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Western Hemisphere Trade Corporations: Reconsidered

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WESTERN HEMISPHERE TRADE CORPORATIONS: RECONSIDERED

INTRODUCTION

Sections 921 and 922 of the 1954 Internal Revenue Code[1] provide for special tax advantages for domestic corporations doing business in Western Hemisphere countries. However, these advantages may be accompanied by certain pitfalls. Upon consideration of this method of trade, the Western Hemisphere Trade Corporation (WHTC) should consider the qualification requirements, the advantages weighed together with the possible pitfalls, and the major areas of litigation. In this regard, certain changes enacted recently by the Congress and the Internal Revenue Service give added advantages to the use of WHTC[2] by all applying domestic corporations.

HISTORY

The WHTC stands as one of the major exceptions to the general United States policy of treating income from foreign sources in the same manner as income from domestic sources.[3] Its beginning was in the World War II Excess Profits Tax Act which exempted domestic corporations from the excess profits tax if 95 percent of their income was from sources outside the United States; the thought being that the excess profits tax was for application to the domestic economy only.[4] Following this rationale, three domestic corporations whose business and facilities were located in Central and South America brought pressure for relief from the increasing wartime corporate rate.[5] Though the legis-

1. All "Section" references will be to the 1954 Internal Revenue Code unless otherwise indicated.

2. Several articles treat the particular problems of the WHTC in some depth: William W Crawford, *Foreign Tax Planning: Western Hemisphere Trade Corporation, Possession Corporation*, 17 N.Y.U. INST. ON FED. TAX. 369 (1959); Leo J. Raskind, *The Western Hemisphere Trade Corporation: A Functional Perspective*, 16 VANDERBILT L. REV. 1 (1962), and the Tax Management Portfolio; *Western Hemisphere Trade Corporations*, No. 30-2nd. The last named study provides for current additions as needed including an updated bibliography

3. Stanley Surray, House Hearings, *General Revenue Revision*, Part 1 p. 1144, 85th Cong. 2nd Sess. (1958).

4. Excess Profit Tax Act, § 727(g) 54 Stat. 988 (1940).

5. In the hearings before the Senate Finance Committee, there was an intimation that if relief was not granted, the corporations in question would give up their U. S. charters and incorporate elsewhere. 1 Senate Hearings on the Revenue Act of 1942, pp. 1204-

lative background is sketchy, their efforts came forth with some clarity in the Revenue Act of 1942[6] and the accompanying Senate Committee Report:

> American corporations trading in foreign countries within the Western Hemisphere are placed at a considerable competitive disadvantage with foreign corporations under the tax rates provided by the bill [Revenue Act of 1942]. To alleviate this competitive inequality, the committee bill relieves such corporations from surtax liability. To obtain this relief 95 per cent of the gross income of such companies must be from sources outside the United States. Moreover, 90 per cent of their income must be from active conduct of a trade or business.[7]

As indicated, if a domestic corporation met the requirements of Section 109, then it was relieved of surtax liability. With the passage of time, this arrangement of surtax exemption created certain problems, as revealed in the House Report that accompanied the Revenue Act of 1950:

> . . . As a result of the exemptions, it is not possible to change either the normal tax rate or the surtax rate without changing the relationship between the tax burdens of taxpayers with these special exemptions and corporate taxpayers generally.
>
> Your committee's bill avoids this dilemma by substituting for the surtax exemption, . . . percentage exemptions equal to 34 percent of the income receiving this special treatment. The effect is to maintain for these special types of income approximately the present tax benefit.[8]

The result was the addition of Section 26 (i) to the '39 Code by Section 122(c) of Revenue Act of 1950, permitting, as seen above, a credit against net income for both the normal tax and the surtax for the WHTC.[9]

1210, and 2 Senate Hearings on the Revenue Act of 1942, pp. 2273-2277. Excerpts from these Hearings can be found in 30-2nd T.M. WHTC beginning at p. B-13. *See also* BITTKER & EBB, TAXATION OF FOREIGN INCOME, pp. 290-295 (1960).

6. Revenue Act, § 109, 56 Stat. 838 (1942), Except for minor changes § 109 is identical to § 921 of the 1954 Code.

7. S. Rep. No. 1631, 77th Cong. A.2d Sess. (1942). 1942-2 Cum. Bull. 504,532. The House, without Hearings, receded by adopting the Senate amendment; House (Conference) Report No. 2586, 77th Cong., 2nd Sess. (1942); 1942-2 Cum. Bull. 704, 707.

8. H. R. Rep. No. 2319, 81st Cong., 2nd Sess. (1950); 1950-2 Cum. Bull. 380, 402.

9. 7 MERTENS, LAW OF FEDERAL INCOME TAXATION § 38.80 (1956).

The Internal Revenue Code of 1954 adopted the prevailing law for the WHTC with two exceptions.[10] First, a provision was included which would permit "incidental purchases" outside the Western Hemisphere without adverse effect, and second, a fractional deduction based on the current corporate rate[11] was enacted in lieu of the mechanically cumbersome credit.[12]

QUALIFICATIONS AS A WHTC

As specified by Section 921, the WHTC must do its business in a "country or countries in North, Central, or South America, or in the West Indies, ..." Though this has been the generally accepted definition of the Western Hemisphere, there have been peripheral problems. By ruling, the Internal Revenue Service has indicated that Puerto Rico,[13] the Virgin Islands,[14] the Greater Antilles, the Lesser Antilles, the Bahamas,[15] Greenland,[16] St. Pierre, Great Miquelon, and Little Miquelon[17] are all considered part of the Western Hemisphere. Bermuda[18] and the Falkland Islands[19] are not part of the Western Hemisphere. Alaska, as a state of the United States, is not a country as contemplated by Section 921.[20]

Also, as specified by Section 921, there is an exception to the rule that *all* business be carried on in the Western Hemisphere. This exception is found in the phrase "incidental purchases." As defined by the regulations, "incidental purchases" means: ". . . purchases (of any kind for any purpose) which are (i) minor in relation to the entire business or (ii) nonrecurring or unusual in character." [21]

The regulations go on to point out that purchases of any type (as noted above) will be considered incidental if they do not exceed 5 per-

10. Internal Revenue Code of 1954, 68A Stat. 290 (1954).

11. H. R. Rep. No. 1337, 83rd Cong., 2nd Sess. (1954); 1954-3 USC Cong. and Adm. News 4017, 4395.

12. The credit varied from year to year, and within years depending upon the current corporate rate, the most recent legislative change, and the accounting period that the taxpayer used. MERTENS, *supra*, note 9 at § 38.80.

13. I.T. 3748, 1945 Cum. Bull. 152.

14. I.T. 4067, 1951-2 Cum. Bull. 55.

15. Rev. Rul. 55-105, 1955-1 Cum. Bull. 94.

16. Rev. Rul. 60-307, 1960-2 Cum. Bull. 214.

17. Rev. Rul. 66-4, 1966-1 Cum. Bull. 177.

18. I.T. 3990, 1950-1 Cum. Bull. 57.

19. *Supra* note 15.

20. *Ibid.*

21. Treas. Reg. 1.921 (a) (1) (1960).

cent of all the corporation's gross receipts for the taxable year in question. The Commissioner, via ruling, has determined that unusual and nonrecurring purchases can be as much as 15 percent of gross receipts and still be considered "incidental." [22]

In two cases both involving the Otis Elevator Company and the identical issue, the Court of Claims held that the following purchases made outside the Western Hemisphere for the calendar years indicated were not so substantial as to deny the taxpayer his status as a WHTC:

1950 — 6.2%[23]
1951 — 8.4%
1952 — 16.9%
1953 — 15.2%[24]

Otis Elevator had purchased component parts in Europe for elevators being installed in South America.

However, in *Tops of Canada, Ltd.*,[25] the court held that purchases of 34 percent of the total gross receipts for the taxable year were neither minor nor incidental in proportion to the entire business. The purchases, made in Hong Kong and Japan, were found by the court to be recurring and usual in the petitioner's course of business. It has been suggested that this problem could be avoided merely by selling to a Western Hemisphere entity and then reselling to the WHTC. However, this suggestion should be considered with some hesitation for the regulations indicate that "all the facts of each particular case" will be considered.[26] The *Tops* case, reinforced the Commissioner's position by holding that the Treasury's regulation will be supported unless "weighty reasons" to the contrary can be given,[27] appears to be adequate precedent for discouraging certain circumventers.

The regulations further indicate that incidental economic contact outside the Western Hemisphere will not disqualify a WHTC.[28] An example used is the retention of title outside the Western Hemisphere to insure collection.[29] One wonders if an American export company,

22. Rev. Rul. 59-356, 1959-2 Cum. Bull. 177.
23. Otis Elevator Co. v. U.S., 301 F.2d 320 (Ct. Cl. 1962).
24. For the taxable years 1951-3, Otis Elevator Co. v. U.S., 356 F.2d 157 (Ct. Cl. 1966).
25. 36 T.C. 326 (1961).
26. *Supra* note 21.
27. *Supra* note 25 at 335.
28. *Supra* note 21.
29. Treas. Reg. § 1.92(6), Example (1).

holding itself out as a WHTC, could be able to sell directly to a European company with title passing in Europe and still be able to maintain its status as a WHTC. This possibility has been suggested under the regulations noted above,[30] but this would seem to be something more than the *incidental* economic contact that the regulations are attempting to describe.

A third requirement for WHTC status is that at least 95 percent of the gross income be derived from sources outside the United States,[31] and this must be true for the preceding three years or such shorter period of time as the corporation was actually in existence. The Internal Revenue Service has refined this to mean the preceding 36 months prior to the close of the taxable year. This Ruling was promulgated to avoid the short tax year due to a change in an accounting period.[32] In determining whether a corporation meets the requirements for a WHTC, and specifically the requirement that 95 percent of its income be derived from sources outside the United States, the Revenue Service has changed its position and now will consider requests for rulings on whether qualifications of a WHTC have been met.[33]

One of the major problems of the "95 percent test" is the difficulty of ascertaining whether, in fact, income has been earned outside the United States. In two cases,[34] the courts held that the "passage of title" test was determinative as to the place of sale, ruling out the "substance of the sale" test argued for by the Commissioner. After a good deal of unfavorable litigation, the Commissioner has accepted this point.[35] As a result, by avoiding the "substance of the sale" test, it is possible for a domestic company with little or no investment abroad to set itself up as a WHTC, thus making the complete reversal from the original concept of American corporations with actual investment and participation abroad. In addition, the conscious plan to avoid taxes and meet the re-

30. TM 30-2nd, *Western Hemisphere Trade Corporations*, P A-19; Phelps, *New Look at Rule of WHTC in the Export Field*, 19 J. TAXATION 54, 55 (July, 1963).

31. Int. Rev. Code § 921(1).

32. Rev. Rul. 65-260, 1965-2 Cum. Bull. 243.

33. Rev. Proc. 64-31, 1964-2 Cum. Bull. 947 which changed the "no ruling" status of Rev. Proc. 62-32, 62-2 Cum. Bull. 527, 531.

34. Commissioner v. Hammond Organ Western Export Corp., 327 F.2d 964 (7 Cir. 1963) and Commissioner v. Pfaudler Interamerican Corp., 330 F.2d 471 (2 Cir. 1964). The latter case in the tax court (¶ 63,109 P-H memo TC) gives a detailed discussion of the mechanics of handling the passage of title for the WHTC situation.

35. Rev. Rul. 64-198, 1964-2 Cum. Bull. 189.

quirements of the WHTC by the simple expedient of having title pass outside the United States has been permitted by the courts:

> . . . Retaining title until delivery served a legitimate business purpose apart from the tax consequences. . . . Plaintiff was faced with the choice of two legitimate courses of conduct either of which would be commercially sound and justifiable. We are not prepared to say that in this situation plaintiff was bound to choose that course which would best pay the treasury.[36]

The Revenue Service has ruled for some time that setting up a new corporation to qualify as a WHTC is not tax avoidance as contemplated by Section 129 of the '39 Code (now Section 269 of the '54 Code).[37]

Because of these decisions, many American manufacturing firms have established subsidiaries to make all the parent's sales to Western Hemisphere countries. However, relationships between the parent corporation and the WHTC subsidiary are subject to reallocation of income under Section 482 if the Commissioner determines that the transactions are not at "arm's length." [38] Whether "arm's length" means selling goods to the subsidiary at something more than cost (thus reducing the potential benefit of the WHTC) has not been decided by the courts. It has been argued strongly that when operating as a subsidiary, the WHTC should be given the full advantage of its status.[39]

Particular types of income must be considered with different standards in order to determine their source under the "95 percent test" of Section 921 (i). The source of rental income will be determined by the location of the rental property; if outside the United States, it will be considered foreign source income.[40] In the case of compensation for services, the test will be where the services have been performed.[41]

Insured loss recoveries are income attributable to the place where the situs of the property is located. If the property is in transit to a new location when lost and a new situs has not been established, then the original situs will govern. For example, goods shipped from a WHTC

36. A. P. Green Export Co. v. U. S., 284 F.2d 383, 390 (Ct. Cl. 1960).

37. I. T. 3757, 1945 Cum. Bull. 200.

38. Rev. Rul. 15, 1953-1 Cum. Bull. 141; see also Rev. Rul. 57-542, 1957-2 Cum. Bull. 464 where a U. S. Affiliate was purchasing from its WHTC.

39. Baker and Baker, *Pricing of Goods in International Transactions Between Controlled Taxpayers*, 10 TAX EXECUTIVE 235 (April 1958). Crawford, *Western Hemisphere Trade Corporation*, 17 N.Y.U. INST. ON FED. TAX. 369, 381 (1959).

40. Int. Rev. Code § 862(a)(4).

41. Int. Rev. Code §§ 861(a)(3) and 862(a)(3).

to Cuba are lost in transit; the income would be attributable to the United States.[42] In this matter, the Revenue Service has also indicated that the residence of the insurance underwriter, or the place of execution of the insurance contract, will not be considered in determining where the property is sold or the source of income.[43] These rulings regarding insurance have been criticized severely because they tend to compound the natural disaster by generally making the United States the source of income, thus endangering the corporation's opportunity of meeting the already high eligibility requirements of the WHTC.[44] It is suggested that insurance recoveries be treated as a sale and the passage of title test be applied.[45]

With regard to interest income from the United States, the District of Columbia, and the Territories, the WHTC, by earning 95 percent or more of its gross income outside the United States, meets the requirements of Section 861 (a) (i) (B) which states that where less than 20 percent gross income of a domestic corporation is derived from sources within the United States, it will be considered foreign source income. Though not a hindrance to the WHTC taxpayer, Section 861 is not a great help for the Commissioner has ruled that interest income under Section 103 (Interest on Governmental Obligations) cannot be used in determining whether the requirements of the WHTC have been met.[46] Aside from governmental obligations, interest earned from United States sources is income within the United States. In addition, collection and distribution of interest from non-United States sources by a United States bank will not alter the source of the income.[47]

Generally, the sources of income are governed by Code Sections 861 through 864. In cases where income is derived from sources both within and without the United States, an appropriate allocation of expenses and gross income will be made as directed by the regulations.[48]

The fourth major test for qualification as a WHTC is found in Section 921(2). It requires that at least 90 percent of the gross income of the WHTC be derived from the ". . . active conduct of a trade or busi-

42. I. T. 3902, 1948-1 Cum. Bull. 64.

43. Rev. Rul. 60-278, 1961-2 Cum. Bull. 214 clarified by Rev. Rul. 61-195, 1961-2 Cum. Bull. 133.

44. Baker et al., *Insured Losses and the Source of Income Problem of Western Hemisphere Trade Corporations,* 16 TAX EXECUTIVE 156 (April 1964).

45. *Supra* note 44 at 162.

46. Rev. Rul. 57-435, 1957-2 Cum. Bull. 462.

47. Electrical Export Corp. v. U. S., 290 F.2d 923, 7 AFTR 2d 1583 (Ct. Cl. 1961).

48. Treas. Reg. § 1.863-4.

ness" for the past three years, or such part of that time as the WHTC was in existence.

It should be pointed out at the beginning that the requirement is based on gross income (sales less cost of goods sold). Thus a WHTC with high cost goods and some interest and dividend income could find this requirement a significant barrier.[49]

With respect to dividends, the regulation clearly states that dividend income will not be considered as income derived from the active conduct of a trade or business.[50]

In the case of interest, interest income will not be considered income earned in the active conduct of a trade or business unless the interest earned is on accounts of Western Hemisphere customers not residents of the United States.[51] As noted earlier, interest on certain United States governmental obligations, as specified in Section 103, are excluded from gross income.[52]

In addition to particular types of income which are derived from the active conduct of a trade or business, the Revenue Service has, on occasion, attacked the entire business of a WHTC as not being "active." Though never very successful, this action by the Revenue Service raises possibilities for the future and opens up for examination the question of "active conduct" of a trade or business. In *Frank v. International Canadian Corporation*,[53] the Commissioner argued that the business carried on by the appellant corporation (a subsidiary WHTC) was inactive and "inert" because, first, the same business had been carried on by the appellant's parent company for some 20 years; second, the appellant carried on none of the normal activities for the sale of the products in question since employees of the parent company, with the exception of one man, did the subsidiary's business; and third, the appellant had no source of supply, customers, plant or employee organization. The Court of Appeals for the Ninth Circuit held that the appellant did carry on an active trade or business, rejecting all of the Commissioner's arguments. In affirming the District Court, the Court of Appeals found that there were good business reasons for forming the

49. Graubart, *Pitfalls of Western Hemisphere Trade Corporations*, 38 TAXES 863 (1960). *See also* 674 CCH Standard Federal Tax Reports 4347.03.

50. Reg. 1.921-1(a)(3), see also Towne Securities Corp. v. Pedrick, 44 AFTR 1258 (1953).

51. Rev. Rul. 65-290, 65-2 Cum. Bull. 241.

52. *Supra* note 46.

53. 308 F.2d 525, 10 AFTR 2d 5609 (1962).

WHTC, and that there was no requirement that the WHTC be restricted to new business. In addition, the court went on to point out that the lack of a complete employee organization would not in and of itself disqualify the WHTC, especially when a management fee was paid for services rendered by the parent and the subsidiary had at least one employee who kept the books of the subsidiary and who reviewed all paper work. Finally, in reply to the Commissioner's third argument, the court stated that there was no requirement that a WHTC have a manufacturing capability, customers, or source of supplies of its own.[54]

In addition to the major qualifications just discussed, there are two additional requirements for the WHTC. First, a statement is required to accompany the WHTC's tax return to include information sufficient to determine whether the requirements of Section 921 have been met.[55] Second, as indicated in the first paragraph of Section 921, the WHTC must be a domestic corporation; that is, a corporation organized under the laws of the United States, states or territories, or in the United States.[56] However, if the law of a foreign country requires incorporation solely for the purpose of title and operation of property, such foreign corporation, if 100 percent owned by a domestic corporation, will be treated as a domestic corporation.[57] This code provision has been applied by ruling particularly to the case of a WHTC doing business in Canada or Mexico.[58]

Considerations in Selecting the WHTC

The major reason for considering the WHTC is, of course, the special deduction permitted by Section 922. As was shown earlier, the deduction is determined by multiplying taxable income by a fraction, the numerator of which is 14, and the denominator of which is the current corporate normal and surtax rate as found in Section 11 of the Code. The current rate (22+26=48) applied to the example given in the regulations [1.922-1 (6) Ex (1)] gives the following result:

54. The Court cited A. P. Green Export Co. v. U. S., 284 F.2d 383, 6 AFTR 2d 5951 (Ct. Cl. 1960) which held that an extensive investment abroad was not a requirement for a WHTC.

55. Treas. Reg. 1.921-1(c); See TM 30-2d p. B-45 for an example of this statement.

56. Int. Rev. Code § 7701(a)(4).

57. Int. Rev. Code § 1504(d).

58. Rev. Rul. 55-372, 1955-1 Cum. Bull. 339.

Gross Income	$100,000
Less Deductions	40,000
Taxable Income	60,000
14/48 of $60,000	17,500
Taxable Income Less Deduction	$ 42,500

It should be noted that in addition to the more favorable fractional deduction (14/48 vs 14/52), that the taxable income less deduction will be taxed at the more favorable rate, thus supplying a double advantage when the corporate rate is reduced (Unfortunately, the opposite result is also true when the rate is increased.). The regulation also states that the fraction as specified in Section 922(2) applies to the full amount of the corporation's taxable income whether or not the amount is sufficient to exceed the amount subject to the normal tax.[59]

There are additional problems when calculating the amount of the special deduction. First, in the case of net operating loss carryovers and carrybacks, they must first be deducted before determining the special deduction.[60] It should be remembered that as the foreign tax exceeds 36 percent (48 minus 14) and approaches 48 percent, the tax benefits of the WHTC will be decreased.[61] But to the extent foreign taxes do not exceed United States taxes, then the foreign tax credit can be applied.[62] Where a WHTC is taking advantage of the foreign tax credit and it is a member of an affiliate group with some members having losses and others having gains, then the Section 922 deduction must be allocated using detailed rules set out by the Commissioner.[63]

In the case of consolidated returns, several recent changes in the regulations have clarified their usage by the WHTC. In general, the new regulations provide that the income of the consolidated group will be allocated by multiplying the consolidated income of the group by a fraction the numerator of which is the total WHTCs' incomes and the denominator is the total taxable income of the group. Detailed rules are provided for determining what is taxable income and what is consolidated taxable income.[64] Though the 2 percent penalty in rate on the

59. Treas. Reg. § 1.922-1(a).

60. Rev. Rul. 63-157, 63-2 Cum. Bull. 296.

61. 30 2nd T.M., *Western Hemisphere Trade Corporation*, P. A-15. *See also* Lamp; *Western Hemisphere Trade Corporation*, 18 TAX EXECUTIVE 193, 195 (1966).

62. Int. Rev. Code § 901 (6)(1).

63. Rev. Rul. 58-618, 58-2 Cum. Bull. 430.

64. Treas. Reg. § 1.1502-25 (adopted 12/30/66; TD 6909).

consolidated returns never did apply to the WHTC, its repeal in 1964 for all other corporations should be helpful in preparing consolidated returns for affiliated groups with both WHTC members and non-WHTC members.[65]

Finally, in considering the special deduction, the Revenue Service has ruled that a corporation located in a United States possession cannot avail itself of the special deduction of Section 922 while benefiting from exemption of federal taxation as a "possessions" corporation under Section 931. Even though a corporation could meet the requirements of both sections, the Commissioner feels that the basis for taxation is "wholly different and mutually exclusive." [66]

In addition to the obvious benefits of the special deduction and the related problems discussed above, there are other significant considerations in using a domestic corporation. By operating as a domestic corporation, and usually as a domestic subsidiary, profits from the subsidiary WHTC to its parent can be transferred as dividends and 85 percent will pass without taxation, thus making an effective rate of 7.2 percent (48 times 15 percent).[67] In the case of members of an affiliate group, the dividends from the WHTC subsidiary would pass 100 percent tax free but with the loss of all but one of the following: surtax exemption, $100,000 minimum accumulated earnings credit, and several other deduction limitations.[68]

By operating as a domestic corporation, the WHTC avoids the difficulties of Section 367 which requires prior approval by a foreign corporation for purposes of determining extent of gain or loss in exchanges incident to liquidation and reorganization. However, as a domestic corporation, the WHTC is faced with Section 482 which raises the ever present possibility of allocation of income and deductions between parent and subsidiary if the Commissioner determines that this is necessary to reflect clearly the income of the organization. The Commissioner has been more specific on this point in the form of rulings by saying that all transactions between the parent corporation and the subsidiary WHTC should be at "arm's length." [69] In *Frank v. International Canadian Corp.*,[70] the Court of Appeals, in upholding 6 percent markup

65. Int. Rev. Code § 1503 as amended by P. L. 88-272, Effective 1/1/64.

66. Rev. Rul. 63-224, 63-2 Cum. Bull. 297.

67. Int. Rev. Code § 243(a)(1).

68. Int. Rev. Code § 243(a)(3); The limitations are found at § 243(b)(3).

69. Rev. Rul. 15, 53-1 Cum. Bull. 141; See also Rev. Rul. 57-542, 57-2 Cum. Bull. 462; *supra* Notes 38 and 39.

70. *Supra* note 53 at 5616.

from the manufacturing parent to the WHTC, indicated that "arm's length" were not the magic words required by Section 482:

> For example, it was not any less proper for the district court to use here "reasonable return" standard than it was for other courts to use "full fair value," "fair price, including a reasonable profit," "method which seems not unreasonable," "fair consideration which reflects arm's length dealing," ". . . fair and reasonable," or "fair and fairly arrived at," or "judged as to fairness" all used in interpreting Section 45 (now 482).[71]

However, in the case of *Eli Lilly v. U.S.*,[72] the Court of Claims upheld a rather arbitrary reallocation of income between the parent and the WHTC subsidiary stating that in applying the arm's length standard the revenue agent properly allocated income. Vigorous opposition continues and the courts have not seen the last of Section 482 and its relationship with the WHTC.[73]

Another recent change that makes the domestic characteristic of the WHTC more appealing is the "pass through" requirements of Section 951 of the Code, denying foreign subsidiaries the tax deferral advantage they previously possessed. By attributing income earned by a controlled foreign corporation[74] back to the United States shareholder where it will be taxed at the domestic rate, the system of "tax haven" countries and deferral treatment of currently earned income has been severely limited.[75]

FUTURE OF THE WHTC

Though subject to constant criticism,[76] the future of the WHTC

71. *Supra* note 70. The court's footnotes have been omitted.

72. 19 AFTR 2nd 712 (Ct. Cl. 1967).

73. *Supra* note 39.

74. Int. Rev. Code § 951 et seq. as amended by § 12 of the 1962 Revenue Act.

75. The "minimum distribution" feature of § 963 and the Export Trade Corporation provisions (§ 970 et seq.) are additional alternatives to the WHTC in solving the problems posed by the 1962 Revenue Act changes to § 951.

76. *See, e.g.*, Stanley Surrey, *Taxation of Foreign Investment*, 56 COLUM. L. REV. 815, 838 (1956) in which it was expressed as follows:

> " . . . It is doubtful that in 1942 any exporter would seriously have attempted to urge tax reduction for the export trade as an appropriate tax policy. . . . Yet tax reduction for exporters accidentally came into the law and exists today. And now this WHTC provision is being extolled as a farsighted, significant, Congressional policy decision. . . [O]ne can . . . be pardoned for smiling at the glorious raiments in which this provision of humble origin is now clothed. And yet there are those who seek to use this shaky foundation as a base for still further preferences. . . ."

holds many possibilities. The American Bar Association as part of the Omnibus Tax Bill for the 89th Congress recommended that the word "incidental" be struck out so that purchases of any amount outside the Western Hemisphere would not effect the qualifications of the WHTC.[77] Though the provision and the bill made little headway through the legislative process, the stage has been set for more direct and greater efforts in future sessions of Congress. Because of the hostility, as noted above, the possibility of unfavorable legislation also exists.[78] Congress has indicated that it is more willing to give tax relief to business efforts that actually have some development and physical presence in a foreign country, particularly the "less developed countries." [79] However, notwithstanding the historical inconsistencies and current adverse economic and policy considerations, there is little likelihood of significant unfavorable legislation for the WHTC in the near future. This feeling was expressed in the House Report that accompanied the reenactment of the WHTC provision in the 1954 code:

> Although your committee believes that the present WHTC provisions produce some anomalous results, it has retained these provisions in order to avoid any disturbances at the present time to established channels of trade . . .[80]

A more significant threat than possible legislation is the attitude of the Treasury toward, and its treatment of, the WHTC. For instance, the determination of an "arm's length transaction" under the proposed regulations of Section 482[81] will, if accepted as proposed, be in immediate conflict with the decision in *Frank v. International Canadian Corp.*[82] The proposed regulations, replacing the first proposal, made in April, 1965, describe three methods for determining an arm's length price; i.e., comparable uncontrolled price, resale price, and the cost plus method. Another possible area of conflict with the Revenue Service would be the application of Section 269. Using Section 269 the

77. § 54 HR 11450, 89th Cong., 2nd Sess.

78. Flynn, *Western Hemisphere Trade Corporation: Quo Vadis*, 12 TAX L. REV. 413, 421 (1957).

79. The Export Trade Corporation provisions (§ 970 et seq.) and the qualified investments in less developed countries (§ 955) are examples of Congressional intent in this area.

80. S. Rep. No. 1337, 83rd Cong. 2nd Sess., 1954-3 USC Cong. & Adm. News 4017, 4104.

81. Proposed Treas. Reg. § 1.482-2(3), 31 Fed. Reg. 10394, 673 CCH Para. 2992 (1966). See also Pergament, *New 482 Regs, Provide Arm's-Length Rules . . .*, 25 J. TAXATION 238 (Oct., 1966).

82. *Supra* note 70.

Revenue Service could assert that in acquiring a WHTC, a party is getting the deduction of Section 922 for the primary purpose of avoiding taxes and therefore should be denied the deduction of Section 922. The Commissioner has, in the case of new corporations, thus far limited himself to finding that where a WHTC is created for the express purpose of availing itself of the advantages of Section 922, such action does not constitute tax avoidance.[83]

Conclusion

The requirements for qualification and operation as a WHTC remain formidable. Yet several recent developments have given rise to the need for a reconsideration of the potentialities of the WHTC. New factors beneficial to the WHTC are: 1) the Revenue Service accepting the view of the courts that the passage of title test should be used in determining where the sale takes place; 2) the reduction of the corporate rate in 1964 giving a proportionally greater effect to the special deduction as well as lowering corporate rates generally; 3) the loss of deferral treatment of income of controlled foreign corporations, thus making the alternative of the WHTC approach more attractive; 4) the repeal of the 2 percent tax for the filing of the consolidated return for *all* members of an affiliated group, thus making possible the transfer of dividends to the parent at no tax cost; and 5) the generally favorable series of court decisions with respect to WHTCs.

Factors threatening the WHTC are the possibility of reapportionment of income and deductions under Section 482 and the unfriendly attitude of the Revenue Service and the Treasury generally toward the questionable beginnings and current use of the WHTC.

In conclusion, parties contemplating the initiation of any foreign operations should consider all forms of business entities in conjunction with their study of the tax structures of the foreign countries involved.[84] The WHTC should be given special consideration as possibly the optimum form of business entity if the bulk of the planned business will be conducted in the West Indies, North, Central or South America.

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83. I.T. 3757, 1945 Cum. Bull. 200.

84. Kalish, *Tax Considerations in Organizing for Business Abroad,* 44 Taxes 71 (Feb., 1966). Tax Management Portfolio Series: *Export Operations, No. 64; Foreign Operations, Source of Income, No. 80; Foreign Income, Sec. 482 Allocations, No. 115.*