

FOREIGN TAX CREDIT FOR INCOME TAX PAID WITH RESPECT TO ROYALTIES, ETC.

JULY 25 (legislative day, JULY 16), 1956.—Ordered to be printed

Mr. FREAR, from the Committee on Finance, submitted the following

R E P O R T

[To accompany H. R. 7643]

The Committee on Finance, to whom was referred the bill (H. R. 7643) to amend the Internal Revenue Code of 1939 and the Internal Revenue Code of 1954 with respect to foreign tax credit for United Kingdom income paid with respect to royalties and other like amounts, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

PROVISIONS OF THE BILL

This bill, as reported, amends the foreign tax credit provisions in the Internal Revenue Code of 1939 and the Internal Revenue Code of 1954. It provides that a United States recipient of a royalty for the use of copyrights, patents, and other similar properties derived from sources within the United Kingdom is to be deemed for the purposes of the foreign tax credit to have paid any income, war profits, or excess-profits taxes paid to the United Kingdom by which such royalty was reduced if the recipient elects to include in its gross income the amount of the United Kingdom tax. The change made by your committee's bill, as amended, is to apply for all taxable years beginning on or after January 1, 1950.

REASONS FOR THE BILL

Under the tax laws of the United Kingdom, royalties and dividends paid by British corporations as advance payments of the shareholder's, or royalty recipient's tax. Recipients of such dividends or royalties who are subject to income tax by

the United Kingdom are taxed on the gross amount of the dividends or royalties and are considered to have paid the tax on the dividends or royalties previously collected from the corporate payor.

The supreme Court decision in *Biddle v. Commissioner*, (302 U. S. 573 (1938)), held that a United States shareholder receiving dividends from a British corporation was not considered to have paid the corporate taxes by which the dividends were reduced and, therefore, was not entitled to the foreign tax credit for such taxes. In the same manner the courts have not permitted a United States recipient of a royalty from a British corporation to take a foreign tax credit for the British taxes imposed upon the royalty payment. (See *Irving Air Chute Co. v. Commissioner*, 143 F. 2d 256 (CCA-2, 1944).)

To prevent double taxation a tax convention with the United Kingdom, for taxable years beginning on or after January 1, 1945, provides that British corporate taxes on dividends paid to United States shareholders are considered to have been paid by the shareholder. This overcomes the effect of the Biddle decision and allows a foreign tax credit for the taxes paid. (See subdivision (1) of art. XIII of the Income Tax Convention with the United Kingdom and Great Britain and Northern Ireland.) Under this same tax convention (subdivision (2) of art. VIII), royalties paid by a British corporation to a United States recipient are not subject to the British corporate tax unless the recipient has a permanent business establishment in the United Kingdom. This also was provided to prevent double taxation.

Both the tax-credit approach for dividends and the exemption approach for royalties which are provided under the income-tax convention accord the same relief from the application of the Biddle decision since the British corporate tax rate is less or equal to the United States corporate tax rate. Presently, the United Kingdom imposes a 42.5-percent corporate tax which is eligible for credit, and the United States imposes a 52-percent corporate tax.

In either situation the United States taxpayer has the same amount left after taxes. In the case of a dividend recipient, the full dividend is reported and a foreign tax credit (42.5 percent) for the British taxes paid is allowed as a credit against the United States tax liability (52 percent). In the case of a royalty recipient, the full amount is reported since the royalty is not subject to British taxes under the convention and a 52-percent United States corporate tax is paid.

However, where a United States royalty recipient has a permanent business establishment in the United Kingdom, no relief from double taxation is available under the existing income-tax convention. In this case the royalties are reduced by British corporate taxes and the royalty recipient is not entitled to a foreign tax credit as a result of the Biddle and Irving Air Chute Co. decisions.

This bill would give United States royalty recipients who have permanent business establishments in the United

Kingdom the same relief accorded to dividend recipients under the income-tax convention which is as near to the treatment provided for other royalties as it is possible to provide without reopening the present tax convention with the United Kingdom.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italic; existing law in which no change is proposed is shown in roman):

SECTION 131 (e) OF THE INTERNAL REVENUE CODE OF 1939

SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

(a) ALLOWANCE OF CREDIT.— * * *

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(e) **PROOF OF CREDITS.**—The credits provided in this section shall be allowed only if the taxpayer establishes to the satisfaction of the Commissioner (1) the total amount of income derived from sources without the United States, determined as provided in section 119, (2) the amount of income derived from each country, the tax paid or accrued to which is claimed as a credit under this section, such amount to be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary, and (3) all other information necessary for the verification and computation of such credits. *For the purposes of this section, the recipient of a royalty or other amount paid as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulas, trademarks, and other like property, and derived from sources within the United Kingdom of Great Britain and Northern Ireland, shall be deemed to have paid any income, war-profits, and excess-profits taxes paid to the United Kingdom with respect to such royalty or other amount (including the amount by which the payor's United Kingdom tax was increased by inability to deduct such royalty or other amount) if such recipient elects to include in its gross income the amount of such United Kingdom tax.*

SECTION 905 (b) OF THE INTERNAL REVENUE CODE OF 1954]

SEC. 905. APPLICABLE RULES.

(a) YEAR IN WHICH CREDIT TAKEN.—* * *

(b) **PROOF OF CREDITS.**—The credits provided in this subpart shall be allowed only if the taxpayer establishes to the satisfaction of the Secretary or his delegate—

(1) the total amount of income derived from sources without the United States, determined as provided in part I,

(2) the amount of income derived from each country, the tax paid or accrued to which is claimed as a credit under this subpart, such amount to be determined under regulations prescribed by the Secretary or his delegate, and

(3) all other information necessary for the verification and computation of such credits.

For the purposes of this subpart, the recipient of a royalty or other amount paid as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulas, trademarks, and other like property, and derived from sources within the United Kingdom of Great Britain and Northern Ireland, shall be deemed to have paid any income, war-profits and excess-profits taxes paid to the United Kingdom with respect to such royalty or other amount (including the amount by which the payor's United Kingdom tax was increased by inability to deduct such royalty or other amount) if such recipient elects to include in its taxable income the amount of such United Kingdom tax.

