Michael J. McIntyre, “U.S. Taxation of Foreign Corporations in the Digital Age,” 55 *Bulletin for International Fiscal Documentation* 498-506 (2001).

Summary

The United States taxes foreign corporations only on that portion of their income derived from economic activities that have some nexus with the United States. The highly technical rules that the United States has developed for determining whether the necessary nexus has been established are addressed in this article. Although the focus of this article is on the U.S. statutory rules, tax treaty rules are addressed when necessary to explain how the U.S. statutory rules actually operate or are likely to be interpreted.

Part II of this article presents an overview of the U.S. rules for taxing foreign corporations on business income derived from the United States. Special emphasis is given in this part to the rules governing the taxation of income derived by a foreign corporation from the sale of tangible personal property in the United States. Foreign corporations that are directly engaged in business in the United States are concentrated in the finance, insurance and real estate industries. Most foreign-based multinational companies that engage in manufacturing or marketing goods in the United States operate through a U.S. affiliate. In 1997, foreign corporations engaged in business in the United States had U.S. gross receipts of USD 109 billion, whereas the U.S. gross receipts of foreign-controlled domestic corporations were USD 1.8 trillion.

Part III deals with the U.S. income taxation of foreign corporations engaged in electronic commerce in the United States through the sale of tangible and intangible personal property over the Internet. Most of the relevant U.S. tax rules governing the sale of tangible and intangible property by foreign corporations were developed decades ago, before the Digital Age. The application of these old rules to this new form of business activity is unclear in many respects. The article contends, nevertheless, that the current U.S. tax rules, properly interpreted, give the U.S. tax authorities the power to impose tax on foreign corporations engaged in many forms of electronic commerce in the United States.

Part III also looks at the protection from U.S. taxation that a foreign corporation engaged in electronic commerce in the United States might obtain through a tax treaty. The basic issue, under the I.R.C. and under U.S. tax treaties, is whether a foreign corporation operating a business in the United States through a virtual office has a fixed place of business within the United States. A virtual office, for purposes of this discussion, is a web site employed by a taxpayer to transact its business. This part of the article argues that a virtual office is functionally equivalent to a "bricks and mortar" office and should be treated as a fixed place of business under the I.R.C. and existing U.S. tax treaties. This view obviously rejects the contrary position recently taken by the OECD in its new Commentary on Art. 5 (Permanent establishment) of the its Model Tax Convention on Income and on Capital. The OECD argues that a taxpayer must have a “physical presence” in a country to have a permanent establishment there and that a website is not physical but instead constitutes intangible property. Those arguments are analyzed and found wanting, as a matter of physics and as a matter of law. In particular, the article contends that a website appearing on a customer’s computer screen is physical and does not constitute intangible property.