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The Bases for Taxing Foreign Corporations and Nonresident Alien Individuals on Income From Sources Within and Without the United States

I. INTRODUCTION

Until the Foreign Investors Tax Act of 1966, the concept of "engaging in a trade or business in the United States" had been the sole basis for determining the taxability of the United States source income of foreign corporations and nonresident alien individuals. The FITA significantly altered the scheme of taxing United States source income and introduced the "office or other fixed place of business" concept as a basis for taxing the foreign investor engaged in a trade or business in the United States on certain classes of foreign source income. Neither phrase has received more than skeletal definition in the statute or regulations, but remains a question of fact to be decided in each case.

To the extent that his potential United States tax liability

1. 80 Stat. 1541 (1966) [hereinafter referred to in text and footnotes as FITA].

2. INT. REV. CODE of 1954, §§ 871, 881-82 [hereinafter cited by section number only].

3. The FITA reversed the source of income rules in several situations. See § 861(a); Ross, United States Taxation of Aliens and Foreign Corporations: The Foreign Investors Tax Act of 1966 and Related Developments, 22 TAX L. REV. 279, 297-300 (1967) [hereinafter cited as Ross].

4. Sections 881-82. "Foreign corporation" is defined as one that is not domestic, § 7701(a)(5).

5. Section 871. Section 875 provides that nonresident alien individuals who are members of a partnership or beneficiaries of a trust shall be deemed engaged in a trade or business in the United States if the partnership or trust is so engaged. See Joseph & Koppel, Foreign Investors Tax Act, 45 TAXES 113 (1967).


7. See note 115 infra.

8. Foreign source income is defined in § 863. Prior to the FITA such income was not taxed. The rules for differentiating United States and foreign source income are set out in §§ 861-63; see S. ROBERTS & W. WARREN, U.S. INCOME TAXATION OF FOREIGN CORPORATIONS AND NONRESIDENT ALIENS ¶ VI/1 (1966) [hereinafter cited as ROBERTS & WARREN]; Dailey, The Concept of the Source of Income, 15 TAX L. REV. 415 (1960).


will be a factor in the foreigner's decision to invest in the United States, some measure of predictability in the meaning and application of these two terms is desirable. It is the purpose of this Note to determine the meaning of the terms and to suggest some further guidelines for their application.

II. DEVELOPMENT OF THE STATUTORY SCHEME

Prior to the FITA, the foreign investor not engaged in a trade or business in the United States was subject to a flat tax of thirty per cent on the gross amount of "fixed or determinable annual or periodical" income from United States sources.\textsuperscript{11} If the foreign taxpayer were so engaged, the net amount of all United States source income, whether or not business-related,\textsuperscript{12} was taxed as that of a United States corporation or citizen. The trade or business concept determined not only the applicable rate of tax, but also the availability of deductions and the taxability of capital gains.\textsuperscript{13} For these reasons, the desirability of being found engaged in a trade or business and being taxed accordingly varied in each case depending on the kind of income.

The major accomplishment of the FITA is the alteration of the taxation of foreign investors by subjecting only income "effectively connected"\textsuperscript{14} with the United States trade or business to the regular rates\textsuperscript{15} and income not so connected to the flat thirty per cent rate.\textsuperscript{16} The foreign taxpayer not engaged in

\textsuperscript{11} Ch. 736, § 871(a), 68A Stat. 278 (1954).
\textsuperscript{12} This was known as the "force of attraction" principle. Roberts & Warren § IX/13B (1967); S. Roberts, The Foreign Investors Tax Act of 1966; An Introduction to Its Impact on the United States Income Taxation of Foreign Persons 13 (1967) [hereinafter cited as S. Roberts].
\textsuperscript{13} Sections 871(a), 881. The capital gains of a nonresident alien individual present in the United States for 183 days during the taxable year are subject to a 30% tax. Section 871(a)(2). See S. Rep. No. 2156, 74th Cong., 2d Sess. 21 (1936); Allan & Coggan, Aliens and the Federal Income Tax, 5 Tax L. Rev. 253, 287 (1950).
\textsuperscript{14} The "effectively connected" concept, defined in § 864(c), accomplishes two purposes under the FITA: (1) as applied to United States source income, it distinguishes between investment and business income; (2) as applied to foreign source income, it serves to subject certain classes of that income to United States tax. Roberts & Warren §§ VA-VB. See Ross at 322, 328; Sitrick, The Effectively Connected Concept in the Foreign Investors Tax Act of 1966, 45 Taxes 2 (1967).
\textsuperscript{15} Sections 871(b), 882(a)(1). For this purpose, all income from sources within the United States except fixed periodical income is deemed effectively connected with the trade or business. Section 864 (c)(3). See Sitrick, supra note 14.
\textsuperscript{16} Sections 871(a), 881(a). The foreign taxpayer is taxed depending upon whether it was engaged in a trade or business during the
business in the United States is still subject to the flat percentage tax on all United States source income; and the foreign taxpayer engaged in a trade or business is taxed at the flat percentage rate on "fixed or determinable annual or periodical" income not connected with the business.\(^{17}\) Finally, if the foreign taxpayer is engaged in a trade or business and has an office or other fixed place of business in the United States, foreign source income attributable to the activities of that office is taxable at the regular rates.\(^{18}\)

The concept of trade or business as a basis for taxing foreign corporations on United States source income originated in 1909 in an excise tax on the privilege of doing business in the corporate form.\(^{19}\) Following the passage of the sixteenth amendment in 1913, a tax was imposed on the income of nonresident alien individuals from property owned and business carried on in the United States\(^ {20}\) and, in 1916, the corporate excise tax was replaced by an income tax on United States source income of corporations\(^ {21}\) on the theory that jurisdiction to tax may be based on the source of the income as well as citizenship of the taxpayer.\(^ {22}\) The Revenue Act of 1936\(^ {23}\) differentiated in the rate taxpayable year. Sections 871(b), 882. Thus income may be generated in one year, but not subject to tax during that year because of the taxpayer's accounting method. In the year when the income is taxable, the taxpayer may no longer be engaged in a trade or business and, therefore, the income will be taxed differently. Sections 871(a), 881; Ross at 339. The same timing may exist with respect to the "office or other fixed place of business" concept as a basis for taxing foreign source income. See H.R. REP. No. 1450, 89th Cong., 2d Sess. 63 (1966) [hereinafter cited H.R. REP. No. 1450]. To meet this problem, the Commissioner may argue that the foreign source income was generated by activity through the United States office and, since the foreign taxpayer is still engaged in a trade or business, the foreign source income remains taxable. Ross at 340.

17. Sections 871(a)(1)(A), 881(a)(1). Investment income may be effectively connected with the trade or business if, for example, the foreign corporation with a United States branch which manufactures products buys stock in a domestic corporation to assure a constant supply of raw materials. H.R. REP. No. 1450, at 59.

18. Section 864(c)(4)(B). The foreign tax credit was revised to provide the foreign investor taxed under this provision a credit for foreign taxes paid on the same income. Section 906. On the foreign tax credit see Surrey, Current Issues in the Taxation of Foreign Corporate Investment, 56 Colum. L. Rev. 815, 819 (1956).


22. Jurisdiction to tax may be based on the taxpayer's political allegiance, his residence, or the situs or origin of the income. LEAGUE
of tax applicable to nonresident aliens and foreign corporations according to whether or not they were engaged in a trade or business in the United States. This was done in order to facilitate collection of the tax.\(^\text{24}\)

Based on this legislative history concerning the reason for the differentiation, the administrative feasibility of collecting a net income tax on United States source income ought to have been a major factor in deciding the question of whether or not the foreign taxpayer was engaged in a trade or business.\(^\text{25}\) The courts did not, however, consider this factor but relied wholly on the kind and extent of activity carried on in the United States. This approach prevented the development of reliable guidelines in the area. The confusion was compounded by the fact that the position of the Commissioner in any given case was not governed by a continuous policy but rather by a desire to establish the maximum tax liability.\(^\text{26}\)

The Fowler Task Force, appointed to suggest a program to promote foreign investment in the United States, determined that the unpredictability as to whether foreign investors would be found to be engaged in a trade or business was a deterrent to such investors who were contemplating investment in stocks and securities or real estate in the United States.\(^\text{27}\) Moreover, the fact that both the availability of deductions\(^\text{28}\) and the taxability of capital gains\(^\text{29}\) depended upon a finding that the

\(^{24}\) Revenue Act of 1936, ch. 690, §§ 143-44, 211, 231, 49 Stat. 1700, 1714, 1717.

\(^{25}\) H.R. REP. No. 2475, 74th Cong., 2d Sess. 9-10 (1936); see Aktiebolaget Separator, 45 B.T.A. 243, 252 (dissenting opinion) (administrative feasibility of collecting income tax should be sole inquiry).


\(^{27}\) REPORT TO THE PRESIDENT OF THE UNITED STATES FROM THE TASK FORCE ON PROMOTING INCREASED FOREIGN INVESTMENT IN UNITED STATES CORPORATE SECURITIES AND INCREASED FOREIGN FINANCING FOR UNITED STATES CORPORATIONS OPERATING ABROAD 28 (1964) [hereinafter cited as Fowler Task Force].

\(^{28}\) Sections 873, 882(c).

\(^{29}\) Sections 871(a), 871(a) (2), 881.
foreign taxpayer was engaged in a trade or business, coupled with the fact that all United States source income was taxed as business income if such a finding were made, was thought to be inequitable and a deterrent to parallel investments.\(^\text{30}\)

In response to the Task Force recommendations, the FITA amended the definition of trade or business in order to exclude trading in stock and securities\(^\text{31}\) from the trade or business concept and provided an election to treat the ownership of real estate as a trade or business.\(^\text{32}\) The FITA also differentiated between the business and nonbusiness income of both nonresident alien individuals and foreign corporations,\(^\text{33}\) and provided that business income which would be deemed foreign source income under the Code\(^\text{34}\) is nevertheless subject to United States tax if it is attributable to an "office or fixed place of business" in the United States.\(^\text{35}\) This last provision seems to be a reflection of two policies. First, since the source of income is a basis for jurisdiction to tax that income, the United States can and should tax income which, although having a foreign source under the definitional statute, is in reality generated by activities in the United States.\(^\text{36}\) Second, the existence of a business office in the United States enhances the administrative feasibility of collecting the tax.\(^\text{37}\)

### III. TRADE OR BUSINESS\(^\text{38}\)

Although the FITA’s amended definition of “trade or busi-

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31. Section 864(b)(2).
32. Sections 871(d), 882(d).
33. See note 14 supra.
34. Section 863.
35. Section 864(c)(4)(B).
37. On the problems of collecting the tax, see Note, Transnational Evasion of United States Taxation, 81 Harv. L. Rev. 876 (1968).
38. “Business” was first defined in the context of the 1909 corporate excise tax as any activity in which a person might be engaged for profit. Flint v. Stone Tracy Co., 220 U.S. 107 (1911). If the corporation were not actively conducting a business, but merely maintaining its corporate existence for the purpose of owning and maintaining its investments, it was not doing business and, therefore, was not subject to the tax. McCoach v. Minehill & S.H.R.R., 228 U.S. 295 (1913); see Stafford Owners, Inc. v. United States, 39 F.2d 743 (Ct. Cl. 1930). This precedent was made applicable to the trade or business question. Lewellyn v. Pittsburgh, B. & L.E.R.R., 222 F. 177, 185 (3d Cir. 1932); Berliner Handels-Gesellschaft v. United States, 30 F. Supp. 490 (Ct. Cl. 1939); G.C.M. 17,014, XV Cum. Bull. (1936).
ness" largely eliminates the problem with respect to investment in stocks or securities and real estate, the issue will be of increased importance in other areas because of the new provision for taxing certain types of foreign source income. For this purpose, the pre-FITTA law will continue to determine the trade or business question.

The most important factor in finding that the nonresident alien individual or foreign corporation is engaged in a trade or business is the continuity and regularity of activity carried on in the United States. In European Naval Stores, for example, where a single sale had been made in the United States on the foreign corporation's behalf, the Tax Court concluded that there was no trade or business. Similarly, in Continental Trading, Inc. v. Commissioner, the foreign corporation carried on various transactions with United States banks to finance its foreign operations, received dividends from and sold stock of domestic corporations, purchased and resold one carload of milk fat, and made several purchases and resales of tin cans. The court held that the corporation's isolated sales were not continuous enough and its investment activities too insubstantial to constitute a trade or business. In ascertaining whether a business is sufficiently continuous, the courts consider the number of transactions completed in the United States, the total income derived therefrom, and the extent of activities carried on in the United States to effect those transactions.

Analogous to the continuity requirement is the requirement

39. Jan Casimir Lewenhaupt, 20 T.C. 151 (1953), aff'd per curiam, 221 F.2d 227 (9th Cir. 1955); Pinchot v. Commissioner, 113 F.2d 718 (2d Cir. 1940); Roberts & Warren, ¶ 1; cf. Jorge Pasquel, 23 P-H Tax Ct. Mem. 54,002 (1953).
40. 11 T.C. 127 (1949).
41. 28 T.C. 1321, aff'd, 265 F.2d 40 (9th Cir.), cert. denied, 361 U.S. 827 (1959), noted in 12 STAN. L. REV. 249 (1959); see Linen Thread Co., 14 T.C. 725 (1950).
42. Based on these activities, the corporation contended that it was engaged in a trade or business in the United States in order to obtain the benefit of the 85% dividends received credit under § 243(a).
that the activity carried on in the United States be that usually engaged in by the taxpayer.\textsuperscript{46} Thus, if a foreign corporation usually makes sales of its merchandise outside the United States but, out of necessity, completes all transactions within the United States for a short period of time, it is not engaging in its usual activity and may not be engaged in a trade or business.\textsuperscript{47}

The qualitative tests for determining whether the taxpayer is engaged in a trade or business largely center around the "business purpose"\textsuperscript{48} criterion of tax law.\textsuperscript{49} The Commissioner has argued with some success that when the activities carried on in the United States are merely routine and clerical, their only purpose is to secure the regular rate of tax and, therefore, the taxpayer should be denied the benefits of being taxed as if engaged in a trade or business.\textsuperscript{50} In contrast, the fact that management decisions are made in the United States is not enough to constitute a trade or business.\textsuperscript{51}

While the FITA did not attempt to remedy the obvious confusion in the law as to what constitutes trade or business generally, it did seek to eliminate the deterrent effect of such confusion on foreign investors in two areas where its effect had been most pronounced: investment in stocks and ownership of real estate.\textsuperscript{62} The Act excludes trading in stocks from the definition of trade or business and provides the nonresident alien with an election to treat ownership of real estate as a business if it would not otherwise be so treated. However, these measures may not provide the certainty which the FITA was intended to effect.

\textsuperscript{46} European Naval Stores Co., 11 T.C. 127 (1948); B.W. Jones Trust v. Commissioner, 132 F.2d 914 (4th Cir. 1943), aff'd 46 B.T.A. 531 (1942); see Amalgamated Dental Co., 6 T.C. 1009 (1946); Investors' Mort. Sec. Co., 14 P-H Tax Ct. Mem. 62 (1945).

\textsuperscript{47} European Naval Stores Co., 11 T.C. 127 (1948); see text accompanying note 40 supra.


\textsuperscript{51} Spermacet Whaling & Shipping Co., 30 T.C. 618 (1958); cf. United States v. Balanovski, 236 F.2d 298 (2d Cir. 1956); Commissioner v. Nubar, 185 F.2d 584 (4th Cir. 1950).

\textsuperscript{52} See FOWLER TASK FORCE 28; Garelick, What Constitutes Doing Business Within the United States by a Nonresident Alien Individual or a Foreign Corporation, 18 TAX L. REV. 423 (1963).
A. OWNERSHIP AND MANAGEMENT OF REAL ESTATE

Prior to the FITA, the trade or business question in cases involving ownership of real estate\textsuperscript{53} turned largely on the extent of the activity of the taxpayer or his agent in connection with the property. Thus, if the terms of the lease were such that the taxpayer or his agent was required to collect rents, supervise repairs, pay expenses, and, in general, exercise constant supervision over the property, those activities would constitute a trade or business.\textsuperscript{54} On the other hand, the fact that the property was rented under a strict net lease was likely to lead to the conclusion that the foreign taxpayer was not in a trade or business.\textsuperscript{55} Moreover, the intent of the taxpayer to do business or merely to hold the property for the receipt of income\textsuperscript{56} might be inferred from the method of acquisition of the property.\textsuperscript{57} The activity of the taxpayer or his agent in connection with the real estate might be characterized as "incidental" and not itself a business if the rental income were less than income from other sources within the United States.\textsuperscript{58} In addition, the number of buildings owned,\textsuperscript{59} the length and terms of the leases,\textsuperscript{60} and the expenses incurred\textsuperscript{61} in connection with the management were often considered significant.

The plethora of factors which various courts have considered significant illustrates the lack of definitive guidelines as to the tax liabilities of foreign real estate investors.\textsuperscript{62} The 1966 revi-

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\item \textsuperscript{53} Grier v. United States, 120 F. Supp. 395 (D. Conn. 1954), aff'd per curiam, 218 F.2d 603 (2d Cir. 1955); see generally Comment, The Single Rental as a "Trade or Business" Under the Internal Revenue Code, 23 U. Cin. L. Rev. 111 (1955).
\item \textsuperscript{54} Compare Jan Casimir Lewenhaupt, 20 T.C. 151 (1953), aff'd per curiam, 221 F.2d 227 (9th Cir. 1955), and Inez De Amodio, 34 T.C. 894 (1960), aff'd, 299 F.2d 623 (3d Cir. 1962), with Evelyn M.L. Neill, 46 B.T.A. 197 (1942).
\item \textsuperscript{55} Evelyn M.L. Neill, 46 T.C. 197 (1942); cf. Angela Pacheco, 9 P-H B.T.A. Mem. 505 (1940).
\item \textsuperscript{56} See Pinchot v. Commissioner, 113 F.2d 718 (2d Cir. 1940).
\item \textsuperscript{57} Elizabeth Herbert, 30 T.C. 26 (1958); Evelyn M.L. Neill, 46 B.T.A. 197 (1942); Garelick, What Constitutes Doing Business Within the United States by a Nonresident Alien Individual or a Foreign Corporation, 18 Tax L. Rev. 423, 444 (1963). But see Inez De Amodio, 34 T.C. 894 (1960), aff'd, 299 F.2d 623 (3d Cir. 1962).
\item \textsuperscript{59} Pinchot v. Commissioner, 113 F.2d 718 (2d Cir. 1940).
\item \textsuperscript{60} See Elizabeth Herbert, 30 T.C. 26 (1958); Angela Pacheco, 9 P-H B.T.A. Mem. 505 (1940).
\item \textsuperscript{61} Evelyn M.L. Neill, 46 B.T.A. 197 (1942).
\item \textsuperscript{62} The problem was especially acute since the determination that
sion of the statute purports to eliminate the unpredictability of the trade or business question and the problem of imposing the tax on gross rental income by providing nonresident aliens and foreign corporations with an election to treat income from real property as effectively connected with a trade or business if such income would not otherwise be so treated, regardless of whether he is otherwise engaged in a trade or business. However, there are two limitations on the availability of the statutory election, either of which may result in the perpetuation of the uncertainty of prior law as to whether ownership of real estate constitutes a trade or business. First, the election is available only in connection with transactions entered into for profit. The legislative history indicates that the purpose of this limitation is to disallow deductions incurred to maintain a personal residence. However, the courts have held under the forerunner of section 864 that the terms "holding for profit" and "trade or business" are synonymous. If the statutory provision is nothing more than a restatement of this conclusory language, it does not achieve any change from prior law. Moreover, the courts have given some weight to certain external factors to determine the intent of the taxpayer with respect to the real estate. The fact that the taxpayer purchased the real estate has been held indicative of a business purpose, while the acquisition by gift or inheritance may indicate a lack of that purpose.

The ownership of real estate was not a trade or business served as a denial of the deduction for expenses incurred in connection with that property. Sections 873, 882(c) (2). Although such a denial might not be of great significance when the property is rented under a net lease, the tax liability of the foreign investor might exceed the net rentals if he assumed any of the financial responsibilities of management. See S. Rep. No. 1707, 89th Cong., 2d Sess. 34 (1966) [hereinafter cited as S. Rep. No. 1707].

63. Income from real property includes that from real estate located in the United States, rents or royalties from mines, wells, or other natural deposits, and that from the disposal of timber, coal, or domestic iron ore when the foreign taxpayer retains an economic interest. Sections 631(b) & (c), 871(d) (1) (A), 882(d) (1) (A).

64. Sections 871(d), 882(d).

65. Sections 871(d) (1) (B), 882(d) (1) (B).


67. Id. at 75.

68. E.g., Pinchot v. Commissioner, 113 F.2d 718 (2d Cir. 1940); see McCoach v. Minehill & S.H.R.R., 228 U.S. 295 (1913); see also G.C.M. 18,835, 1937-2 Cum. Bull. 141, 144.


70. Elizabeth Herbert, 30 T.C. 26 (1958); authorities cited note 57 supra.
The Commissioner has contended that the amount of income derived from the property should indicate whether the taxpayer is holding the real estate for business purposes. In view of the legislative doubts as to the propriety of taxing the gross amount of rental income, these intent factors should not control the availability of the election. Instead, the courts should limit application of the not-for-profit proviso to those cases in which it appears as a matter of fact that the real estate is held for the foreign investor's personal use.

The second limitation on the availability of the election to treat income from real estate as connected with a trade or business is that “but for this subsection, [the income] would not be treated as income which is effectively connected with the conduct of a trade or business within the United States.” The scope of this limitation can be determined by looking to the statutory definition of effectively connected income. Under section 864, rental income is treated as effectively connected with a trade or business if the foreign taxpayer is otherwise engaged in a trade or business and the property is held for or used in the business, or the business activities were a “material factor” in the realization of that income. Thus, the initial determination of whether the foreign investor is engaged in a trade or business must still be made, and the ownership of real estate is not excluded from the definition of a trade or business.

The fact that ownership and management of real estate may still constitute a trade or business will not often be material since the majority of foreign investors will prefer to be taxed on net rather than gross rental income. Moreover, it was one of the purposes in enacting the provision to ensure that deductions for expenses in connection with the real estate were available in all cases. However, because the nonresident alien individual is

73. Sections 871(d) (1) (B), 882(d) (1) (B) (emphasis added).
74. Section 864(c).
75. Section 864(c) (2) (A) & (B). The source of the funds used to acquire the asset, the disposition of the income from such asset, and the extent of management and control exercised by the United States business over the asset are factors to be considered. In general, the presence of these factors will be determinative of the question of whether the income from such assets is to be treated as effectively connected with the trade or business. H.R. Rep. No. 1450, at 59. The relationship between the asset and the needs of the business will be given particular regard. S. Rep. No. 1707, at 19.
taxed on his capital gains only if he is engaged in a trade or business, it may be to his advantage to be taxed on gross rentals in some situations. This advantage would be foreclosed by a determination that the foreign investor is engaged in a trade or business in the United States. This possibility, to the extent it is to be determined according to the criteria found in prior case law, seems inconsistent with the recommendation of the Fowler Task Force to encourage foreign investment in the United States by eliminating the uncertainty in this area.

A reasonable solution to the problem of taxing only net rental income, while at the same time encouraging other investment in the United States, would seem to be the implementation of regulations providing that, simply because the foreign investor is deemed engaged in a trade or business due to activities in connection with real estate, this shall not affect the taxability of any other income, including capital gains, from United States sources.

B. TRADING IN STOCKS, SECURITIES, OR COMMODITIES

Prior to the FITA, the Code provided that trade or business did not include transactions in stocks, securities, or commodities effected “through a resident broker, commission agent, or custodian.” In addition, the Supreme Court in Higgins v. Commissioner affirmed the Tax Court holding that stock transactions did not constitute a trade or business for purposes of the business expense deduction. The taxpayer in Higgins argued that the continuity, regularity, and extent of his transactions distinguished him from the small trader who engaged in only occasional trading, while the Commissioner maintained that a trade or business could not be established by the number of transactions effected and amount of gain obtained on the stock exchange. The Supreme Court rejected the extent of activity test in the context of the expense deduction, but subsequent cases indicated that where the trading activities of the foreign investor were not effected solely through a resident broker,

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77. Sections 871(a), 881. See Fowler Task Force 28.
78. Fowler Task Force 28.
80. 312 U.S. 212 (1941).
81. Revenue Act of 1932, ch. 209, § 23(a), 47 Stat. 179 (now § 162(a)).
83. See text accompanying note 39 supra.
84. Fernand C.A. Adda, 10 T.C. 273, aff’d, 171 F.2d 457 (4th Cir.),
the extent of activity was relevant, and the foreign investor might be held to be engaged in a trade or business.

Thus, in Fernand C.A. Adda, the first case to so limit the broker exception, the court noted that the provision had been enacted because of the administrative difficulty of collecting an income tax from the foreign stock investor. The court concluded that when the foreign investor's brother, acting as a discretionary investment agent, was present in the United States, the collection problem did not exist and the investor was deemed engaged in a trade or business. The Adda court did not make an examination of the kind and extent of the activity on the stock exchange, except to note that the transactions had been effected through several resident brokers and that several custodian accounts were maintained under the direction of the agent. The fact that the trading was not shown to be insubstantial was sufficient basis for finding a trade or business.

In a similar case, Commissioner v. Nubar, the foreign investor was present in the United States for a period of six years, dealing through brokers but making all trading decisions and financial arrangements on his own “business judgment.” The Fourth Circuit, reversing the Tax Court, concluded that the foreign taxpayer's activities constituted a trade or business and that the investor could not avoid such a holding by showing that the business activity resulted in purchases and sales executed through resident brokers. Although the Nubar holding seems principally based on the exercise of business judgment by the taxpayer in the United States, the court emphasized the amount of trading activity and the fact that the investor traded on margin, supposedly indicating an intent to obtain profit rather than maintain a long-term investment account.

A number of factors related to the extent of activity have been considered in determining whether the activity is a trade or

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86. 10 T.C. at 276.
87. 185 F.2d 584 (4th Cir. 1950).
88. See Fuld v. Commissioner, 139 F.2d 465 (2d Cir. 943) (taxpayers changed from policy of investment to speculation by purchasing large lots of shares).
business: whether or not the transactions were on margin, as in *Nubar*; total gain over the taxable years; the average holding period of the portfolio; and whether the stocks were income producing or were sold to produce gain. If a consideration of these factors led to the conclusion that the investor's activity was "investment" rather than "trading," the presence of a discretionary agent in the United States was not determinative, as in *Adda*, and the investor was found not engaged in a trade or business. From these cases, the Fowler Task Force concluded that a greater degree of predictability was necessary in this area in order to attract foreign investors to the United States stock market, that the resident broker exception should be reaffirmed, and that the extent of activity should be eliminated as a factor in finding a trade or business.

In response to the Task Force recommendations, the statutory definition of trade or business now expressly excludes trading in stocks, securities, or commodities "through a resident broker, commission agent, custodian, or other independent agent." The exception does not apply, however, if the foreign investor has an office or other fixed place of business in the United States "through which or by the direction of which the transactions . . . are effected." This latter proviso would seem to perpetuate the *Adda* and *Nubar* results except that the statute further provides that trade or business does not include trading for the taxpayer's own account by the taxpayer himself, a resident broker, or a dependent discretionary agent, this is without regard to whether or not the taxpayer, broker, or

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89. Commissioner v. *Nubar*, 185 F.2d 584 (4th Cir. 1950); Edward A. Neuman de Vegvar, 28 T.C. 1055 (1957).
90. *Adda*.
91. *Adda*.
92. *Adda*.
93. *Adda*.
94. *Adda*.
96. Section 864(b) (2) (A) (i). A similar provision applies to trading in commodities, if the commodities are of a kind customarily dealt in on an organized commodity exchange and the transaction is of the kind customarily consummated at such place. Section 864(b) (2) (B); Treas. Reg. § 1.864-2(c) (1), 32 Fed. Reg. 14,849 (1967).
97. Section 864(b) (2) (C).
98. Section 864(b) (2) (A) (ii). This provision is not applicable to a dealer in stocks and securities. See text accompanying note 107 infra.
agent is present in the United States.\textsuperscript{99} The regulations, how-
however, seem to distinguish between the "presence" of the taxpayer
or his employee\textsuperscript{100} in the United States and the "presence" or "residence" of a broker or other agent.\textsuperscript{101} If this distinction is
accepted by the courts, the nonresident alien would not be
deemed engaged in a trade or business where the taxpayer
deals through a discretionary agent, but if the resident agent
were an employee of the nonresident alien, there is some basis
in the regulations for determining that the alien is in a trade or
business in the United States. It thus appears that the trade or
business question may turn upon the kind of relationship\textsuperscript{102}
between the foreign investor and the person effecting transactions
on his behalf in the United States, as under pre-FITA law.
The distinction between an "employee" and an "other agent" may
be a difficult one for both the foreign investor and the courts,
and seems to have little bearing on the policy of the statute to
courage foreign investment in the United States by predictable
definition of what will constitute a trade or business. If the
Commissioner enforces these distinctions, the courts should reject
them as unnecessary to the effectuation of the language of the
statute and the intent of Congress.

The amended definition of trade or business may still in-
clude stock and security trading activities in two specific in-
estances. First, a foreign corporation\textsuperscript{103} whose principal business
is dealing in stocks or securities for its own account may be
engaged in a trade or business because of transactions by the
taxpayer, an employee, or a resident\textsuperscript{t} broker or agent if its prin-

\begin{itemize}
  \item \textsuperscript{99} Treas. Reg. §§ 1.864-2(c) (2) (i)-(c) (1967).
  \item \textsuperscript{100} Treas. Reg. §§ 1.864-2(c) (2) (i) (a) & (b) (1967).
  \item \textsuperscript{101} Treas. Reg. § 1.864-2(c) (ii) (c) (1967).
  \item \textsuperscript{102} The regulations contain special provisions for partnerships.
  Treas. Reg. § 1.864-2(c) (ii) (1967). A nonresident alien or foreign cor-
   poration may obtain the benefit of the statutory definition of trade or
   business although he is a member of and grants discretionary authority
   to a partnership, domestic or foreign, which trades for the account of
   the foreign taxpayer or for its own account, unless the partnership is a
   dealer in stocks, or its principal business is dealing in stocks for its
   own account and its principal office is in the United States. As to what
   constitutes a principal office, see text accompanying notes 104-06 infra.
   The principal office-principal business proviso does not apply to a part-
   nership which is owned, determined in accord with § 707(b) (3), directly
   or indirectly by five or fewer individuals. See Fernand C.A. Adda, 10
   T.C. 273 (1946) (relationship between alien individual and resident
   agent analogized to a partnership).
  \item \textsuperscript{103} In this context, "foreign corporation" does not include a cor-
   poration which is or would be, but for § 542(c) (?) or § 542(b) (1) (C),
   a personal holding company.
\end{itemize}
principal office is in the United States.\textsuperscript{104} In this context, the regulations provide that the foreign investment company can have only one principal office, the location of which is to be determined by comparing the nontrading activities of the United States place of business with the activities conducted at its foreign offices.\textsuperscript{105} It appears that the office where management is located and conducts most of its general business activities is to be considered the principal office of the investment corporation.\textsuperscript{106} If that office is in the United States, its activities must be examined to determine whether they constitute a trade or business. However, it appears that where a foreign corporation's principal business is trading securities and its principal office is in the United States, such corporations will be engaged in a trade or business producing United States source income, and hence will be taxed at the regular rates on such income.

The second class of foreign investors excluded from those who may grant discretionary authority without thereby being deemed engaged in a business is a "dealer."\textsuperscript{107} A dealer may obtain the benefit of the statutory definition by trading through a resident broker or other nondiscretionary agent only so long as he does not have an office or other place of business in the United States.\textsuperscript{108} Since the statutory definition of trade or business is merely exclusionary, however, if the dealer establishes an office in the United States, it will be necessary to examine the kind of activities carried on by that office to determine whether the activity is a trade or business.\textsuperscript{110}

\textsuperscript{104} Section 864(b) (2) (A) (ii).
\textsuperscript{105} Treas. Reg. § 1.864-2(c) (2) (iii) (b) (1967); see S. Rep. No. 1707, at 16–17.
\textsuperscript{106} Treas. Reg. § 1.864-2(c) (2) (iii) (b) (1967); see Scottish Am. Inv. Co., 47 B.T.A. 474 (1942), aff'd, 323 U.S. 119 (1944), aff'd 139 F.2d 419 (4th Cir. 1944), rev'd 142 F.2d 401 (3d Cir. 1944); Scottish Am. Inv. Co., 12 T.C. 49 (1949).
\textsuperscript{107} A dealer is "a merchant of stocks or securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged as a merchant in purchasing stocks or securities and selling them to customers with a view to the gains and profits that may be derived therefrom." Treas. Reg. § 1.864-2(c) (2) (iv) (a) (1967). An individual who trades stock for investment or speculation, whether or not such activity constitutes a trade or business, is not a dealer for this purpose. One who is a dealer shall be considered a dealer although his transactions in the United States would not constitute him a dealer. H.R. Rep. No. 1450, at 57.
\textsuperscript{108} Section 864(b) (2) (A) (ii); see S. Rep. No. 1707, at 17.
\textsuperscript{109} Sections 864(b) (2) (A) (i), 864(b) (2) (C).
\textsuperscript{110} Where the possibility exists that the dealer may be engaged in a trade or business under the amended definition, "the question . . .
It appears that a dealer may at least maintain an office in the United States to carry out merely administrative details. In *Scottish American Investment Company*, an investment trust established an office in the United States with the duties of maintaining records of all holdings and transactions in the United States, acting on proxy requests, and paying local expenses. All decisions as to stock transactions were made at the foreign office and effected through resident brokers, who then sent confirmation of the particular transaction to the United States office for recording. On these facts, the Tax Court concluded that the activities in the United States were merely routine and clerical and, therefore, did not constitute a trade or business.

It would be consistent with the statute, if the purpose of excluding trading in stocks and securities from the statutory definition of a trade or business is to encourage foreign investment in the United States, to permit a “dealer” to supervise its investments through a United States office without thereby being deemed engaged in a trade or business. Furthermore, in order to achieve the maximum foreign investment under the amended definition of “trade or business,” “dealer” should be narrowly construed. If the dealer’s activities in the United States go beyond the merely clerical functions outlined in *Scottish American Investment*, however, the United States’ interest in uniformly taxing foreign investors engaged in a trade or business and in protecting the balance of payments position should transcend the interest in encouraging foreign investment.

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remains a question of fact to be determined under the rules of present law.” S Rep. No. 1707, at 17.
111. 12 T.C. 49 (1949).
112. The same office was held to qualify as an “office or place of business” under the 1936 Act. Scottish Am. Inv. Co., 47 B.T.A. 474 (1942), aff’d, 323 U.S. 199 (1944), affd 139 F.2d 419 (4th Cir. 1943), rev’d 142 F.2d 401 (3d Cir. 1944). Cf. B.W. Jones Trust, 46 B.T.A. 531 (1942), aff’d, 132 F.2d 914 (4th Cir. 1943). In Jones, several English trusts were managed by a trustee in England, but an American trustee maintained an office in New York. The trusts were held resident in the United States and, as an alternative holding, the New York office was a place of business maintained because of “administrative necessity of having local supervision of affairs.” 46 B.T.A. at 538. See Aktiebolaget Separator, 45 B.T.A. 243 (1941), aff’d per curiam, 128 F.2d 739 (2d Cir. 1942).
113. See Ross at 314. The author suggests the restrictions of the “dealer” limit may undermine the intended effect of removing deterrents to portfolio investments.
IV. OFFICE OR OTHER FIXED PLACE OF BUSINESS

The FITA provides that the foreign investor engaged in a trade or business and having an office or other fixed place of business in the United States shall be taxed on foreign source income attributable to that office.\textsuperscript{114} There are three limitations on the attribution of income to the foreign investor's office: (1) the income must be within the defined classes,\textsuperscript{115} (2) the office must be a "material factor" in the production of the income,\textsuperscript{116} and (3) the income must be attributable to the regular business activities of that office.\textsuperscript{117}

The legislative history states a dual purpose for enacting this provision.\textsuperscript{118} First, under existing source of income rules, the United States occasionally became a "tax haven" for some foreign investors in the sense that neither the United States nor any other country exerted jurisdiction to tax certain items of income.\textsuperscript{119} A second and more important reason for the pro-

\textsuperscript{114} Sections 871(b) (1), 882(a) (1), 864(c) (4) (B).

\textsuperscript{115} The only classes of foreign source income which will be treated as effectively connected with the United States office are (1) rents or royalties for use or privilege of using outside the United States patents, copyrights, secret processes, good will, trademarks, trade brands, franchises, and similar property, including any gain or loss from the sale of such property, derived in the active conduct of the trade or business, § 864(c) (4) (B) (i); (2) dividends or interest, or gain or loss from the sale or exchange of stock or notes, bonds or other evidences of indebtedness, either derived in the active conduct of a banking, financing, or similar business within the United States or received by a corporation whose principal business is trading in stocks or securities for its own account, § 864(c) (4) (B) (ii); (3) that derived from the sale outside the United States through such office or place of business of personal property held as inventory, unless it is sold for use outside the United States and a foreign office of the taxpayer outside the United States participated materially in the sale, § 864(c) (4) (B) (iii). See the source of income rules in §§ 861-63.

\textsuperscript{116} Section 864(c) (5) (B).

\textsuperscript{117} Id.; see S. REP. No. 1707, at 17.

\textsuperscript{118} The office or other fixed place of business test acts as an objective standard for determining whether certain items of income are "effectively connected" with the United States trade or business. The effectively connected concept performs the second function of separating United States source income into investment and business income. S. Roberts 12. The Fowler Task Force recommended that such a separation be made since the lumping of all United States source income under the "force of attraction" principle, see note 12 supra, operated to deter foreign taxpayers engaged in a trade or business in the United States from investing in United States stocks or securities. Fowler Task Force 27. See Ross at 292; Sitrick, The Effectively Connected Concept in the Foreign Investors Tax Act of 1966, 45 Taxes 2 (1967).

\textsuperscript{119} H.R. REP. No. 1450, at 14. The House Report gave the example of a foreign corporation incorporated in a country which does not tax
vision is the legislative policy that income generated by activities in the United States ought to be subject to United States taxation\textsuperscript{120} notwithstanding the statutory source rules. Assuming the validity of this policy, two questions must be considered: First, whether the office or other fixed place of business concept adequately fulfills this function, and second, whether the same result might have been more readily accomplished by altering the statutory source of income rules. Before proceeding to an evaluation, however, it is necessary to consider the factors which must be present to have an “office or other fixed place of business.”

A. A Permanent Location

The use of the word “fixed” in the statute indicates that the United States office must be a permanent facility. The real question is whether the phrase is implicitly limited to an office where business is transacted as distinguished from one where merely clerical functions are performed.\textsuperscript{121} Except for domestic corporations on income derived outside that country. Hence, that corporation could avoid the taxes of the country of incorporation by maintaining its sales office in the United States. Under the statutory source of income rules, §§ 861-63, the corporation could avoid any United States source income by having title to the goods pass outside the United States, id. S. Rep. No. 1707, at 18; see Rev. Rul. 65-263, 1965-2 CUM. BULL. 561; Piedras Negras Broadcasting Co., 43 B.T.A. 297 (1941), aff’d, 127 F.2d 260 (5th Cir. 1942); Krahmer, \textit{Federal Income Tax Treatment of International Sales of Goods: A Reevaluation of the Title-Passage Test}, 17 TAX L. REV. 235 (1962).


121. The statute provides little guidance to any definition of the term except that the office of an agent is to be disregarded unless the agent is not an independent agent acting in the ordinary course of his business, § 864(c) (5) (A) (ii), and has authority to negotiate contracts for the foreign principal or has a stock of merchandise from which he regularly fills orders. Section 864(c) (5) (A) (i). The agency provision is substantially similar to the permanent establishment concept existing in United States income tax treaties. S. Rep. No. 1707, at 20; Treas. Reg. § 519.103(a) (1966); TD 5206, 1943-1 CUM. BULL. 526; Consolidated Premium Iron Ores, Ltd., 28 T.C. 127 (1957), aff’d, 265 F.2d 320 (6th Cir. 1959). An enterprise of the contracting party is not taxable in the United States except as its profits are allocable to its permanent establishment in the United States. Tax Convention with Canada, Art. I. See Frank Handfield, 23 T.C. 633 (1955). There are several reasons why the interpretation of the permanent establishment treaties may be of little aid in defining the FITA office or place of business: First, the terms of each treaty are a result of extended negotiation and reciprocity is a factor in their interpretation. Ross at 320. Reciprocity is not to be a factor in applying the FITA concept. S. Rep. No. 1707, at 20. Second, fixed place of business and agency are two
the addition of the word "fixed" in the 1966 version, the FITA and the 1936 Code contain the identical phrase, "office or other place of business." The phrase appeared in the 1936 Code as an alternative test for determining whether the contacts of the nonresident alien individual or foreign corporation were sufficient to make the collection of an income tax on United States source income administratively feasible. As it appears in the 1966 amendments to the Code, the phrase serves to indicate the extent of contact with the United States deemed by the legislature sufficient to warrant the collection of an income tax on income from sources without the United States. To the extent that the two phrases manifest the same policy of assuring sufficient business contacts with the United States to make the collection of an income tax administratively feasible, the interpretation of the 1936 Code should be relevant to the current provision. Thus, where the issue is whether the foreign investor's use of the United States office of another will be deemed to be within the statute, case law under the 1936 Code is relevant since both instances involve a determination as to "sufficient business contacts." Furthermore, the legislative history of the FITA indicates that Congress intended the factors relevant to interpretation of the 1936 Code to be considered in the imputed office situation.

Under the 1936 Code, an office or other place of business was defined as a place for the regular transaction of business, as distinguished from a place where merely casual and incidental

different concepts under the treaties, see Treas. Reg. § 519.103(a) (1966), whereas the office of the agent is to be attributed to the foreign principal under the FITA, if certain conditions are met. Thus, it appears that if the foreign principal has a dependent agent who maintains a stock of merchandise from which to fill orders in the United States, but that agent has no office in the United States, the principal would have no office. S. Roberts 19.

123. It has been suggested that the addition of the word "fixed" signifies only the change in context. Ross at 329. But the phrase in the context of the 1966 Act may be influenced by the fact that it will almost always be to the taxpayer's advantage not to have a United States office, while it will be to the Commissioner's advantage to find the taxpayer has a United States office. Id. at 330.
124. See note 24 supra and accompanying text.
125. If use is irregular or only occasional, "taking into account the overall needs and conduct of the business of such alien individual or foreign corporation," it is to be disregarded. H.R. Rep. No. 1450, at 15; S. Rep. No. 1707, at 21.
transactions were effected. In *Aktiebolaget Separator*, the Tax Court construed the phrase to involve an intent to carry on at a permanent location in the United States the same kind of activity as that which would constitute a trade or business. The activities were required to be regular and continuous, and to fulfill a function necessary to the main business of the foreign investor. The problem of determining whether use of the office of another by a foreign taxpayer should impute maintenance of the office to the foreign taxpayer will be particularly difficult in the case of a domestic parent and a foreign wholly-owned subsidiary corporation since management policies will emanate from the parent's home office. Since the infrequent use of another's office does not come within the statute, the statute is apparently intended to impute the parent's office to the subsidiary only if it regularly and continuously carries on its business through the parent's office. Moreover, the legislative history indicates that the location of management or controlling interests in an American office will not bring the foreign taxpayer within the statute so long as its day-to-day affairs are conducted by a "managing director" from the foreign place of business. Therefore, even though the officers of a foreign subsidiary regularly confer with the parent's officers and visit the parent's place of business for the purpose of conferring, so long as the subsidiary's officers regularly conduct the subsidiary's business outside of the United States, the parent of-

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126. Treas. Reg. § 103, art. 19.231-1(b), construed in Linen Thread Co., 4 T.C. 802, aff'd, 152 F.2d 625 (2d Cir. 1945).
127. 45 B.T.A. 243 (1941), aff'd per curiam, 128 F.2d 739 (2d Cir. 1942).
128. 45 B.T.A. at 249; see Scottish Am. Inv. Co., 12 T.C. 49 (1949); B.W. Jones Trust, 46 B.T.A. 531 (1942), aff'd, 132 F.2d 914 (4th Cir. 1943).
129. See Linen Thread Co., 14 T.C. 725 (1950). The company made two sales in the United States, one of them through a United States office. The court, holding that there was no trade or business in the United States, focused on the lack of business reasons for channeling the sale through the United States office. The office was intended for the collection of dividends, it was not equipped for selling, no salesmen operated out of it, and the agent was not operating under solicitation instructions. Moreover, the court stated, even if the sales were within the business purpose of the office, the sales income was such a small part of the total American income that it could not be said that the sales were business.
130. See Ross at 342-43.
131. S. REP. No. 1707, at 19.
The office will not be imputed to the subsidiary. The distinction between “management” and the day-to-day conduct of the business may be a difficult one. For example, the legislative history suggests that when all orders directed to the foreign subsidiary are subject to review by the domestic parent, the subsidiary will be deemed to have an office in the United States. If, however, the domestic parent merely receives orders and, because it cannot fill them, accepts on behalf of the subsidiary only after consultation with its officers, the parent's office will not be imputed to the subsidiary.

From these legislative hypotheticals, it appears that the office of the domestic parent will not be imputed to the foreign subsidiary unless the parent assumes the authority to act and actually acts for the foreign subsidiary on a regular and continuous basis. To the extent that the parent's office is imputed to the subsidiary on the basis of the subsidiary's cumulative business contacts with the United States, the policy of the statute to tax income generated in the United States is fulfilled.

Unlike the imputed office problem, it is submitted that when the foreign investor itself maintains a permanent location in the United States no more should be required to bring it within the statute for in this context the similarity of the 1936 and 1966 Codes does not hold up. The requirement under the 1936 Act that the office be a place for the regular transaction of business was to prevent foreign taxpayers from electing the tax applicable to them merely by establishing an office in the United States with no purpose but to obtain tax advantages. The context of the FITA phrase “office or other fixed place of business” obviously does not require such a strict construction. Furthermore, the judicial gloss on the phrase under the

134. H.R. Rep. No. 1450, at 63-64, examples (2) & (3). See also Consolidated Premium Iron Ore, Ltd., 28 T.C. 127 (1957), aff'd, 265 F.2d 320 (6th Cir. 1959); European Naval Stores Co., 11 T.C. 127 (1948).
135. A similar situation was held not a trade or business in Amalgamated Dental Co., 6 T.C. 1099 (1946), where the foreign corporation arranged for a domestic corporation, in which it held a one-third interest, to ship directly to the parent's customers. In addition to shipment, the domestic corporation received some orders directly from customers which it filled on behalf of the taxpayer, and billed all customers. The Tax Court concluded that there was no agency relationship between the two corporations, but that the arrangement existed only as a temporary matter because of wartime exigencies.
1936 Act is not necessary in order to ensure that the foreign source income has been generated by business activities in the United States since the statute itself contains two limitations on its applicability: First, the activities of the office must be a “material factor” in producing that income; and second, no foreign source income can be attributed to that office unless it is a factor in the usual course of its business activities.

B. Material Factor

The statute requires that in order to attribute foreign source income to the United States office, the activities of the office must have been a material factor in producing that income. The question of the materiality of such activities is clearly a matter of degree. Presumably, all of the business activities necessary to produce the income must be considered in order to measure the degree of participation of the United States office. There may be a question of whether the activities of the United States office are to be measured against the aggregate activities necessary to produce the income, or whether its participation is to be weighed merely against the activity of each one of the offices of the foreign investor which contributed to the production of the income. The Senate Finance Committee, which added the “material factor” provision to the Act, stated merely that the United States office must be an “essential economic element” but “not necessarily . . . a major factor” in producing the income.

The House Report offers much more guidance with respect to the attribution of income to the United States office. The legislative history is extensive with regard to two of the three types of foreign source income which may be taxed: income from the lease or license of intangible personal property, and income from the sale of inventory property.

Income from the lease or license for the use of intangible personal property is to be considered generated by the United States office if the activities of the office are a material factor in producing that income. When the income is dividends or interest, or gain or loss from the sale or exchange of stocks or notes, § 864(c)(4)(B)(ii), it will not be attributable to the United States office of the foreign taxpayer unless derived from the “active conduct” of a banking, financing, or similar business within the United States, or unless the taxpayer is a corporation whose principal business is trading in stocks or securities for its own account. A foreign corporation trading in stocks and securities for its own account is not engaged in a trade or business in the United States unless its principal office is in the United States. See text accompanying notes 103-06 supra.

137. S. REP. No. 1707, at 21.
138. H.R. REP. No. 1450, at 64.
139. When the income is dividends or interest, or gain or loss from the sale or exchange of stocks or notes, § 864(c)(4)(B)(ii), it will not be attributable to the United States office of the foreign taxpayer unless derived from the “active conduct” of a banking, financing, or similar business within the United States, or unless the taxpayer is a corporation whose principal business is trading in stocks or securities for its own account. A foreign corporation trading in stocks and securities for its own account is not engaged in a trade or business in the United States unless its principal office is in the United States. See text accompanying notes 103-06 supra.
States office if the office (1) actively participates in soliciting, negotiating, or performing other activities necessary to arrange the lease or license, or (2) performs other significant services incident to the lease or license.\textsuperscript{140} The question thus arises as to what constitutes “active participation” or “significant services.” The development or acquisition of the property which is the subject of the license is excluded, as is the general supervision of the activities necessary to arrange the license,\textsuperscript{141} but the legislative history provides no further guidance. Where a tie-in arrangement is involved, the United States office might be considered to have “actively participated” in the sale of the product if it negotiated the license of the tying product. “Significant services” might include the overseeing of the production of the patented article, enforcement of legal rights under the lease or license, renewal of patent registration, the testing of and improvements on the patented article which the licensor is obligated to send to the licensee, or any service necessary to the maintenance of the relationship between the parties. The meaning of the terms is mere conjecture at this point, but the definition provided by the regulations should be broad in order to be consistent with the policy to tax all income generated by these activities where they are carried on in the United States.\textsuperscript{142}

Second, income from the sale of inventory property\textsuperscript{143} is to be considered generated by the United States office only if it actively participates in soliciting, negotiating, or performing other activities required to arrange for the sale.\textsuperscript{144} In this context, the foreign taxpayer’s office will be considered to have ac-

\textsuperscript{141} H.R. Rep. No. 1450, at 65. The general supervision exclusion is an appropriate corollary to the general rule that the foreign taxpayer will not be deemed to have an office in the United States merely because its management is officed there. See text accompanying note 132 supra.
\textsuperscript{142} S. Rep. No. 1707, at 21. In view of the purpose of the Act to tax income generated in the United States, the exclusion of the development or acquisition of the licensed property appears appropriate since the mere ownership of such property does not produce income. See section II, A supra.
\textsuperscript{143} The statute applies to property defined in § 1221 (1):
[S]tock in trade of the taxpayer of other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business . . .
\textsuperscript{144} H.R. Rep. No. 1450, at 66.
tively participated in any sale made as a result of an order solicited or received by it at that place of business. The United States office will not be deemed to have actively participated in a sale made as a result of an unsolicited order when that office is not held out as the place to which such orders should be sent.\textsuperscript{145}

The fact that the United States office "actively participated" in the sale is to be disregarded for purposes of attributing to it foreign source income if the property sold is to be used, consumed, or disposed of outside the United States and another office of the foreign taxpayer outside the United States participated materially in the sale.\textsuperscript{146} The "material participation" of a foreign office is not quite the same as the "active participation" standard applied to the United States office but requires a greater contribution of activity to the sale. "Material participation" is defined as solicitation of the order which is the basis for the sale, the negotiation of the contract of sale, or performance of significant services incident and necessary to the sale, so long as those services were not subject to a separate agreement between the parties.\textsuperscript{147} On the other hand, "active participation" is merely some activity leading toward the consummation of the sale. Essentially, in order to be considered to have materially participated in the sale, the foreign office must be a "major factor" in arranging that sale, while the United States office need be only an "essential economic factor."\textsuperscript{148} Therefore, in order to avoid the attribution of income to the United States office when it has taken some part in arranging the sale, the foreign office must have actually solicited the order or actually negotiated the contract of sale. Mere receipt of the order at the foreign office would probably not be sufficient.

It is unclear whether the "active participation" of the United States office in some phase of the sale will preclude the "material participation" of the foreign office in that same phase of the transaction. Logically, this result would seem to be required in order to prevent foreign taxpayers from structuring the

\textsuperscript{145} \textit{Id.}

\textsuperscript{146} Section 864 (c) (4) (B) (iii); H.R. Rep. No. 1450, at 67. By negative implication, property sold for use within the United States may be attributed to the United States office although another office of the taxpayer without the United States participated materially in the sale. Ross at 384. See United States v. Balanovski, 131 F. Supp. 898 (S.D.N.Y. 1955), aff'd, 236 F.2d 298 (2d Cir. 1956), cert. denied, 352 U.S. 968 (1957).

\textsuperscript{147} H.R. Rep. No. 1450, at 67.

\textsuperscript{148} See text accompanying note 137 supra.
transaction so as to avoid the United States income tax.\textsuperscript{149}
For example, after preliminary negotiations had been conducted
through the United States office, it would not be difficult to ar-
range for their completion elsewhere. A weighing of the ac-
tivities carried on through both of the places of business would
seem a better means for determining where the income was
generated.\textsuperscript{150} Absent such a comparative determination, it ap-
ppears that the United States office will be deemed a "material
factor" in the production of foreign source income if it con-
tributes in any way to the arrangement of the transaction
giving rise to the income.

\textbf{C. Usual Business Activities}

The "usual business activities" provision was inserted by the
Senate Finance Committee as a "de minimus exception" to "ex-
clude from United States tax jurisdiction all foreign income de-
derived from casual sales."\textsuperscript{151} In determining the usual business ac-
tivities of the foreign taxpayer in its United States office, the kind
of business carried on in the United States\textsuperscript{152} rather than the
worldwide business is the critical factor.\textsuperscript{153} Thus, if the foreign
taxpayer establishes a sales office in the United States to service
a particular area, an occasional sale outside of that area will
still be within the usual business of selling. If, however, the
usual business in the United States is manufacturing, an occa-
sional sale of the manufactured goods through that place of
business will be outside the statute.

The concept is analogous to the trade or business test in its
apparent requirement that the business activities giving rise to
the foreign source income be regular and continuous,\textsuperscript{154} and it is
probable that the same difficulties of evaluation will exist here.
The operation of the standard should be based on both a quanti-
tative assessment of the major and incidental activities of the

\textsuperscript{149} The foreign office will not be considered to have performed
materially merely because the sale is made subject to its approval, the
property sold is held in or distributed from that office, it is used to have
the title pass outside the United States, or it performed merely cler-
\textsuperscript{150} See United States v. Balanovski, 131 F. Supp. 898 (S.D.N.Y.
1955), aff'd, 236 F.2d 298 (2d Cir. 1956), cert. denied, 352 U.S. 968
(1957); cf. Consolidated Premium Iron Ores, Ltd., 28 T.C. 127 (1957),
aff'd, 265 F.2d 320 (6th Cir. 1959).
\textsuperscript{151} S. Rep. No. 1707, at 21.
\textsuperscript{152} Id.
\textsuperscript{153} See note 129 supra.
\textsuperscript{154} See text accompanying notes 39-53 supra.
United States office and a totalling up of the number of and income derived from the transactions alleged to be within the usual business activities. Moreover, the purpose of the foreign taxpayer in establishing the United States place of business should be relevant since, if it is established to carry out a particular business function, the mere fact that it does so infrequently should not take it out of the statute.

V. CONCLUSION

Having considered the elements which constitute an "office or other fixed place of business," the value of this concept and the alternative of changing the source of income rules should be compared.

The purpose of the statutory phrase "office or other fixed place of business" is to provide an objective standard for determining when foreign source income is generated by business activities in the United States. The only objectivity of "office or other fixed place of business," however, is the requirement of a permanent and fixed location. The other statutory requirements of "material factor" and "usual business activities" will be, like the trade or business question, subjective issues of fact in each case.

Instead of introducing this new concept to the taxation of foreign corporations and nonresident aliens, Congress might have chosen to alter the source of income rules. At least four reasons appear to militate against such a change. First, the decision to tax income heretofore deemed to have its source outside the United States represents a substantial change in the asserted jurisdiction to tax. For this reason, it may be that Congress felt a certain reluctance, albeit unvoiced, to extend that jurisdiction across the board. Moreover, the requirement of a permanent location in the United States seems to be an implicit indication that more extensive contact with the United States is essential to the assertion of jurisdiction.

The second reason, closely related to the first, is that alteration of the source of income rules might result in taxing income not in fact generated by business activities in the United States. A third reason is the administrative unfeasibility of enforcing the collection of an income tax based on broad source of income rules. Fourth, to the extent that the "office or

155. See text accompanying notes 140-42 supra.
156. See note 24 supra and accompanying text.
other fixed place of business” is an objective standard, its application is predictable whereas the source of income rules, being of wider application, are necessarily vague. Hence, the scheme of the FITA is preferable to amendment of the source of income statute.

The definition of the “trade or business” concept accomplished by the FITA eliminates the major areas of confusion in the taxation of foreign corporations and nonresident alien individuals—investment in stocks or securities and real estate. The concept will, however, assume greater importance in the future because of the introduction of “office or other place of business” in the statute. The foreign taxpayer will seek to avoid a holding that he is engaged in a trade or business in the United States so that the second question will not arise. It is not improbable that the courts will fail to consider the two questions separately, but rather, if the foreign taxpayer has a fixed place of business in the United States, proceed directly to an assessment of the business activities conducted there. This approach would detract from the development of a concise judicial definition of both concepts. Moreover, the existence of a clear policy to tax income generated by business activities in the United States should aid the courts in the application of “an office or other fixed place of business.” To the extent that the courts fail to separate the two questions, the implementation of this policy is obscured. Therefore, the courts should endeavor to consider the facts of each case in the proper context, thereby constructing coherent definitions of “trade or business” and “office or other fixed place of business.”