service, for conformity beyond the distinct notion of net gain which appears in the many decisions on taxes which get at that gain indirectly. It would be inconsistent to demand a greater conformity with United States concepts from direct taxes on net gain than from those which are credited despite their approximations of that gain. The fact remains that the main efforts of the decision-making bodies have been directed toward analyzing those taxes which get at the net gain by some route other than the obvious.

### III. *Purpose*

Even a tax levied directly upon net income could, presumably, be levied for a purpose other than the raising of revenue, and so fail to satisfy the purpose requirement generally accepted as necessary for credit under § 901. For example, this country has seen the imposition of domestic taxes, such as those on child labor and the processing of food products,<sup>133</sup> which, though computed upon net income and levied as income taxes, were held to be an unconstitutional exercise of power by the Federal Government. But here the question is not a constitutional one, and if the evil at which the tax credit is aimed is double taxation, the evil exists quite independently of the motive of the taxing power. Only one case has involved the denial of credit wholly on the

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133. *Bailey v. Drexel Furniture*, 259 U.S. 20 (1922), concerned the Child Labor Tax Law and declared it unconstitutional even though the tax was levied upon net income. *United States v. Butler*, 297 U.S. 1 (1936), declared unconstitutional a processing tax computed upon the difference between farm and exchange values of farm products. The Court declared that, "the tax can only be sustained by ignoring the avowed purpose and operation of the act and holding it a measure merely laying an excise upon processors to raise revenue for the support of government." 297 U.S. at 58. For further judicial examination of the problems of motive in tax legislation, see *United States v. Kahriger*, 345 U.S. 22 (1953); *United States v. Sanchez*, 340 U.S. 42 (1950); *Sonzinsky v. United States*, 300 U.S. 506 (1937); *United States v. Constantine*, 296 U.S. 287 (1935); *Nigro v. United States*, 276 U.S. 332 (1928); *Hill v. Wallace*, 259 U.S. 44 (1922); *McCray v. United States*, 195 U.S. 27 (1904); *Veazie Bank v. Fenno*, 75 U.S. (8 Wall.) 533 (1869).

grounds of purpose,<sup>134</sup> so that the point need not be labored. There have, however, been other suggestions that certain purposes (already discussed in the context of methods of computation) would suffice to disqualify a tax levied on net gains. It may not be too much to say that the method of computation gives rise to a presumption as to purpose, but the decisions on point show the ways in which any such presumption may be rebutted.

The first case on point was *Havana Electric Railway* which involved public utilities in Cuba, owned by the U.S. taxpayer.<sup>135</sup> The taxpayer succeeded in persuading the Board of Tax Appeals that the tax levied on his net income was not a franchise tax, but the Board explicitly recognized the possibility that such a tax would fail to qualify, however computed. There is a similar suggestion in the *Keasbey & Mattison* case, already discussed,<sup>136</sup> in which credit was actually denied because the levy was not upon net income. The court went on to give as a second ground the fact that this was not an income, but an excise tax. To what extent the second holding was independent of the first is not clear. The *American Metal* case was another<sup>137</sup> to discuss the hallmarks of a privilege tax in such a way as to imply that they could be fatal to creditability however the tax was assessed. Two cases concerned with the creditability of Canadian taxes levied on insurance premiums, irrespective of gain, denied credit on that basis, but in each there was specific mention of the purpose of the tax as an independent criterion in qualifying for credit.<sup>138</sup>

The only case to meet the issue head on, by disqualifying a net income tax precisely because of the purpose of the levy, was *New York and Honduras Rosaria Mining Company v. Commissioner*,<sup>139</sup> which is discussed further in the context of § 903,

134. *New York and Honduras Rosaria Mining Co. v. Commissioner*, 168 F.2d 745 (2d Cir. 1948) *rev'd* 8 T.C. 1232 (1947).

135. *Havana Electric Railway, Light & Power Co.*, 34 B.T.A. 782 (1936), *rev'd on rehearing*, 29 B.T.A. 1151 (1934).

136. 133 F.2d 894.

137. 221 F.2d 134.

138. I.T. 3211, 1938-2 CUM. BULL. 177; 40 B.T.A. 540 (1939); I.T. 3138, 1937-2 CUM. BULL. 230. For a more detailed discussion of the same tax, see *St. Paul Fire & Marine Insurance Co. v. Reynolds*, 44 F. Supp. 863 (D. Minn. 1942).

139. 168 F.2d 745.



below. So, too, is a recent decision concerning taxes on insurance premiums which may cast doubt on the last two cases discussed.

In *New York and Honduras*, the Tax Court (ultimately reversed by the Court of Appeals for the Second Circuit) held that, notwithstanding that this tax was on a net income base, it was a privilege tax, and so was not within the purview of the credit provisions. This was a rare species of tax indeed: having succeeded in meeting the most rigorous requirements of the credit, it failed on the issue of purpose. The court listed five factors which marked the tax as a privilege tax. Honduras had no general income tax law; the government owned the mines and permitted exploitation only on certain conditions, which included payment of this tax; payment was consideration for the right to mine under a contract between government and taxpayer; there was no uniformity of tax rate between different mines and, finally, forfeiture of a mandatory advance payment would result from suspension of mining operations. All these spelled "franchise" or "privilege" to the Tax Court, but not to the Court of Appeals, which focused on the absence of a forfeiture-of-mining rights provision found in other Honduras taxes, as well as the computation, on "liquid profits," which satisfied United States notions of net income. The court went on to say of the non-refundable advance payment: "but the taxpayer has not stopped operations."<sup>140</sup> It was this last factor, the non-refundable advance payment, which surely marks the tax as something other than an income tax. The court's inability to deal intelligently with the Commissioner's argument, that non-refundability of the advance payment marked this as something other than an income tax, highlights the weakness of elevating "purpose" over "result" in determining creditability. Even the particular purpose of the tax, when applied to this taxpayer, cannot give as good a guide to the central question of double taxation as an inquiry as to the actual effect of the tax. Any inquiry as to purpose is best avoided. In practice, the search is often fruitless and, in any event, the factor is irrelevant to the mischief at which the tax credit is supposed to be directed.

In conclusion, it seems safe to say that here, as elsewhere in the area, it is the method of computation which almost always governs. This is the one consistent feature of virtually all the decisions discussed in this paper.

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140. *Id.* at 749.

#### IV. *Taxes in Lieu of Income Taxes*

Taxes credited under § 903, as taxes in lieu of income taxes, remain to be discussed. It should be said at the outset that the statutory language, and I.R.S. Regulation § 1.903-1, have combined to limit the effect of this provision to what might be called a *Seatrains* situation, and little more. That case resulted in credit under § 131 (predecessor to § 901) and was decided shortly before the "in lieu" credit was enacted in 1942.<sup>141</sup> The statutory language of § 903 states that for the purposes of the credit under § 901:

the term "income, war profits and excess profits taxes" shall include a tax paid in lieu of a tax on income, war profits, or excess profits otherwise generally imposed by any foreign country or by any possession of the United States.

The most important limitation contained in that language, though sometimes erroneously attributed to the Service's interpretation,<sup>142</sup> is the phrase "otherwise generally imposed. . . ." Without that, the provision could have been applied to any tax which, by any route, resulted in a levy upon that wealth which would have been reached by an income, etc., tax. The requirement that a generally applicable tax exist in the country in question has raised a few problems over the exact nature of that tax, in relation to credit under § 903,<sup>143</sup> but these need not concern us.

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141. *Seatrains* was decided in May, 1942. The "in lieu" provision became § 158(f) of the Revenue Act of 1942, effective January 1, 1942.

142. See letters of Senator Walter F. George, former Chairman of the Senate Finance Committee, to the Secretary and Undersecretary of the Treasury, dated May 29, 1952 and August 10, 1954. [1956] 3 Std. Fed. Tax Rep. (CCH) ¶ 4312; see [1977] 6 Std. Fed. Tax Rep. (CCH) ¶ 4312.

143. See particularly *Compania Embotelladora Coca-Cola S.A. v. United States*, 139 F. Supp. 953 (Ct. Cl. 1956). In this case, under an income tax statute of general application, the government of Cuba levied a tax on the net profits of the taxpayer. These were paid and credited against domestic tax liability under § 131(a) [now § 901]. The Commissioner argued that this barred the taxpayer from crediting under § 131(h) [now § 903], as a tax paid "in lieu of" an income tax, a production tax levied on the manufacture, sale or consumption of, among other things, soft drinks. Prior to the promulgation of the general income tax law in 1941, payment of the production tax exempted any taxpayer from the Cuban profits tax. This was a tax on the profits of corporations and was Cuba's first income tax of general application. In the instant case, the Government conceded that this exemption qualified the production tax as a tax "in lieu of" an income tax under [§ 903] prior to the introduction of a general income tax from which this taxpayer was not exempt. Once that was introduced, ran the argument, the production tax could no longer qualify as a tax "in lieu" because the new tax was, in effect, a substitute for the older and less general tax

Regulation § 1.903-1 further restricted the "in lieu" provision; its three requirements deserve brief mention. First, there must be "in force a general income tax law"; this mirrors the statutory requirement, save that there is no mention of war profits and excess profits taxes. Second, but for a specific provision applicable to him, the taxpayer must be subject to that generally applicable income tax. This has been interpreted to include the "in lieu" tax as such a specific provision, even where not expressly stated.<sup>144</sup> Third, the tax for which credit is sought must be in lieu of, not in addition to, a generally applicable tax. Certain taxes have been denied credit because supplementary<sup>145</sup> and in the *American Metal* case,<sup>146</sup> the unsuccessful argument was that the tax was there partially in lieu of income tax.

The example given by the Service in Regulation § 1.903-1 is of a gross tax levied in lieu of a net tax because:

The ascertainment of taxable income, though not the determination of gross income, . . . is found administratively difficult.

It has already been noted that this does not go beyond the *Seatrains* decision, that the Service has never acquiesced in that decision, and that the identical Cuban tax was later credited under the "in lieu" provision.<sup>147</sup>

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from which the taxpayer was exempt. The Court of Claims rejected this contention holding, for the taxpayer, that because the production tax continued to provide exemption from the profits tax (which would otherwise be levied in addition to the newer income tax, both being creditable) it continued to be creditable under [§ 903].

144. *E.g.*, in *Northwestern Mutual Fire Association v. Commissioner*, 181 F.2d 133 (9th Cir. 1950), *rev'g* 12 T.C. 498 (1949), the court held creditable a Canadian tax on insurance companies which was older than that country's income tax. The fact that the Canadian tax upon gross income or upon net premium income was substantially the same as that imposed by the United States was thought crucial, as was the fact that, older though it may be, the Canadian insurance tax seemed to explain why insurance companies were not also subject to a general income tax. There was no specific exemption.

145. *E.g.*, *Lanman & Kemp-Barclay & Co.*, 26 T.C. 582 (1956); *Abbott Laboratories International Co. v. United States*, 160 F. Supp. 321, 331 (1958); *Guantanamo & Western Railroad Co.*, 31 T.C. 842, 857 (1959); Rev. Rul. 70-464, 1970-2 CUM. BULL. 152; Rev. Rul. 70-21, 1970-1 CUM. BULL. 158; Rev. Rul. 68-318, 1968-1 CUM. BULL. 342; Rev. Rul. 58-3, 1958-1 CUM. BULL. 263; Rev. Rul. 57-62, 1957-1 CUM. BULL. 241; Rev. Rul. 56-658, 1956-2 CUM. BULL. 501.

146. 221 F.2d 134.

147. I.T. 3903, 1948-1 CUM. BULL. 70.

The most important effect of the Regulation has been to tie the category of qualifying taxes closely to that category which qualifies under the "true" income tax provision of § 901. The few cases under § 903<sup>148</sup> suggest that the requirement that the taxpayer be otherwise subject to the generally-imposed tax is responsible for this close tie. The exception for creditability of taxes other than those directly upon income is, in other words, limited to those taxes resulting from exceptions made by the taxing country. The resulting category is a small one. It requires a relationship to profits much the same as that required under the main credit provision. The result is that the concept of "income" is not broadened at all. Indeed, given the possibility that the *Seatrains* decision marked the beginning of a trend toward liberalizing the application of the main provision (a trend interrupted by the enactment of the "in lieu" credit), it may be that the enactment has had virtually no effect.

The most explicit judicial suggestion that this limited effect does not comport with congressional intention is *Northwestern Mutual Fire Association*, a case concerning a Canadian tax on the premium income of insurance companies. The particular tax in issue was held to qualify under the "in lieu" credit, even though it would not have qualified under the main provision for "true" income taxes.<sup>149</sup> To the extent that this indicates a real extension of the credit, it is an unusual case; indeed the court explicitly rejected the Service's contention that a direct relationship to profits was required.<sup>150</sup>

In 1973, the select group of taxes qualifying as taxes in lieu of income taxes was increased by one when a Greek tax on public

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148. OWENS, *supra* note 13, at 72-83.

149. The in lieu tax was computed as a percentage of the net premium received by the insurance companies. "Net premium" allowed deductions from gross premium for rebates and cancellation refunds, but not for any of the attendant expenses of doing business. 44 F. Supp. at 865. It would not therefore have qualified as a foreign income tax under the "designed to reach net gain" requirement, set forth in *Bank of America*. See text accompanying note 86, *supra*.

150. 181 F.2d at 135. There is considerable authority contrary to *Northwestern Mutual Fire Association*, denying credit for the Canadian tax on premium income, either because the companies involved were not otherwise subject to the generally applicable income tax, or because the Canadian tax pre-dated the general income tax and so could not be said to be in lieu of it. This trend was reversed in a 1972 ruling, revoking several earlier rulings, in which no reason was given for the about-turn. This may have ended a long-standing problem for American insurers operating in Canada. Rev. Rul. 72-84, 1972-1 CUM. BULL. 216.

works contractors, offered as an option to a direct income tax and very much of the administrative-convenience type, was held to be creditable.<sup>151</sup>

The *New York & Honduras Mining Company* case<sup>152</sup> raises a problem concerning the "in lieu" credit which may be of more academic than practical import. There, the tax qualified for credit as an income tax partly because the contract between the taxpayer and the government, made under a general income tax statute, satisfied certain of the creditability requirements lacking in the statute itself. This was the computation upon "liquid profits," which term was defined in the contract, but not in the statute. This curious aspect of the case, which has not attracted attention, appears to raise the question: If definitional requirements of the income tax credit may be satisfied by a specific contractual agreement, even though absent from the statute itself, would a tax levied in lieu of that tax satisfy the "in lieu" credit requirement that there be a generally applicable income tax?

In other words, if Honduras had levied a different tax on certain of the mining company's operations, specifically in lieu of that tax which qualified for credit, and specifically on the grounds of administrative convenience, would it have qualified for credit as a tax in lieu of an income tax? It could not properly be argued that the agreement between taxpayer and government was the "specific provision" but for which the taxpayer would have been subject to the general income tax, for it was precisely this provision which qualified that tax as an income tax for credit purposes. Probably, given the application of § 903 already discussed, such a tax would not qualify for credit, even though the one for which it was a substitute had done so. While of no great practical importance, this peculiarity may highlight an inadequacy of the application of the "in lieu" credit, in relation to its purpose. It may suggest that the *New York & Honduras Mining Company* case was wrongly decided.

### V. Conclusion

The general difficulty encountered in applying the foreign tax credit has been the reconciliation of the general with the particular, the purpose with the provision designed to effect it. The statutory provision is particular insofar as it specifies "income"

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151. Rev. Rul. 73-588, 1973-2 CUM. BULL. 268.

152. 168 F.2d 745.

taxes, but it lacks the particularity which would result from an accompanying definition. The purpose of the credit provision is more general, and this dissonance between the policy and its instrument has resulted in an understandable reluctance, in the Service and the courts, to put the language of the statute alongside the known purpose of its drafter. The accepted purpose of the credit provision is the mitigation of double taxation — an imprecise concept which is best left to economists. The decisions make no more than passing reference to the “well-known” purpose of the credit, a concession to form, but a minimal aid to construction.

In short, the way in which the credit for foreign income taxes has been applied is a fair reflection of the tension between the limited certainty of the language and the uncertain confines of the purpose behind it. Those taxes which have been levied upon wealth certain to include net gain have generally been credited; those which indicate an understanding of wealth quite different from that reflected in the United States understanding of “income” have not. There has been no definition more certain than that. If the resulting achievement is haphazard and inconsistent, the fault is not in the tribunals which have struggled with the problem. It is the necessary consequence of a failure to state precisely the policy behind the credit.