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UNITED STATES INTERNATIONAL TAXATION: JURISDICTION TO TAX AND ACCOMMODATION AMONG COMPETING TAX SYSTEMS

*by Louis L. Ceruzzi**

The United States purports to have jurisdiction to impose a tax upon income earned within its borders by all persons, corporations, partnerships, associations, or other profit-making entities, regardless of their situs or nation of citizenship.[1] Furthermore, the United States purports to have jurisdiction to levy a tax upon the world-wide income of all United States citizens, residents, and corporations.

Similarly, other nations in the international community assert jurisdiction to tax the world-wide income of their citizens, residents, and corporations, and/or income earned by foreigners within their national boundaries. Thus, international taxation parallels other areas of the law in which potential conflicts exist due to overlapping jurisdictions.[2] However, the dilemma of overlapping tax jurisdictions may be more acute as the jurisdictional conflicts are between governments of nation-states, and may well affect the volume and channels of international business.[3]

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1. U.S. CONST. art. I, § 8, cl. 1; *Id.*, amend. XVI; I.R.C. §§ 1, 861, 871(b), 877(b). It should be noted that the Internal Revenue Code creates exemptions from the United States income tax for certain religious, charitable and educational institutions.

2. J. BISCHELL & R. FEINSCHRIEBER, FUNDAMENTALS OF INTERNATIONAL TAXATION, 5 (1977) (hereinafter cited as BISCHELL).

3. H. STEINER & D. VAGTS, TRANSNATIONAL LEGAL PROBLEMS, 1119 (1976) (hereinafter cited as STEINER).

This paper endeavors to present a study of the jurisdictional bases of the United States taxation of transnational income. Additionally, it will examine the problems that arise when a taxpayer, or his income, is connected with two or more sovereign states; each of which asserts jurisdiction to levy a tax. For example, a corporation may be owned by citizens or residents of Country A; be incorporated in Country B; carry on manufacturing operations in Country C; and, make sales in Country D; thus providing A, B, C, and D with a jurisdictional nexus to support a tax.

Finally, this paper will examine various methods of accommodation and reconciliation between the competing claims of overlapping national tax jurisdictions.

The various tax systems of nation-states in the international community may be classified as either global (i.e., the Anglo-Saxon or unitary system) or schedular (the Continental system) depending upon the principles stressed by the nation in ascertaining what constitutes that minimum connection which will warrant the exercise of jurisdiction to tax.[4]

The global system, found primarily in the industrialized capital exporting nations of the United States, Western Europe and Japan, stresses the status of the taxpayer as the jurisdictional connection. If the taxpayer is found to be a citizen or a resident of the country, he is subject to a tax on his global income, (i.e., income from both foreign and domestic sources). In general, all types of income are taxed at the same rates.[5]

The schedular system stresses the source of the income as the jurisdictional connection, and the tax is imposed by virtue of economic activities within the nation-state. Schedular systems differentiate between different types of income. To illustrate, such a system might tax wages at one rate, dividends at another, and business profits at a third.[6]

The United States system of taxation, although principally classified as global, does employ some of the attributes of the schedular income tax systems. For example, the Internal Revenue Code differentiates between earned and passive income, and it provides special treatment for capital gains, sale of a residence, proceeds of life insurance, and so on. Furthermore, the United States employs

4. Norr, *Jurisdiction to Tax and International Income*, 17 TAX L. REV. 431, 433-35 (1962) (hereinafter cited as Norr).

5. *Id.*

6. *Id.* at 434.

the schedular system's territorial rule of source jurisdiction together with the global system's jurisdictional connection of the status of the taxpayer. Each of these alone, the source of the income or the status of the taxpayer, is sufficient to support the tax.[7] To illustrate, if a foreign individual or corporation earns income within the United States, such income will be subject to the United States tax because of its source.[8] Alternatively, if a United States citizen or corporation receives income from either a domestic or foreign source, such income is subject to the tax because of the taxpayer's status as a citizen of the United States.[9] Similarly, a resident alien of the United States is subject to United States taxation of his world-wide income due to his status as a United States resident.[10]

The concept of source jurisdiction is analogous to the common law concept of in rem jurisdiction in that jurisdiction to tax is asserted because the income is generated, or the property is located, within the territorial boundaries of the nation-state. The rationale for imposing a tax upon 'source income' is that the source nation provides the community of economic life which makes possible the production of the income.[11]

United States law relies upon source basis jurisdiction to tax nonresident aliens and foreign corporations on their income derived from sources within the United States.[12] Treasury Regulation Section 1.871-1 (a) states:

> Nonresident alien individuals are taxable only on certain income from sources within the United States and on income described in Section 864 (c) (4) from sources without the United States which is effectively connected for the taxable year with the conduct of a trade or business within the United States.

The principle of source of income jurisdiction was upheld by the Supreme Court in the case of *DeGanay v. Lederer*.[13] DeGanay

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7. BISCHELL, *supra* note 2, at 6.

8. I.R.C. §§ 861, 871(b), 877(b).

9. *Id.* § 1; Treas. Reg. § 1.1-1(a).

10. *Id.*

11. *See* Owens, *International Aspects of Income Taxation in the United States*, in WORLD TAX SERIES, TAXATION IN THE UNITED STATES (1963) (hereinafter cited as Owens).

12. I.R.C. §§ 872(a), 882(b).

13. 250 U.S. 376 (1919).

a French citizen and resident, owned stocks and bonds issued by United States corporations and mortgages secured by properties within the United States. The securities were held for DeGanay by her United States agent, who was empowered to deal with the property and reinvest the proceeds as he might deem best, and to remit the net income to DeGanay in France. The Supreme Court first determined that securities per se are property and are therefore encompassed within the meaning of the statutory language.[14]

The applicable statute was c. 16, Section II, A, subdiv. 1 of the Income Tax Law of October 3, 1913, which provided that:

> There shall be levied . . . a tax . . . annually . . . upon the entire net income from all property owned and of every business, trade, or profession carried on in the United States by persons residing elsewhere.

The Justices rejected the argument that the maxim *mobila sequuntor personam* applied and found that the situs of the property and the generation of the income was within the United States. The Court held that Congress had the power to tax income arising from sources within the United States regardless of the residency or nation of citizenship of the recipient.

The question of the power of the United States to lay an estate tax on property[15] owned by a nonresident alien[16] and located within the United States was adjudicated by the Supreme Court in *Burnet v. Brooks.*[17] The Court noted that as a sovereign nation, the

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14. *Id.* at 381. "To the general understanding and with the common meaning usually attached to such descriptive terms, bonds, mortgages, and certificates of stock are regarded as property. By state and federal statutes they are often treated as property, not as mere evidences of the interest which they represent. . . . We have no doubt that the securities, herein involved, are property."

15. The property here consisted of bonds (of foreign corporations and governments, domestic corporations and a domestic municipality, and accrued interest) plus stock (in a foreign corporation) and cash.

16. Here, a subject of Great Britain and a resident of Cuba.

17. 288 U.S. 378 (1933). Two questions were certified: (1) whether the property is covered by the relevant statutory provisions and (2) whether, if construed to be applicable, those provisions are valid under the Fifth Amendment of the Federal Constitution. The Court first determined that both the legislative intent and logical deduction required that the property in question be covered by the statutory provisions. 288 U.S. at 388-95. It then concluded that there was no constitutional ground upon which to attack the federal government's right to tax.

United States is vested with all of those powers necessary to conduct and maintain international relations.[18]

> So far as our relation to other nations is concerned, and apart from any self-imposed constitutional restriction, we cannot fail to regard the property in question as being *within the jurisdiction* of the United States, that is, it was property within the reach of the power which the United States by virtue of its sovereignty could exercise as against other nations and their subjects without violating any established principle of international law.[19]

The Court reviewed the sovereign taxing powers as exerted by Great Britain in the exercise of jurisdiction based on situs of property, and found it to be in accord with that exerted by the United States.[20] The Court held that:

> We determine national power in relation to other countries and their subjects by applying the principles of jurisdiction recognized in international relations. Applying those principles we cannot doubt that the Congress had the power to enact the statute . . .[21]

Rather than denigrate or deny the sovereign taxing power, the Court recommended a concept just then coming into widespread use: international committee decisions.[22]

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18. The Court placed particular reliance upon a prior case, United States v. Bennet, 232 U.S. 299 (1914), wherein it had clearly distinguished the federal tax authority from the states'. The power of the states to tax derives from their constitutional authority to tax; the due process rule is applied to the states' power of taxation precisely because it both enforces and protects their spheres of activity. The Court cannot so apply the due process rule to the federal government since the taxing power of that government is part of the national sovereignty which the Constitution has not regulated.

19. Burnet v. Brooks, 288 U.S. 378, 396 (1933).

20. *E.g.*, Winans v. Attorney-General [1910] A.C. 27: "Being physically situated in England at the time of their owner's death (who was both a citizen of, and domiciled in the United States) [his securities] were subject to English law and the jurisdiction of the English courts, and taxes might therefore *prima facie* be leviable upon them."

21. *Id.* at 405-06.

22. *Id.* at 399-400.

> For many years this subject has been under consideration by international committees of experts, and drafts of conventions have been proposed, the advantages of which lie in the mutual concessions

The concept of jurisdiction based upon the status of a taxpayer is analogous to the common law concept of in personam jurisdiction in that the nation state asserts jurisdiction to tax because the individual or corporation is a resident or citizen of the taxing sovereign.[23]

The United States purports to have world-wide tax jurisdiction over its citizens no matter where they reside.

> In general, all citizens of the United States, wherever resident, and all resident alien individuals are liable for the income taxes imposed by the Code whether the income is received from sources within or without the United States.[24]

The Supreme Court has held that the taxing power of the federal government in its sovereign capacity is not confined to the geographical boundaries of the United States. The power may be employed to tax a United States citizen or corporation even though they be outside of the territorial limits of the United States.[25]

Although citizens of the United States may be domiciled in a foreign nation, the United States considers taxation of their income to be a matter of domestic law. The Supreme Court has held that:

> International law is a part of our law and as such it is the law of all States of the Union (*The Paquete Habana*, 175 U.S. 677, 700), but is is a part of our law for the application of its own principles, and these are concerned with international rights and duties and not with domestic rights and duties, . . . the United States is not debarred by any rule of international law from governing the conduct of its own citizens upon the high seas or even in foreign countries when the rights of other nations or their nationals are not infringed. With respect to such exercise of authority there is no question of international law, but solely the purport of municipal law which establishes the duty of the citizen in relation to his own government.[26]

> or reciprocal restrictions to be voluntarily made or accepted by Powers freely negotiating on the basis of recognized principles of jurisdiction. . . . The United States is as competent as other nations to enter into such negotiations.

23. BISCHELL, *supra* note 2, at 6.
24. Treas. Reg. § 1.1-1(b).
25. United States v. Bennett, 232 U.S. 299, 307 (1914).
26. Skiriotes v. Florida, 313 U.S. 69, 72-73 (1941).

The case of *Cook v. Tait*,[27] presented the Supreme Court with the question of whether the United States had the power to impose an income tax upon a United States citizen who at the time the income was earned was permanently resident and domiciled in Mexico, and whose income was derived from real and personal property located in Mexico. Cook contended that Congress was without power to lay the tax as both he and his income-producing property were without the territorial jurisdiction of the United States. He put forth the argument that when a citizen and his property are outside the territorial boundaries of the United States, such citizen derives no benefit from the United States, and hence, should not be subject to United States taxation. The Court held that:

> [T]he government, by its very nature, benefits the citizen and his property wherever found and, therefore, has the power to make the benefit complete . . . [t]he basis of the power to tax was not and cannot be made dependent upon the situs of the property in all cases, it being in or out of the United States, and was not and cannot be made dependent upon the domicile of the citizen, that being in or out of the United States, but upon his relation as citizen to the United States and the relation of the latter to him as citizen. The consequence of the relations is that the native citizen who is taxed may have domicile, and the property from which his income is derived may have situs, in a foreign country and the tax be legal—the government having power to impose the tax.[28]

United States law also uses residence as a basis for the imposition of taxes. The Internal Revenue Code subjects the world-wide income of resident aliens to United States tax in the same manner as United States citizens.[29] An alien's status as a resident or nonresident of the United States is determinative of the type and amount of income that will be subject to United States taxation.[30] (The resident alien is taxed on his world-wide income, and the nonresident

27. 245 U.S. 47 (1924).

28. *Id.* at 56.

29. I.R.C. § 1; Treas. Reg. § 1.1-1(a).

30. For a discussion of the factors relevant in determining whether or not a taxpayer is a resident *see:* Josette J. F. Verrier Friedman, 37 T.C. 539 (1961); Joyce de la Begassiere, 31 T.C. 1031 (1959), *aff'd per curium*, 272 F.2d 709 (5th Cir. 1959).

alien is taxed only on his income from United States sources.) Accordingly, this has been an area fraught with much litigation.[31]

It should be noted that for purposes of United States tax law a determination that an individual is a resident of a foreign country does not preclude the United States from finding the same individual to be a resident of the United States. When Ingemar Johansson fought a series of world championship boxing matches with Floyd Patterson in the United States, he relied upon a determination by the Swiss tax authorities that he was a resident of Switzerland and within the purview of a United States-Switzerland tax treaty that exempted the United States source earnings of Swiss residents from United States taxation. However, the Fifth Circuit Court of Appeals found that for United States tax purposes Johansson was not a Swiss resident, and held that, "[w]e are not bound by the determination of the Swiss tax authorities."[32]

The question of the power to lay a tax on the income of a resident alien was litigated in the case of *Commissioner v. Nubar.*[33] The case concerned an alien of Egyptian nationality and French residence who came to the United States in order to visit relatives and attend the New York Worlds Fair. He was admitted on a three month visa, and desired to return to France after the visa expired; however, the outbreak of World War II made this impossible. During his stay in the United States, the taxpayer derived a considerable amount of income from speculation in securities and commodities. He claimed he was a nonresident alien as he did not intend to make the United States his domicile; in fact, he was precluded from returning to his European domicile due to circumstances brought about by the war. The court said that domicile was not a requisite for bringing the taxpayer within the taxing jurisdiction of the United States. The Congress used the word residence, not domicile, when it promulgated the statute and therefore, the critical issue was whether the taxpayer was a resident of the United States at the time the income-producing activities took place.[34] The court found that he was, noting that domicile requires the bodily presence of the person within the national boundaries and the person's intent to remain therein, while residence requires only the bodily presence of the person within the

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31. S. ROBERTS & W. WARREN, UNITED STATES TAXATION OF FOREIGN CORPORATIONS AND NON RESIDENT ALIENS, iv-11, (1966).

32. Johansson v. United States, 336 F.2d 809, 812 (5th Cir. 1964).

33. 185 F.2d 584 (4th Cir.), *cert. denied*, 341 U.S. 925 (1950).

34. *Id.* at 586-88.

national boundaries.[35] Therefore, as a resident of the United States, the taxpayer was subject to the United States income tax.

The Court justified the imposition of the tax on a benefit theory of taxation. The Court said:

> It was never intended that persons who were present in the country for long periods of time and had taken advantage of its facilities for the purpose of carrying on business, should be exempted from taxation of income derived from sources within the country merely because they were aliens.[36]

The United States applies similar principles of status and source jurisdiction to the taxation of corporations.[37] Domestic corporations, those created or organized in the United States under federal or state law, are taxed on their world-wide income.[38] All other corporations are deemed foreign corporations, and are taxed only upon United States source income.[39] Thus, it is the place of incorporation that is decisive in determining whether the corporation is taxable on its world-wide income or on only its United States source income.[40]

It is noteworthy that the United States is one of the few nations that employ the criterion of place of incorporation as a jurisdictional basis for taxation of a corporation's world-wide income. Most foreign systems classify as domestic only those corporations which have a seat or place of management within the country.[41] For example, the British system of taxation determines the status of a corporation according to the location of its chief seat of management, regardless of its place of incorporation.[42]

The foregoing analysis of United States international tax law has examined the various claims that the United States seeks to enforce against individuals or corporations that stand in certain relationships vis-à-vis the United States. The following may be extrapolated as the general pattern of United States taxation.

1) United States citizens, residents, and corporations,

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35. *Id.* at 587.
36. *Id.* at 586.
37. Owens, *supra* note 11, at 981.
38. I.R.C. § 7701(a)(4).
39. *Id.* § 7701(a)(5).
40. Owens, *supra* note 11, at 982.
41. STEINER, *supra* note 3, at 1092.
42. De Beers Consolidated Mines, Ltd. v. Howe, [1904-7] All E.R. Rep. 1256 (1906).

are taxed on their world-wide income regardless of the source of the income or the location of the taxpayer or his income-earning property.

2) Nonresident aliens and foreign corporations are taxed only on income derived from sources within the United States.

The United States employs its system of taxation to finance the operations of its government. Likewise, other nations in the international community employ systems of taxation to finance their operations. When two or more nations assert jurisdiction to tax the same taxpayer or corporation, international double taxation may arise.

Those observers who advocate the greatest free flow of ideas, persons, and wealth, across national boundaries find international double taxation to be charged with a strong degree of inequity.

> One should be able to live and move and distribute one's property over the world without being heavily penalized and without the necessity for constant vigilance to avoid the confiscatory pyramiding of taxes.[43]

Apart from the question of equity is the economic aspect of double taxation. Double taxation can be a severe detriment to global prosperity.

> World prosperity is promoted by enlarged world trade and capital movements, free from the restrictions which the . . . tax laws may impose. International double taxation discourages the growth of a world economy. The discouragement arises, not only from the taxes themselves, but also from uncertainty as to when they will be imposed.[44]

There are no rules of international law which exist to limit the extent of any country's tax jurisdiction.[45] Clearly, as there are no prescribed limits on the extent of a nation's tax jurisdiction, when taxpayers or their income, cross national boundaries, they will be subject to the tax jurisdictions of two or more sovereign states.

International double taxation may arise in four basic situations:

1) If a United States citizen, resident, or corporation, earns money in a foreign nation which taxes under source of income principles, the taxpayer will be subject to taxation by both the

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43. Blough, *Treaties to Eliminate International Double Taxation and Fiscal Evasion*, 5th N.Y.U. INSTITUTE ON FEDERAL TAXATION 208 (1947) (hereinafter cited as Blough).

44. *Id.* at 208-09.

45. Norr, *supra* note 4, at 439.

United States and the foreign nation.

2) If a non-resident alien earns income from sources within the United States and is a resident or citizen of a foreign nation that employs the principles of status jurisdiction, the alien will be taxed by both the United States and the foreign nation.

3) If the United States and a foreign nation both claim that the taxpayer is a resident of their country, the taxpayer will be subject to taxation by both the United States and the foreign nation.

4) If the United States and a foreign nation both claim that the income of a taxpayer (under their respective source of income rules) was derived from sources within their national boundaries, the taxpayer will be subject to taxation by both the United States and the foreign nation.

If the taxpayer looks to customary international law to seek relief from these jurisdictional conflicts he will find none.

> In most situations international law does not provide rules for a choice among the different bases of jurisdiction that international law recognizes. If a state has a basis of jurisdiction that is recognized under international law, it may generally exercise its jurisdiction even though another state may also have a recognized basis of jurisdiction.[46]

Fortunately, the nations of the international community have taken it upon themselves to alleviate the problems of international double taxation. As Norr observed "the necessities of commercial and fiscal co-existence and a decent self-restraint, often grounded in considerations of administrative convenience, have led the nations of the world to voluntarily limit the scope of their tax jurisdiction by both unilateral and bilateral actions."[47]

The extent of relief from international double taxation, and the methods of providing such relief will vary according to the nations' economic, political, and fiscal conditions. An examination of the voluntary measures taken by the United States follows.

Unilaterally, the United States provides taxpayers with two basic methods of relief from international double taxation; namely, the foreign tax credit, and tax deferral.

Section 901 (a) of the Internal Revenue Code allows a United States corporation a tax credit for the amount of income taxes paid

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46. RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 37, comment (a) (1965).

47. Norr, *supra* note 4, at 439.

or accrued during the taxable year to a foreign entity. The credit is available only for income taxes similar to those imposed by the United States tax system. This is a particularly important consideration for taxpayers planning investments in a country such as France, for example, which derives seventy percent of its tax revenue from non-income taxes, which are not eligible for the foreign tax credit.[48]

The creditability of many taxes has been litigated in the courts and ruled upon by the Internal Revenue Service. Noteworthy are the following:[49]

Country and Tax		*Qualifies*	*Does not qualify*
Britain			
Dividends; royalties		x	
Standard taxes			x
National Insurance Act	(paid by employee)	x	
	(paid by employer)		x
France			
Turnover tax			x
Germany (West)			
Turnover tax			x
Trade taxes; income; corporation		x	
Japan			
Local Tax Law, arts. 24(1) and 294(1)		x	
Local Tax Law, art. 52			x
Royalties (withholding)		x	
Saudi Arabia			
General tax		x	
Switzerland			
Canton of Vaud (direct and on net profits)		x	
National Defense Tax (except on capital and reserves)		x	
Taiwan			
Business tax			x

The foreign tax credit provides a substantial modification of the world-wide jurisdictional rule. Basically, in promulgating the credit, Congress reaffirmed its earlier decision to tax United States citizens,

48. STEINER, *supra* note 3, at 1087.

49. For a detailed examination of the foreign tax credit *see* Oliner & Ceruzzi, *An Introduction to the United States Foreign Tax Credits*, 17 TAXES INTERPRETED NO. 9 (Oct. 30, 1978).

residents, and corporations on their world-wide income; however, in order to alleviate the problems of double taxation, Congress gave primary effect to income taxes of source jurisdictions and considered United States tax claims met to the extent that a tax payment had been made to the country of source. This principle of the country of citizenship yielding to the tax jurisdiction of the source country has been recognized by the Organization for Economic Cooperation and Development and by the major industrial nations of the world.[50] This benefits the taxpayer at the expense of the United States Treasury; however, in all respsects, it appears to be an equitable principle because the protection and services of the nation where income-producing activity is taking place provide a greater benefit to the taxpayer than the esoteric benefit of citizenship espoused previously by the Supreme Court in *Cook v. Tait.*[51]

The policy embodied in the granting of the foreign tax credit is the promotion of neutrality between foreign and domestic source income of United States citizens, residents, and corporations. The United States employs a *global*, (as opposed to a *schedular*) system of income taxation which subjects all types of income to the same rates of taxation. In keeping with the policy of taxing income from all sources in a like manner, the foreign tax credit insures that a foreign-earned dollar will be taxed at the same rate as a United States-earned dollar. Furthermore, the credit, by allowing taxpayers to pay the same net tax on their foreign or domestic income, will theoretically provide the investor with an unbiased choice of investment forums, thus promoting the free flow of capital across national boundaries.

The second method of relief from double taxation provided to United States taxpayers is tax deferral. Foreign corporations, even if managed and controlled by United States citizens, are not subject to United States taxes unless they earn income within the geographical boundaries of the United States.[52]

In general, United States shareholders of foreign corporations are not subject to taxation on the foreign source income of such corporations until it is repatriated in dividends to the United States.[53]

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50. Surrey, *Current Issues in the Taxation of Corporate Foreign Investment*, 56 COLUM. L. REV. 815, 818 (1959).

51. 245 U.S. 47 (1924).

52. Jenks, *Taxation of Foreign Income*, 42 GEO. WASH. L. REV. 537, 550 (1974).

53. Owens, *supra*, note 11, at 1046. This statement must be qualified

Thus, double taxation is eliminated, as the foreign corporation will only be subject to the tax of the foreign jurisdiction.

Investing through the vehicle of foreign corporations, rather than simply foreign branches of United States corporations (which would be subject to United States tax due to their status as 'citizens' of the United States) gives a tax preference to the investor. As long as the corporation reinvests this income outside of the United States, the income is not subject to United States tax and is in effect a tax-free loan from the United States Treasury. Until repatriated, the foreign earnings can be reinvested, or even advanced as loans to the domestic parent or other United States shareholders; and when repatriation is desired, it may be possible to time the distributions so that the shareholders may take advantage of offsetting losses or low income years.[54] In fact, this income may be continually reinvested in foreign ventures, and if so, taxes to the United States may never be paid.

It is argued that tax deferral encourages the avoidance of taxes by multinational corporations. Because there will be no United States tax on foreign income unless repatriated, the corporations are encouraged to operate in nations with low effective rates of taxation.[55] By so doing, the corporations pay only the low foreign tax, and are at an advantage, tax-wise, vis-à-vis their purely domestic competitors.

The less developed countries are faced with a particularly serious problem. Since a crucial factor in determining whether or not to invest is the tax rate of the foreign host country, the less developed countries must engage in more or less of a bidding war in order to attract foreign investment. All other things being equal, the multinational corporations would rather pay a tax of ten percent than a tax of fifty. However, by keeping their tax rates low so as to attract foreign investment, the less developed countries are simultaneously constricting their ability to raise revenues.[56]

There are, of course, two sides to any argument. The advocates of tax deferral point out that although the less developed countries

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by I.R.C. §§ 951-72 which eliminate this deferral of taxation in certain situations by imposing a tax on the undistributed profits of certain controlled foreign corporations.

54. B. BITTKER & L. EBB, TAXATION OF FOREIGN INCOME, 251 (1960).

55. P. RICHMAN, TAXATION OF FOREIGN INVESTMENT INCOME, 51 (1963).

56. *See* P. MUSGRAVE, UNITED STATES TAXATION OF FOREIGN INVESTMENT INCOME 75-96 (1969).

are forced to keep their income tax rates low, the foreign investment that they attract is highly beneficial to the local economy and it serves to strengthen the infrastructures of the less developed countries. United States businessmen argue that without the multinational firms, the capital formation, employment opportunities, and marketing development created by the corporations would be absent. It is clear that many nations recognize the need to attract foreign capital and expertise. The government of Singapore, in addition to tax incentives, advertises the lack of strong unions and goes so far as to offer a strike holiday to attract transnational business.[57]

To be sure, the arguments regarding deferral of foreign taxes present important policy considerations which will have great influence upon the future of tax laws of the United States.

In addition to the unilateral measures of tax deferral and the foreign tax credit, the United States is presently a party to some twenty-four bilateral agreements known as tax treaties, or tax conventions. Because the subject matter of tax treaties is less general, and the methods of negotiation less formal, than friendship, commerce, or navigation treaties, tax treaties are usually referred to in diplomatic language as tax conventions. However, by whatever name they are called, tax conventions or treaties have the same force and authority as other treaties.[58]

Tax treaties are designed primarily to prevent the imposition of double taxation on a taxpayer whose person or income has connections with two or more sovereign states.

One may wonder why the United States does not seek to achieve its goals of tax neutrality and avoidance of double taxation statutorily; that is, with strictly unilateral measures. Obviously, if the United States granted a full tax credit for every dollar of tax paid to a foreign nation these goals would be achieved. However, they would be achieved entirely at the expense of the United States Treasury. In addition, whenever a foreign nation decided it had a sufficient nexus with the taxpayer or his income, it could impose a tax which would then have to be credited by the United States. This would be the case even if by United States standards the source of the income was within the United States. Therefore, it is the policy of the United States government to cede its purported right to tax only when it determines the claim of the foreign country is valid

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57. R. BARNETT & R. MULLER, GLOBAL REACH: THE POWER OF THE MULTINATIONAL CORPORATIONS 138 (1974).

58. Blough, *supra* note 43, at 209.

vis-à-vis the United States. For these reasons, the United States finds bilateral tax conventions a suitable means for achieving its aforementioned policies without having to bear the burden of loss in taxing power.[59]

Furthermore, the foreign tax credit and tax deferral are applicable in only a limited number of situations. Recall that the foreign tax credit is available only to United States taxpayers who have paid 'income taxes' to foreign nations. There are many nations of the world that, unlike the United States, do not rely upon income tax as their primary source of revenue. Consequently, the United States taxpayer, who finds himself subject to these non-income foreign taxes, is afforded no remedy by the United States to alleviate the burden of international double taxation. However, by means of tax conventions, the United States can agree with other nations bilaterally to make various concessions in its tax laws, and vice-versa, so as to mitigate the effects of international double taxation.

It is hoped that this paper has given the student of international tax law some insight into the reach of, and accommodation among, international tax systems. The members of the international community have recognized the failure of customary law to deal with the overlapping jurisdictional claims of international tax systems, and have made great strides in creating new international law to deal with these problems.

The nations of the world have met with great success in solving the problem of international double taxation. Had they not been successful, private enterprise would have severely reduced its investment in non-domestic business and this would have been extremely detrimental to both the under-developed economies of the Third World, and the economies of the industrialized powers who are in constant need of resources to fuel their industrial machines and provide markets for their products.

There is still much room left for the nations of the world to adopt additional unilateral and bilateral measures to aid in the transnational coordination of national tax systems. It is hoped that the members of the international community will work toward the creation of an integrated system of taxing transnational trade and investments so that the free flow of persons, capital, goods, and ideas across national boundaries is not impeded by conflicts among the national tax systems of the world.

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59. *See* Slowinski, Haderlien and Meyer, *International Tax Treaties: Where Are We?—Where Are We Going?* 5 VA. J. INT'L L. 133 (1965).