

WWW.Foreign Corporation.Com: The United States Taxation of International Business Transactions Conducted Over the Internet

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INTRODUCTION

Imagine yourself sitting on a beach in the United States. Now imagine yourself sitting on a beach with your laptop computer connected to your cellular phone. Do not worry, nobody is looking. While surfing the web, you encounter a site that has a picture of the most beautiful shoes you have ever seen. Unfortunately, after purchasing your laptop, you cannot seem to find the money to make the transatlantic journey necessary to purchase these shoes.

After clearing the tears from your eyes, you notice a line on the screen that reads "Click here to purchase these shoes on line." Interested, you click your mouse twice. Before you know it, you are screaming to your friend to grab your wallet and get your credit card. You enter the credit card information onto your laptop and within seconds a new screen appears which reads "Congratulations on your purchase, you will be receiving these shoes within ten days."

Shortly after receiving your shoes, you are watching the news when the following headline appears, "The IRS is now seeking to tax foreign corporations that conduct business in the United States solely through their web sites." Shocked, you decide to watch the

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entire story. The Internal Revenue Service is claiming that the foreign corporation from which you ordered your shoes was engaged in a trade or business within the United States. As a result, the corporation has incurred a tax liability to the United States on its income that is effectively connected with this trade or business. During a commercial you think to yourself, if this company never entered the United States, how could it be engaged in a trade or business within the United States? As the news reporter continues with this late breaking story, your question is answered. The Internal Revenue Service believes that a foreign corporation can be considered to be engaged in a trade or business within the United States even if its only connection to the United States is its web site.¹ However, you are aware of a leading group of tax experts that claim that the United States tax laws do not adequately address the issue of whether a foreign business can be considered engaged in a trade or business within the United States solely by reason of the fact that its web site is viewed in the United States.²

According to the United States Treasury Department (“the Treasury”), the rapid growth of commercial transactions conducted over the World Wide Web permits a foreigner to engage in extensive commercial transactions without ever physically entering the United States.³ The Internet allows commercial transactions to be conducted without any direct human interaction. While it is clear that the sale of goods over the Internet would undoubtedly classify the seller as being engaged in a trade or business, it is not equally as clear whether or not the seller is engaged in a trade or business within the United States.⁴

1. See I.R.C. § 882(a)(1) (1998) (stating that a foreign corporation engaged in a trade or business within the United States will be taxed at the same graduated tax rates as domestic corporations on their income that is effectively connected to this trade or business).

2. See Anne Devereaux, *Aba Tax Section Meeting: IRS's Halpern Briefs Panel on Nonresident Withholding Rules*, 96 TNT 94-17 (May 13, 1996), available in LEXIS 96 TNT 94-17 (reaching this consensus after a similar hypothetical was discussed at the meeting).

3. See Office of Tax Policy, U.S. Dep't of the Treasury, *Selected Tax Policy Implications of Global Electronic § 7.2.3.1* (1996), reprinted in 1996 DAILY TAX REP. (BNA) 226 (Nov. 22 1996) [hereinafter *Treasury Discussion Paper*].

4. See James Cigler & Susan Stinnett, *Treasury Seeks Cybertax Answers with Electronic Commerce Discussion Paper*, 8 J. INT'L TAX'N 56, 59 (1997); see also *Treasury*

The explosion of commercial transactions conducted over the Internet is raising new problems in federal taxation.⁵ This is because the location of a transaction conducted electronically is not always known. The United States taxing regime focuses on the source of the income and the residence of the seller.⁶ Electronic commerce on the other hand, can be conducted anywhere, regardless of the location of the transaction or the parties to the transaction.⁷

This Note advocates the need for a ruling by a United States taxing authority that succinctly concludes that a foreign corporation conducting business in the United States solely through its Internet web site is not considered under current tax law to be engaged in a trade or business within the United States. Part I provides an overview of the current United States tax laws that pertain to international transactions. This Part also briefly provides an overview of the different components that enable commercial transactions to be conducted electronically. Part II discusses past rulings of various courts and government agencies that have decided whether or not a certain activity constitutes a trade or business within the United States under current tax law. Part III presents arguments that address the issue of whether or not a foreign corporation conducting business in the United States solely through its Internet web site is considered under current United States tax law to be engaged in a trade or business within the United States. Additionally, Part III presents different views regarding whether or not current United States tax law needs to be modified to adapt to the growth of electronic commerce. Part III also presents arguments regarding whether current United States tax law is adequate to handle transactions conducted over the Internet. Finally, Part III argues that under current United States tax law, a foreign corporation doing business in the United States

Discussion Paper, *supra* note 3, § 7.2.3.1 (stating that the Treasury is unsure as to whether these transactions can be classified as being engaged in a United States trade or business).

5. See Peter A. Glicklich et al., *Internet Sales Pose International Tax Challenges*, 84 J. TAX'N 325, 327 (1996).

6. See Cigler & Stinnet, *supra* note 4, at 59.

7. See Treasury Discussion Paper, *supra* note 3, § 7.2.3.1. (stating that the location of commercial transactions conducted electronically can't be ascertained).

solely through Internet web site should not be considered engaged in a trade or business within the United States. This Note concludes that current United States tax law does not need to be modified to adapt to international business transactions conducted over the Internet and that foreign corporations doing business within the United States solely through their Internet web sites are not considered engaged in a trade or business within the United States.

I. THE UNITED STATES TAXING REGIME WITH REGARD TO INTERNATIONAL TRANSACTIONS

This Part discusses relevant provisions of the United States Internal Revenue Code (“the Code”) that illustrate the importance of a determination as to whether or not an entity is engaged in a trade or business within the United States. This Part also provides an overview of the different types of technology that have fostered the growth of electronic commerce. Section A begins with a discussion of how United States tax law determines the residence of individuals and entities. Moreover, Section A provides an overview of the taxes imposed by the United States on individuals, entities and transactions. Finally, Section A discusses the withholding obligation of a payor when it has been determined that the payee has incurred a tax liability to the United States. Section B examines the many rules used by the United States to determine the source of the income earned. Section C reviews the pertinent section of the Internal Revenue Code that presents the “engaged in a trade or business within the United States” concept. Moreover, Section C discusses the “effectively connected income” requirement. Finally, Section D provides relevant information regarding the different types of technology that enable international transactions to be conducted electronically.

A. *The United States Tax Law*

1. Residency Rules

Current United States tax law considers a United States person to be either a “citizen or resident of the United States,”⁸ “a domestic partnership,”⁹ “a domestic corporation,”¹⁰ any estate other than one which has foreign source income that is not effectively connected with a trade or business in the United States,¹¹ or any trust¹² that “a court within the United States is able to exercise primary supervision over.”¹³

A non-resident alien individual that becomes a resident alien individual becomes subject to United States tax in the same manner as a United States citizen.¹⁴ An individual will be treated as a resident alien of the United States if such individual is lawfully admitted for permanent residence within the United States.¹⁵ Additionally, an individual will be treated as a resident alien if “such individual meets the substantial presence test.”¹⁶ However, an in-

8. I.R.C. § 7701(a)(30)(A).

9. I.R.C. §§ 7701(a)(30)(B) & 7701(a)(2) (defining a partnership to include a syndicate, group, pool, venture, or other unincorporated association through which business or financial matters are carried on).

10. I.R.C. § 7701(a)(30)(C); *see also* I.R.C. § 7701(a)(3) (defining a corporation to include an association, joint stock company or insurance company).

11. *See* I.R.C. § 7701(a)(30)(D); *see also* I.R.C. § 7701(a)(31)(A) (stating that a foreign estate is one with foreign source income that is not effectively connected with the conduct of a trade or business within the United States).

12. *See* I.R.C. § 7701(a)(30)(E); *see also* I.R.C. § 875(2) (stating that a beneficiary of a trust or estate which is considered to be engaged in trade or business within the United States will also be treated as being engaged in trade or business within the United States).

13. I.R.C. § 7701(a)(30)(E)(i).

14. *See* I.R.C. § 7701(b)(1)(A) (stating that an alien individual will be treated as a resident of the United States if such individual meets one of the following tests). *See also* Treas. Reg. § 1.1-1(b) (1999) (stating that the United States taxes citizens and all resident aliens of the United States on their worldwide income, whether the income is United States source income or foreign source income).

15. *See* I.R.C. § 7701(b)(1)(A)(i); *see also* Treas. Reg. § 301.7701(b)-1(b)(1) (1999) (stating that a lawful permanent resident is an individual who has been lawfully granted the privilege of residing permanently in the United States as an immigrant in accordance with immigration laws).

16. I.R.C. § 7701(b)(1)(A)(ii). The substantial presence test is met if the individual

dividual may avoid the substantial presence test if “such individual is present in the United States on fewer than 183 days during the current year, and it is established for the current year that such individual has a tax home . . . in a foreign country and has a closer connection to such foreign country than to the United States.”¹⁷ Finally, an individual may make an election to become a resident alien.¹⁸ In sum, an alien individual failing to meet at least one of the aforementioned tests will be treated as a non-resident alien individual.¹⁹

For federal tax purposes an entity with two or more members will be treated as a partnership or a corporation.²⁰ Furthermore, certain entities are automatically treated as corporations, also known as “per se” corporations.²¹ A business entity with only one member is classified either as a corporation or as a sole proprietorship.²² Finally, an entity that chooses not to be classified according to the default provisions may elect to be treated either as a partnership or corporation.²³

is present in the United States for at least 31 days in the current taxable year and is present at least 183 days in the past three years according to the following formula. The formula used first multiplies the days present in the United States during the current year by one, multiplies the days present in the immediately preceding year by 1/3, and days present in the second preceding year by 1/6. If the total of these days equals at least 183, the substantial presence test is met. *See* I.R.C. § 7701(b)(3).

17. I.R.C. § 7701(b)(3)(B); *see also* Treas. Reg. § 301.7701(b)-2(c)(1) (1999) (defining an individual’s tax home to be located at the individual’s principal place of business and if the individual has no regular place of business, then the individual’s tax home is the individual’s regular place of abode).

18. *See* I.R.C. § 7701(b)(1)(A)(iii); *see also* I.R.C. § 7701(b)(4) (stating that an individual may make this election if such individual is present in the current year for at least 31 consecutive days, met the substantial presence test for the prior year and was present in the United States at least 75 percent of the days in the current year that began with the first day of the 31 consecutive day period).

19. *See* I.R.C. § 7701(b)(1)(B) (stating that an individual is a non-resident alien individual if such individual is neither a United States citizen nor passes one of the tests mentioned in I.R.C § 7701(b)(1)(A)).

20. *See* Treas. Reg. § 301.7701-2(a) (1999).

21. *See* Treas. Reg. § 301.7701-2(b)(8) (1999) (containing a list of domestic and foreign business entities that are automatically treated as a corporation, no further election is necessary).

22. *See* Treas. Reg. § 301.7701-2(a) (1999) (stating that if the entity has one member, the entity will be treated as a corporation or disregarded). An entity is said to be disregarded when it is treated as a sole proprietorship. *See id.*

23. *See* Treas. Reg. § 301.7701-3(a) (1999) (as amended in 1998). The regulations

A corporation is a domestic corporation if created or organized in the United States, organized under the laws of any state, or organized under the laws of the United States.²⁴ Furthermore, there is no requirement that a domestic corporation conduct business or own property within the United States.²⁵ A corporation not meeting one of the aforementioned requirements is a foreign corporation.²⁶ A foreign corporation engaged in a trade or business within the United States will only be taxed on income that is effectively connected with this trade or business.²⁷

A partnership is a domestic partnership if it is created or organized in the United States, organized under the laws of any state, or organized under the laws of the United States.²⁸ Additionally, a non-resident partnership will be considered a domestic partnership if the partnership is engaged in any trade or business within the United States.²⁹ In this situation, the nationality and residence of the partners is irrelevant.³⁰ A partnership that fails to fall within one of the aforementioned is classified as a foreign partnership.³¹ Finally, the Secretary of the Treasury may proscribe that a foreign partnership will be treated as a domestic partnership, or that a domestic partnership will be treated as foreign partnership.³²

contain certain default provisions that are effective if an entity fails to make an election. However, if an entity does make an election, they will be classified according to their choice, subject to additional rules that limit one's choice depending on the liability of an entity's members. *See id.*

24. *See* I.R.C. § 7701(a)(4).

25. *See* Treas. Reg. § 301.7701-5 (1999).

26. *See* I.R.C. § 7701(a)(5) (stating that a foreign corporation is any corporation that is not a domestic corporation).

27. *See* Treas. Reg. § 301.7701-5 (1999).

28. *See* I.R.C. § 7701(a)(4).

29. *See* Treas. Reg. § 301.7701-5 (1999); *see also* I.R.C. § 875(1) (stating that if a non-resident individual or corporation is a member of a partnership considered to be engaged in a trade or business within the United States, then either the individual or corporation will also be considered engaged in a trade or business within the United States).

30. *See* Treas. Reg. § 301.7701-5 (1999) (stating that whether a partnership is to be regarded as resident or non-resident is not determined by the nationality or residence of the partners nor by the location of where the partnership was created).

31. *See* I.R.C. § 7701(a)(5) (stating that a foreign partnership is any partnership that is not a domestic partnership).

32. *See* I.R.C. § 7701(a)(4) (granting this discretionary authority to the Secretary of the Treasury).

2. United States Tax Liability

All United States citizens and all resident aliens of the United States are taxed on their worldwide income, regardless of the source of this income.³³ The United States Supreme Court justifies taxing worldwide income on the theory that United States citizens are entitled to the benefits of citizenship even when they reside outside the United States.³⁴ Non-resident alien individuals, on the other hand, are only taxed on certain types of United States source income,³⁵ as opposed to foreign source income, and are also taxed on income which is “effectively connected with the conduct of a trade or business within the United States.”³⁶

When an individual changes his status from a resident alien citizen to a non-resident alien within the same taxable year, the individual’s tax year is divided into two periods.³⁷ In the period prior to becoming a non-resident alien, the individual is taxed comparably to a United States citizen.³⁸ In the period subsequent to abandonment of residence, the individual is taxed as a non-resident alien.³⁹

Non-resident aliens are subject to a thirty percent tax on their United States source income⁴⁰ that consists of “interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations and other fixed or determinable annual or periodical gains, profits, and income, (“FDAP income”) . . . but only to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States.”⁴¹ The

33. See Treas. Reg. § 1.1-1(b) (1999).

34. See *Cook v. Tait*, 265 U.S. 47, 56 (1924) (stating that the taxation of United States citizens on their worldwide income does not violate the Constitution).

35. See I.R.C. § 872(a)(1) (taxing non-resident aliens only on their United States source income, rather than on both United States and foreign source income).

36. I.R.C. § 872(a)(2).

37. See Treas. Reg. § 1.871-13(a) (1999).

38. See *id.*

39. See *id.*

40. See I.R.C. § 871(a)(1).

41. I.R.C. § 871(a)(1)(A); see also § I.R.C. 881 (a)(1)(A) (pertaining to corporations where as I.R.C. § 871(a)(1)(A) applies to individuals). Most references in this Note will be to the relevant code sections that pertain to individuals unless a discrepancy exists with regard to corporations. Furthermore, the provisions omitted that pertain to corporations are analogous to those that pertain to individuals.

definition of FDAP income includes income received from covenants not to compete.⁴² In addition to the aforementioned tax, gains from the sale of intangible property are subject to a thirty percent tax if they are “contingent on the productivity, use, or disposition of the property or interest [in the property] sold or exchanged.”⁴³ Finally, a non-resident alien present in the United States for a period of one-hundred eighty-three days or more within one taxable year is subject to a thirty percent tax on the amount of his net capital gains.⁴⁴

A non-resident alien receiving United States source interest income is not subject to United States tax if the interest paid qualifies as portfolio interest.⁴⁵ Bearer debt is portfolio interest⁴⁶ only if the bearer debt is sold pursuant to the requirements of section 163(f)(2)(B) of the Internal Revenue Code.⁴⁷ Debt in registered form qualifies as portfolio interest if the lender receives a statement that the beneficial owner of the obligation is not a United States person.⁴⁸ However, the portfolio interest exception will not be available if the beneficial owner of an obligation owns ten percent or more of the “total combined voting power of all classes of stock of such corporation entitled to vote.”⁴⁹ In the case of an obligation of a partnership, the portfolio interest exception is not available to the beneficial owner of the obligation if he owns “10

42. See Rev. Rul. 74-108, 1974-1 C.B. 248 (stating that covenants not to compete are FDAP income and their source is the place where the promisor forfeited his right to act); see also *Korfund Co. v. Commissioner*, 1 T.C. 1180 (1943) (holding that the source of covenants not to compete is determined by reference to the place where the covenant not to compete is located).

43. See I.R.C. § 871(a)(1)(D).

44. See I.R.C. § 871(a)(2) (stating that a 30 percent tax will be imposed when the excess is United States source income).

45. See I.R.C. § 871(h)(1); see also § 871(h)(2) (stating that portfolio interest means all interest except that which is excluded according to this subparagraph).

46. See I.R.C. § 871(h)(2)(A)(i) (stating that bearer debt can be portfolio interest).

47. See I.R.C. § 871(h)(2)(A)(ii). Section § 163(f)(2)(B) requires that the lender make arrangements that are designed to ensure that such obligations will not be sold to a United States citizen, that the obligation pay interest outside the United States, and that the debt indicate on the face of the certificate that any United States person who holds such obligation will be subject to the limitation of the United States tax laws. See I.R.C. § 163(f)(2)(B).

48. See I.R.C. § 871(h)(2)(B).

49. I.R.C. § 871(h)(3)(B)(i).

percent or more of the capital or profits interest in such partnership.”⁵⁰ Finally, interest earned on a bank deposit is not subject to the thirty percent tax⁵¹ if the bank’s income “is not effectively connected with the conduct of a trade or business within the United States.”⁵²

A non-resident alien engaged in a trade or business within the United States will be taxed at graduated rates only on income effectively connected with the conduct of a trade or business within the United States.⁵³ A similar provision exists for foreign corporations on their income effectively connected with a trade or business within the United States.⁵⁴ Finally, when a foreign corporation is engaged in a trade or business within the United States through a branch in the United States and this branch distributes money to the foreign corporation’s home office, the United States imposes an additional thirty percent tax on this distribution.⁵⁵

A non-resident alien individual who is not engaged in a trade or business within the United States may elect to be treated as such, and any income which is received by such individual will “to the extent derived from sources within the United States, be treated as effectively connected with the conduct of a trade or business

50. I.R.C. § 871(h)(3)(B)(ii).

51. *See* I.R.C. § 871(i)(1) (stating that there will be no tax imposed under I.R.C. § 871(a) if the income earned is from interest on bank deposits).

52. I.R.C. § 871(i)(2)(A).

53. *See* I.R.C. § 871(b). Section 1 is the provision that United States citizens use to calculate their tax liability. I.R.C. § 1. Thus, section 871(b) allows foreigners with income effectively connected to a trade or business within the United States to be taxed on this income at the same graduated rates as United States citizens are taxed. This allows foreigners to deduct expenses against their effectively connected income so they are no longer subject to the 30 percent flat tax on earnings stated in section 871(a). I.R.C. § 871(a).

54. *See* I.R.C. § 882 (allowing foreign corporations engaged in a trade or business within the United States to be taxed at the same graduated rates that United States corporations are taxed at if a foreign corporation’s income is effectively connected with a trade or business within the United States). This provision also allows foreign corporations to deduct expenses against their effectively connected income and therefore they are also no longer subject to the 30 percent flat tax on earnings stated in I.R.C. § 881(a). *See id.*

55. *See* I.R.C. § 884(a) (stating that in addition to the tax imposed under I.R.C. § 882, there is an additional 30 percent tax imposed under this section); *see also* I.R.C. § 884(d) (stating that the 30 percent tax will be imposed on those distributions attributable to income that is effectively connected with a trade or business within the United States).

with the United States.”⁵⁶ Finally, a non-resident alien that derives income from real property situated in the United States may elect to treat such income as effectively connected with the conduct a trade or business within the United States.⁵⁷

3. Withholding Requirements of the Payor

A general withholding obligation arises when certain types of payments are made to either foreign individuals or foreign entities that are the beneficial owners of the income.⁵⁸ A beneficial owner is defined as “the person who is the owner of income for tax purposes and who beneficially owns that income.”⁵⁹ Thus, any individual or entity that has control over the payment of specified types of income to any non-resident alien individual or foreign partnership will be required to “deduct and withhold a [thirty] percent tax.”⁶⁰ A similar withholding obligation exists for payments to foreign corporations.⁶¹ Finally, the amount subject to withholding will be the gross amount of the payment.⁶²

Income effectively connected with the conduct of a trade or business within the United States is not subject to this withholding obligation.⁶³ Additionally, “compensation for personal services

56. I.R.C. § 871(c) (stating that this election is available if the person is legally present in the United States under either a “F”, “J”, “M” or “Q” visa).

57. *See* I.R.C. § 871(d) (stating that if real property is held for the production of income, a non-resident alien may elect to treat income from this real property as effectively connected with a trade or business within the United States).

58. *See* Treas. Reg. §1.1441-1(b)(1) (1999) (stating that a withholding agent must withhold 30 percent of any payment that would be subject to a 30 percent United States tax).

59. Treas. Reg. §1.1441-1(c)(6) (1999) (stating that the person will be treated as the owner of the income if they would be required to include the income under I.R.C. § 61, the gross income provision).

60. *See* I.R.C. § 1441(a); *see also* I.R.C. § 1441(b) (providing a list of the types of income that are subject to withholding, a list similar to that presented in I.R.C. § 871).

61. *See also* I.R.C. § 1442(a) (stating that a similar obligation exists when the recipient of the income is a foreign corporation).

62. *See* Treas. Reg. §1.1441-3(b)(ii) (1999) (explaining that the amount that will be held will be the gross amount, even though the payee may be entitled to a deduction).

63. *See* I.R.C § 1441(c) (stating that no deduction or withholding obligation arises when the income earned is effectively connected with the conduct of a trade or business within the United States).

may be exempted from deduction and withholding.”⁶⁴ Interest income qualifying as portfolio interest is also not subject to the aforementioned withholding provision.⁶⁵

B. *Determining the Source of the Income*

The Internal Revenue Code bifurcates the determination of income into either income from sources within the United States⁶⁶ or income from sources outside the United States.⁶⁷ Some of the different types of income specifically enumerated include interest,⁶⁸ dividends,⁶⁹ compensation for personal services,⁷⁰ rental and royalty income,⁷¹ gains from the sale of personal property⁷² and gains from the transfer of computer programs.⁷³

1. Interest

Interest has been defined as “compensation for the use or forbearance of money.”⁷⁴ The simplest rule for determining the source of interest income is that “the residence of the obligor at the time the interest is *paid* governs its source.”⁷⁵ More specifically, interest paid by the United States, a resident of the United States or a domestic corporation will be United States source income.⁷⁶ Regarding partnerships, only interest paid by partnerships with a United States trade or business will be considered United States

64. I.R.C. § 1441(c)(4).

65. See I.R.C. § 1441(c)(9) (stating that no tax will be required to be deducted and withheld on portfolio interest unless the payor has reason to know that interest is not portfolio interest).

66. See I.R.C. § 861 (providing a list of different types of income that are United States source income).

67. See I.R.C. § 862 (providing a list of different types of income that are from sources without the United States).

68. See I.R.C. § 861(a)(1); see also I.R.C. § 862(a)(1).

69. See I.R.C. § 861(a)(2); see also I.R.C. § 862(a)(2).

70. See I.R.C. § 861(a)(3); see also I.R.C. § 862(a)(3).

71. See I.R.C. § 861(a)(4); see also I.R.C. § 862(a)(4).

72. See I.R.C. § 865(a).

73. See Treas. Reg. § 1.861-18 (1999).

74. Deputy v. Du Pont, 309 U.S. 488, 498 (1939).

75. JOSEPH ISENBERGH, INTERNATIONAL TAXATION: U.S. TAXATION OF FOREIGN TAXPAYERS AND FOREIGN INCOME 31 (Supp. 1993) [hereinafter ISENBERG, U.S. TAXATION] (emphasis in original).

76. See I.R.C. § 861(a)(1).

source income.⁷⁷ Moreover, interest paid by a foreign corporation engaged in a trade or business within the United States will be treated as United States source income only if the interest is actually paid by the foreign corporation's United States trade or business.⁷⁸ Finally, if a foreign corporation engaged in a trade or business within the United States is allowed a deduction for the interest paid by this trade or business and the amount of the deduction allowed exceeds the actual amount of interest paid, such excess will be United States source income.⁷⁹

Foreign source interest income consists of all interest income not determined to be United States source income.⁸⁰ Additionally, interest paid by a domestic corporation that derives at least 80 percent of its gross income from the active conduct of a trade or business outside the United States will be treated as foreign source income.⁸¹ Interest paid by a foreign branch of a domestic corporation or partnership engaged in the commercial banking business will also be considered foreign source interest income.⁸²

2. Dividends

Dividends received from a domestic corporation will be treated

77. See Treas. Reg. § 1.861-2(a)(2) (1999) (stating that interest paid by either a foreign or domestic partnership will be treated as United States source income only if the partnership is engaged in a trade or business within the United States).

78. See I.R.C. § 884(f)(1)(a) (taxing interest paid by a foreign corporation engaged in a trade or business in the United States by stating that the interest will be treated as if it were paid by a domestic corporation). See also I.R.C. § 861(a)(1) (stating that interest paid by a domestic corporation is United States source income).

79. See I.R.C. § 884(f)(1)(b) (stating such excess will be treated as if it were actually paid by a domestic corporation, and thus be United States source income).

80. See I.R.C. § 862(a)(1) (stating that interest not derived from sources within the United States will be foreign source income).

81. See I.R.C. § 861(a)(1)(A) (asserting that interest from a resident alien individual or domestic corporation that meets the 80-percent active foreign business income test will not be treated as United States source income); see also I.R.C. § 861(c)(1)(b) (stating that the 80 percent foreign business income test is met if at least 80 percent of the corporation's gross income is earned from the active conduct of a trade or business located outside the United States). But see I.R.C. § 861(c)(2) (noting that in the case of a domestic corporation meeting the 80-percent foreign business income requirement, the portion of interest received by a related person attributable to the corporation's United States business will be treated as United States source income).

82. See I.R.C. § 861(a)(1)(B).

as United States source income.⁸³ On the other hand, dividends received from a foreign corporation will be treated as foreign source income.⁸⁴ However, if a foreign corporation is engaged in a trade or business within the United States and in the past three years at least twenty-five percent of the foreign corporation's gross income is from the United States, then the portion of the dividend that is attributable to the corporation's United States trade or business will be treated as United States source income.⁸⁵ Finally, substitute dividend payments are sourced using the same rules used to source actual dividend payments.⁸⁶

3. Compensation for Services

Compensation for personal services actually performed within the United States will be United States source income.⁸⁷ On the contrary, compensation paid for services performed outside the United States will be foreign source income.⁸⁸ Additionally, income earned from the performance of personal services within the United States will constitute foreign source income if the income is received by a non-resident alien temporarily present in the United States for a period less than 90 days,⁸⁹ the compensation does not exceed \$3,000,⁹⁰ and "the compensation is for labor or services

83. See I.R.C. § 861(a)(2)(A).

84. See I.R.C. § 862(a)(2) (stating that dividends received from sources other than the United States will be foreign source income).

85. See I.R.C. § 861(a)(2)(B).

86. See Treas. Reg. § 1.861-3(a)(6) (1999) (stating that when sourcing substituted dividend payments, assume the security was not transferred and follow the same rules used for actual dividend payments). "A substitute dividend payment is a payment, made to the transferor of a security in a securities lending transaction or a sale repurchase transaction, of an amount equivalent to a dividend distribution which the owner of the transferred security is entitled to received during the term of the transaction." Treas. Reg. § 1.861-3(a)(6) (1999).

87. See I.R.C. § 861(a)(3); see also James P. Fuller, *Opinion & Analysis: Jim Fuller's U.S. Tax Review*, 13 TAX NOTES INT'L 2193 (Dec. 30, 1996), available in LEXIS, 96 TNI 252-22 (stating that compensation for the performance of personal services or labor will be United States source income only if the person performing the services was physically present in the United States).

88. See I.R.C. § 862(a)(3) (stating that compensation paid for personal services outside the United States will be foreign source income).

89. See I.R.C. § 861(a)(3)(A).

90. See I.R.C. § 861(a)(3)(B).

performed as an employee or under contract with,"⁹¹ a foreign payor not engaged in a trade or business within the United States.⁹²

A corporation that earns income through the performance of personal services by its agent, or employee, will determine the source of this income by looking at the place where the agent performed the services.⁹³ Thus, "[a] person who is not directly engaged in a U.S. trade or business may nevertheless be deemed to be engaged in a U.S. trade or business as the result of the activities of an agent."⁹⁴ However, in one case, the court held that payments made to a foreign corporation, which the court determined was not engaged in a trade or business within the United States, by American advertisers were foreign source income even though the foreign corporation was broadcasting to the United States.⁹⁵

4. Rental and Royalty Income

Rental income effectively connected with the conduct of a trade or business within the United States is taxed using the United States graduated tax rates.⁹⁶ A taxpayer is allowed to deduct from this income expenses incurred in the production of it.⁹⁷ On the other hand, gross rental income not effectively connected with the conduct of a trade or business within the United States is taxed at a

91. I.R.C. § 861(a)(3)(C).

92. See I.R.C. § 861(a)(3)(C)(1).

93. See *Bank of America v. United States*, 680 F.2d 142 (Ct. Cl. 1982) (holding that a corporation will determine the source of income earned from their employees by looking at the location of where the employee performed the service).

94. Treasury Discussion Paper, *supra* note 3, § 7.2.1.1

95. See *Piedras Negras Broadcasting Co. v. Commissioner*, 127 F.2d 260 (5th Cir. 1942) (holding that the primary source of the income was from the radio and power plants in Mexico, not in the United States where the broadcast was made.); see also *Ingram v. Bowers*, 47 F.2d 925, 927 (S.D.N.Y. 1931) (stating that a singer that records and performs in the United States for which he receives compensation from foreign and domestic sources will be United States source income since the United States is the place where the services were performed).

96. See *Espinosa v. Commissioner*, 107 T.C. 146, 149 (1996) (stating that the tax treatment of rental income is drastically different depending on whether or not the income is effectively connected with the conduct of a trade or business within the United States); see also I.R.C. § 871(b) (stating that a non-resident alien engaged in a trade or business within the United States will be taxed according to I.R.C. § 1 which allows for taxation at the graduated tax rates in addition to an allowance for deductions).

97. See *id*

flat thirty percent rate.⁹⁸

Rental or royalty income derived from property situated in the United States or income derived from the right to use such property in the United States will be United States source income.⁹⁹ Conversely, rental or royalty income earned from property located outside of the United States or royalty income derived for the use of property located outside the United States is foreign source income.¹⁰⁰ This definition of property includes intangible property such as “patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises and other like property.”¹⁰¹ Finally, the place of the initial sale of property is irrelevant in determining the source of the royalty income derived from this property.¹⁰²

Rental income not only includes the actual payment of the rent, but also the amount paid by the lessee for taxes, repairs and other expenses incurred under the terms of a net lease.¹⁰³ Compensation paid to the owner of a copyright for its use that is paid in a single lump sum payment rather than periodically, will not affect the classification of the income as a royalty payment.¹⁰⁴ Additionally, the payment to an owner of property for the right to use less than all of the property will also constitute royalty income.¹⁰⁵

98. See I.R.C. § 871(a)(1)(A) (stating that rental income will be taxed at a flat 30 percent rate that does not permit the taxpayer to offset this income with any expenses incurred in the production of it); see also Treas. Reg. § 1.871-7(b)(1) (1999) (stating that rental or royalty income will be included within the definition of FDAP income set forth in I.R.C. § 871(a)(1)(A)).

99. See I.R.C. § 861(a)(4).

100. See I.R.C. § 862(a)(4).

101. I.R.C. § 861(a)(4).

102. See Rev. Rul. 68-443, 1984-2 C.B. 129 (holding that the place of the initial sale of the trademark property was not the controlling factor in the determination of the source of the income).

103. See Rev. Rul. 73-522, 1973-2 C.B. 226 (stating that rental income consists of the amount of money paid for rent, in addition to other consideration paid by the lessee).

104. See *Wodehouse v. Commissioner*, 337 U.S. 369 (1949) (holding that lump sum payments for the use of copyrights results in royalty income, not income from the sale of personal property); see also *Rohmer v. Commissioner*, 153 F.2d 61, 63 (2d Cir. 1946) (stating that the classification of income as royalty income is not affected if the payment is received in a lump sum rather than in part).

105. See *Misbourne Pictures Limited v. Johnson*, 189 F.2d 774 (2d Cir. 1931) (ruling that payment for the transfer of less than all of the rights in property results in royalty

In one case, the IRS held that a payment received by a domestic corporation to broadcast a boxing match in a foreign country was foreign source income since the money was received in exchange for the right to broadcast the boxing match in another country.¹⁰⁶ Moreover, payments made under a licensing agreement for the right to use property in the United States will not be United States source income if the right to use the property in the United States is also sub-licensed to another entity that exercises the right to use the property in the United States.¹⁰⁷

5. Sale of Personal Property

Income from the sale of personal property by a United States resident will be United States source income.¹⁰⁸ However, in the case of a United States resident that maintains an office or other fixed place of business in a foreign country, "income from sales of personal property attributable to such office or other fixed place of business will be sourced outside the United States."¹⁰⁹ For purposes of determining the residence of a seller of personal property, a United States resident is defined as any individual who "is a United States citizen or resident alien and does not have a tax

income); *see also* Rev. Rul. 74-555, 1974-2 C.B. 202 (ruling that payments made by a publisher to a non-resident alien author in exchange for the publisher receiving the right to use the author's book in America constituted royalty income).

106. *See* Rev. Rul. 84-78, 1984-1 C.B. 173 (asserting that the payment received by a domestic corporation from a foreign corporation for either the exclusive or nonexclusive right to broadcast the boxing match in a foreign country is foreign source income). Furthermore, the court held that if an owner of property retains control over the property, the owner has merely granted a right to use the property rather than sold it and payments received by the owner will be treated as royalty payments, not proceeds from the sale of property. *Id.*

107. *See* SDI Netherlands B.V. v. CIR, 107 T.C. 161 (1996) (ruling that a payment made from a licensee to a licensor was not United States source income if the right to use the property was also sub licensed to another entity who acquired the right to use the property in the United States).

108. *See* I.R.C. § 865(a)(1); *but see* I.R.C. § 865(d) (stating that income derived from the sale of intangible property that is contingent on the productivity, use or disposition of this intangible property will have the source of its income determined as if the payments were royalties). *See also* I.R.C. § 865(d)(3) (sourcing income derived from the sale of goodwill according to the country in which the goodwill was generated).

109. I.R.C. § 865(e)(1)(A); *but see* I.R.C. § 865(e)(1)(B) (stating that this exception does not apply unless a tax of at least 10 percent is actually paid to a foreign country with respect to this income).

home . . . in a foreign country, or is a non-resident alien and has a tax home . . . in the United States, [or a] corporation, trust, or estate which is a United States person.”¹¹⁰ A non-resident, on the other hand, is any person not included within the aforementioned definition.¹¹¹

Income derived from the sale of personal property by a non-resident alien will be foreign source income.¹¹² However, if a non-resident maintains an office or other fixed place of business within the United States, income from the sale of personal property attributable to that office or fixed place of business will be United States source income.¹¹³ This exception will not apply to inventory that is sold outside the United States if a non-resident’s office or other fixed place of business in a foreign country materially participated in the sale.¹¹⁴

In addition to the above exception, there are additional rules used to determine the source of income derived from the sale of inventory.¹¹⁵ Generally, the place where title passes determines the source of purchased inventory.¹¹⁶ Nevertheless, title passage occurring within the United States is not sufficient to establish that a non-resident is engaged in a trade or business within the United

110. I.R.C. § 865(g)(1)(A).

111. *See* I.R.C. § 865(g)(1)(B); *but see* I.R.C. § 865(g)(2) (stating that unless a non-resident alien pays a tax of at least 10 percent on any gain derived from the sale of personal property to a foreign country, the person will be treated as a United States resident).

112. *See* I.R.C. § 865(a)(2); *but see* Rev. Rul. 91-32, 1991-1 C.B. 107 (declaring that in the case of a foreign partner that disposes of its interest in a partnership which is engaged in a trade or business within the United States, to the extent that the income is effectively connected to this business, the source of the income will be United States source income).

113. *See* I.R.C. § 865(e)(2)(A) (including inventory property within this exception).

114. *See* I.R.C. § 865(e)(2)(B).

115. *See* I.R.C. § 865(b) (presenting alternative sections of the Code that should be followed when determining the source of income derived from the sale of inventory property).

116. *See* I.R.C. § 861(a)(6) (stating that inventory purchased from outside the United States and sold within the United States will be United States source income). *See also* I.R.C. § 862(a)(6) (stating that inventory purchased from within the United States and sold outside the United States will be foreign source income). *But see* Treas. Reg. § 1.861-7(c) (1999) (stating that if the sales transaction was arranged for the primary purpose of tax avoidance, then the aforementioned rules do not apply and the circumstances of the transaction will be inspected to determine its source).

States.¹¹⁷ Furthermore, income derived from the sale of inventory that is produced in one country and sold in another, is allocated between the country in which the sales activity took place and the country in which the production of the inventory occurred.¹¹⁸

6. Transfer of Computer Programs

According to the Treasury, a computer program is “a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result.”¹¹⁹ The transfer of a computer program is treated either as “(i) A transfer of a copyright right in the computer program; (ii) A transfer of a copy of the computer program (a copyrighted article); (iii) The provision of services for the development or modification of the computer program; or (iv) The provision of know-how relating to computer programming techniques.”¹²⁰ A transaction that fulfills the definition of more than one of the aforementioned will be treated as if it were multiple transactions.¹²¹ Each satisfied category will define a separate transaction.¹²²

A transfer of a computer program is treated as a transfer of a copyright right if the transferee acquires at least one of the following rights in the computer program.¹²³ These include the right to

117. See JOSEPH ISENBERGH, INTERNATIONAL INCOME TAXATION 20:32 (1996) [hereinafter ISENBERGH, INT'L INCOME TAX] (stating that the mere fact that title to goods in the sale of inventory passes in the United States does not itself establish a trade or business within the United States).

118. See I.R.C. § 863(b) (asserting that in the case of inventory produced in one country and then sold in another, income derived from this inventory will be allocated between the two countries and then the source determined specifically for each activity); see also Treas. Reg. § 1.863-3(b) (1999) (presenting a three step analysis that should be followed when determining the source of income derived from the sale of inventory manufactured in one country and sold in another).

119. Treas. Reg. § 1.861-18(a)(3) (1999) (defining a computer program).

120. Treas. Reg. § 1.861-18(b)(1) (1999); see also Treas. Reg. § 1.861-18(a)(2) (stating that the transfer of a computer program requires classification into one of the following four categories).

121. See Treas. Reg. § 1.861-18(b)(2) (1999) (excepting from this rule transactions considered to be de minimis).

122. See *id.*

123. See Treas. Reg. § 1.861-18(c)(1)(i) (1999) (stating that a transfer of a copyright right will exist if any of the rights referred to in Treas. Reg. § 1.861-18(c)(2) are acquired by the transferee).

copy the program and sell it to the public,¹²⁴ “the right to prepare derivative computer programs based upon the copyrighted computer program,”¹²⁵ and the right to demonstrate¹²⁶ or display the computer program to the public.¹²⁷ If the transferee does not acquire any of the aforementioned rights, then the transferee has acquired a copyrighted article.¹²⁸

After the classification of a transaction as either a transfer of a copyright right or a copyrighted article, it must be determined whether the transfer was a sales transaction or a licensing agreement.¹²⁹ Unless substantially all of the rights in a copyright right were transferred, the transaction will not be classified as a sale or exchange, but rather as a licensing agreement.¹³⁰ A transfer of a copyrighted article will be treated as a sales transaction, rather than a licensing agreement, only if the transferee receives the “benefits and burdens of ownership.”¹³¹

C. Income Effectively Connected With the Conduct of a Trade or Business Within the United States

1. Engaged in a Trade or Business

Determining whether an individual is engaged in a trade or business within the United States requires an examination of the specific

124. See Treas. Reg. § 1.861-18(c)(2)(i) (1999).

125. Treas. Reg. § 1.861-18(c)(2)(ii) (1999).

126. See Treas. Reg. § 1.861-18(c)(2)(iii) (1999).

127. See Treas. Reg. § 1.861-18(c)(2)(iv) (1999).

128. See Treas. Reg. § 1.861-18(c)(1)(ii). A copyrighted article “is a copy of a computer program from which the work can be perceived, reproduced or otherwise communicated, either directly or with the aid of a machine or device.” Treas. Reg. § 1.861-18(c)(3) (1999).

129. See Treas. Reg. § 1.861-18(f) (1999); see also *supra* Part I.A.4-5 for a discussion of the rules used to determine the source of income derived from the sale of personal property and the rules used to determine the source of royalty income derived from licensing agreements.

130. See Treas. Reg. § 1.861-18(f)(1) (1999) (stating that the transfer of a copyright right will only be treated as a sales transaction if substantially all of the rights in the copyright were acquired by the transferee).

131. See *id.* § 1.861-18(f)(2) (asserting that if the transferee does not receive the benefits and burdens of ownership, the transaction will be treated as a licensing agreement rather than a sales transaction).

facts of each case.¹³² More specifically, a trade or business is usually found to exist when a taxpayer is engaged in “substantial, regular, or continuous ordinary business activity within the United States.”¹³³ Additionally, the IRS provides assistance in determining whether a taxpayer is engaged in a trade or business within the United States by presenting a rudimentary definition of the engaged in a trade or business concept within the United States.¹³⁴ Finally, when it is determined that a foreigner is engaged in a trade or business within the United States, income effectively connected with the conduct of this trade or business will be taxed in a manner similar to that of a United States resident.¹³⁵

According to the Internal Revenue Code, the performance of personal services within the United States constitutes a United States trade or business.¹³⁶ However, where a non-resident alien individual performs personal services within the United States for either a non-resident who is determined not to be engaged in a trade or business within the United States¹³⁷ or for a United States resident with an office or other place of business in a foreign country,¹³⁸ the performance of personal services alone, subject to certain limitations, will not be sufficient to characterize a taxpayer as

132. See *Higgins v. Commissioner*, 312 U.S. 212, 217 (1941) (declaring that an examination of the facts of each case is required when determining whether a taxpayer is engaged in a trade or business within the United States); see also *Taiyo Hawaii Co. v. Commissioner*, 108 T.C. 27 (1997) (stating that the primary purpose for which the property is held at the time of purchase determines its tax treatment).

133. *Spermacet Whaling & Shipping Co. v. Commissioner*, 30 T.C. 618, 634 (1958) (specifying what type of activity constitutes a trade or business within the United States). *But see* Rev. Rul. 56-165, 1956-1 C.B. 859 (stating the presence of a United States office is not an essential element for a United States trade or business to exist) The IRS found a resident of Switzerland, in the United States for the purpose of demonstrating and selling logging equipment, was engaged in a trade or business even though he had no warehouse or other type of building from which to work).

134. See I.R.C. § 864(b).

135. See I.R.C. § 871(b) (stating that a non-resident alien engaged in a trade or business within the United States will be taxed according to I.R.C. §§ 1 & 55, the sections used by United States residents when determining their tax liability).

136. See I.R.C. § 864(b) (stating that the term trade or business within the United States includes the performance of personal services within the United States).

137. See I.R.C. § 864(b)(1)(A) (including within this non-resident definition foreign alien individuals, partnerships, and corporations).

138. See I.R.C. § 864(b)(1)(B).

engaged in a United States trade or business.¹³⁹

Gain from the disposition of a United States real property interest will be treated as if the taxpayer were engaged in a trade or business within the United States.¹⁴⁰ Personal property on the other hand, such as the trading of securities for one's own account or for another's, whether through a broker or other agent, will not be sufficient to constitute a trade or business within the United States.¹⁴¹ There is a similar rule for commodities,¹⁴² which only applies if the commodity is one regularly traded on an organized exchange.¹⁴³ However, a non-resident will not receive the benefits of the aforementioned rules if they have "an office or other fixed place of business in the United States through which or by the direction of which the transactions in stocks or securities, or in commodities . . . are effected."¹⁴⁴

2. Effectively Connected Income

Again, a non-resident alien engaged in a trade or business within the United States will be taxed in a manner similar to that of United States resident on income effectively connected with the conduct of this trade or business.¹⁴⁵ Also, as a general rule, unless

139. See I.R.C. § 864(b)(1) (limiting this exception to non-resident alien individuals temporarily present in the United States less than 90 days and whose compensation does not exceed \$3,000).

140. See I.R.C. § 897(a).

141. See I.R.C. § 864(b)(2)(A). *But see* I.R.C. § 864(b)(2)(A)(ii) (stating that this exception will not apply in the case of a dealer in stock or securities).

142. See I.R.C. § 864(b)(2)(B)(i). *But see* I.R.C. § 864(b)(2)(B)(ii) (stating that this exception will not apply in the case of a dealer in commodities).

143. See I.R.C. § 864(b)(2)(B)(iii).

144. I.R.C. § 864(c) (stating that I.R.C. § 864(b)(2)(A)(i) and I.R.C. § 864(b)(2)(B)(i) will not apply if this is the case). See generally *Adda v. Commissioner*, 10 T.C. 273, 278 (1948) (holding that where a non-resident has an agent in the United States that is using his own discretion in effecting transactions, the non-resident will be considered engaged in a trade or business within the United States). *Inverworld, Inc. v. Commissioner*, 71 T.C.M. (CCH) 3231 (1996) (holding that a foreign corporation's wholly owned United States subsidiary was a dependent agent of the parent, and thus the subsidiary's office was deemed the parent's, which therefore precluded the parent corporation from benefiting from I.R.C. § 864(b)(2)).

145. See I.R.C. § 871(b) (stating that a non-resident alien engaged in a trade or business within the United States will be taxed according to I.R.C. §§ 1 & 55, the sections used by United States residents when determining their taxable income).

actually engaged in a trade or business, a foreigner has no effectively connected income.¹⁴⁶ Moreover, if a taxpayer is engaged in a trade or business within the United States, all United States source income will be treated as effectively connected with this trade or business, without regard as to whether the income is actually effectively connected.¹⁴⁷ Finally, income or gain actually received by a non-resident in the current year, attributable to a transaction in a prior year, will be treated as effectively connected income in the current year, if this income would have been treated as effectively connected income in the prior year.¹⁴⁸

Certain types of United States source income are not treated as effectively connected with the conduct of a trade or business.¹⁴⁹ Passive investment income, for example, not directly derived from United States trade or business will only be treated as effectively connected income if the income is derived from assets used in a trade or business within the United States¹⁵⁰ (“Asset Use Test”) or if the activities of a trade or business within the United States were a material factor in the production of this income (“Business Ac-

[T]he Effectively Connected Concept divides [United States] source income between a foreign investor’s two pockets. Income that is effectively connected (or is so treated) is placed in his business pocket and taxed at full United States rates on a net basis; income that is not effectively connected is placed in his “investment” pocket and taxed at a flat rate on a gross basis.

PAUL R. MCDANIEL & HUGH J. AULT, INTRODUCTION TO UNITED STATES I INTERNATIONAL TAXATION 55 (4th ed. 1998).

146. See I.R.C. § 864(c)(1)(B) (declaring that a nonresident alien not engaged in a trade or business within the United States can not have effectively connected income); see also ISENBERGH, INT’L INCOME TAX., *supra* note 117, at 21:3.

147. See I.R.C. § 864(c)(3) (illustrating the importance of a determination as to whether a taxpayer is engaged in a trade or business within the United States); *but see* 864(c)(2) (excluding certain United States source income from this rule).

148. See I.R.C. § 864(c)(6) (asserting the fact that income was derived in one year and received in another will not effect the classification of the income as effectively connected).

149. See I.R.C. § 864(c)(2) (presenting different tests to be used when determining whether certain types of income are effectively connected with the conduct of a trade or business within the United States).

150. See I.R.C. § 864(c)(2)(A) (stating that one factor to be taken into account when determining whether or not income is effectively connected is whether this income is derived from assets used in this trade or business); see also Treas. Reg. § 1.864-4(c)(2)(i) (1999) (asserting that the Asset Use Test will be used to determine whether passive income is effectively connected).

tivities Test”).¹⁵¹ The Asset Use Test is satisfied if the asset which produced the income is either “[h]eld for the principal purpose of promoting the present conduct of the trade or business in the United States;”¹⁵² “[a]cquired and held in the ordinary course of the trade or business conducted in the United States;”¹⁵³ or “[o]therwise held in a direct relationship to the trade or business conducted in the United States.”¹⁵⁴ The Business Activities Test is satisfied if an asset used in a corporation’s trade or business was a material factor in the production or realization of income and “such asset . . . was accounted for through such trade or business.”¹⁵⁵

Generally foreign source income will not be treated as effectively connected with the conduct of a trade or business within the United States.¹⁵⁶ However, certain foreign source income will be treated as effectively connected with the conduct of a trade or business within the United States if a non-resident has an office or other fixed place of business within the United States to which this income is attributable.¹⁵⁷ Foreign source income will only be attributable to a United States office if the United States office was a material factor in the production of this income and regularly carries on the type of activities that this income was derived from.¹⁵⁸ Finally, an office of an agent will be attributable to a non-resident only if the agent is a dependent agent with the authority to conclude contracts on behalf of a non-resident.¹⁵⁹

As previously noted, certain types of foreign source income

151. See I.R.C. § 864(c)(2)(B); see also Treas. Reg. § 1.864-4(c)(3)(i) (1999) (explaining that the Business Activities Test is used primarily to determine whether dividend or interest income derived from dealers in stocks and securities, royalty income derived from companies engaged in the business of licensing patents or service fees derived from the active conduct of a servicing business are considered as effectively connected income with the conduct of a United States trade or business).

152. Treas. Reg. 1.864-4(c)(2)(ii)(a) (1999).

153. Treas. Reg. 1.864-4(c)(2)(ii)(b) (1999).

154. Treas. Reg. 1.864-4(c)(2)(ii)(c) (1999).

155. I.R.C. § 864(c)(2).

156. See I.R.C. § 864(c)(4)(A).

157. See I.R.C. § 864(c)(4)(B) (excepting from the general rule certain types of foreign source income attributable to a foreigner’s office or other fixed place of business within the United States).

158. See I.R.C. § 864(c)(5)(B).

159. See I.R.C. § 864(c)(5)(A) (enumerating the requirements that need to be met in order for the office of an agent to be deemed the office of the non-resident).

will be treated as effectively connected income if they are attributable to an office or other fixed place of business within the United States.¹⁶⁰ For example, foreign source rental or royalty income which will be effectively connected income as long as the rental or royalty income is derived from the active conduct of a United States trade or business.¹⁶¹ Additionally, foreign source dividend or interest income derived from either the business of banking, financing or trading stocks for your own account will constitute effectively connected income.¹⁶² Also, foreign source income derived from the sale of personal property will be effectively connected income if the sale occurred through a United States office or other fixed place of business.¹⁶³ However, income derived from personal property sold for use outside the United States through a taxpayer's foreign office that materially participated in the sale will not be effectively connected.¹⁶⁴

D. *The Technology*

Electronic commerce refers "to the use of computer networks to facilitate transactions involving the production, distribution, sale and delivery of goods and services in the marketplace."¹⁶⁵ Electronic commerce permits foreigners to conduct commercial transactions with United States customers without ever entering the United States.¹⁶⁶

1. Information Superhighway

The Information Superhighway refers to "the interconnected

160. See I.R.C. § 864(c)(4)(B).

161. See I.R.C. § 864(c)(4)(B)(i) (including royalty and rental income derived from property located outside the United States as effectively connected income if the income was derived from the active conduct of a United States trade or business).

162. See I.R.C. § 864(c)(4)(B)(ii); *but see* I.R.C. § 864(c)(4)(D) (excluding foreign source dividend, interest or royalty income paid by a foreign corporation to a taxpayer who owns more than 50 percent of the total combined voting power of all classes of stock of this corporation from the effectively connected income definition).

163. See I.R.C. § 864(c)(4)(B)(iii).

164. See I.R.C. § 864(c)(4)(B)(iii).

165. Howard E. Abrams & Richard L. Doernberg, *How Electronic Commerce Works*, 14 TAX NOTES INT'L 1573 (May 12, 1997), available in LEXIS, 97 TNI 91-27.

166. See Treasury Discussion Paper, *supra* note 3, § 7.2.3.1.

series of networks that provide the infrastructure for transporting information throughout the world.”¹⁶⁷ Without this network, computers would not be able to communicate with each other.¹⁶⁸ Communication devices that enable computers to communicate between each other include “telephone systems, cable and satellite communications, and computer networks.”¹⁶⁹ These communication devices are capable of simultaneously supporting numerous transactions between many different users.¹⁷⁰ The most popular Information Superhighway is the Internet.¹⁷¹

2. The Internet

The Internet was first developed by the United States Defense Department¹⁷² and subsequently spread to academic institutions.¹⁷³ The Internet actually refers to the connection between thousands of networks “linking millions of computers worldwide.”¹⁷⁴ Furthermore, the Internet has no central computer or terminal.¹⁷⁵ “[It] is more like a spider’s web, with many ways of getting from point A to point B.”¹⁷⁶

167. See Abrams & Doernberg, *supra* note 165, at 1573.

168. See Treasury Discussion Paper, *supra* note 3, § 2.1 (stating that the Information Superhighway refers to the connection now made between previously separated computers).

169. Treasury Discussion Paper, *supra* note 3, § 2.2.

170. See Abrams & Doernberg, *supra* note 165, at 1573 (explaining that the Information Superhighway is really just an electronic highway that is capable of supporting a very large number of electronic commerce applications).

171. See Treasury Discussion Paper, *supra* note 3, § 2.4 (stating that the most popular part of the Information Superhighway is the Internet).

172. See Abrams & Doernberg, *supra* note 165, at 1573 (stating that Internet was initially developed to support military research); see also Treasury Discussion Paper, *supra* note 3, § 2.4 (asserting that the Internet was originally a system connecting governmental and academic institutions).

173. See Treasury Discussion Paper, *supra* note 3, § 2.4 (asserting that the Internet was originally a system connecting governmental and academic institutions).

174. Abrams & Doernberg, *supra* note 165, at 1573 (emphasizing that the Internet refers to the connection made between different computers and not the physical connections that include phone lines, cable and radio transmissions).

175. See Thomas Kesoglou, Note, *International Tax Complications: Can Personal Services Constitute a U.S. Trade or Business on the Internet?*, 22 RUTGERS L. REC. 4, §14 (1997).

176. *Like a Flock of Birds: How The Internet Works Without Really Trying*, ECONOMIST, July 1, 1995, at 6.

The language that computers use to communicate with each other over the internet is called "TCP/IP" protocol.¹⁷⁷ This language is transported between different computers and networks through routers.¹⁷⁸ "However, since the Internet is not tied to any communications technology, Internet traffic can also travel over cable TV systems, satellite lines, or fiber optic cables."¹⁷⁹ Access to the internet is provided by Internet service providers.¹⁸⁰ Examples include American Online, Prodigy and CompuServe.¹⁸¹

3. The World Wide Web

The World Wide Web ("the Web") is a tool used to locate and access information from storage facilities known as servers.¹⁸² "Information can be loaded onto and unloaded from a server by remote control from anywhere in the world."¹⁸³ Accordingly, the importance of the location of a server has greatly diminished.¹⁸⁴

The Web is distinguishable from other components of the Internet because it is a "multimedia, hypertext system."¹⁸⁵ It enables users to view animated web sites and access other animated web sites by clicking a mouse.¹⁸⁶ A user can access these features

177. See Treasury Discussion Paper, *supra* note 3, § 2.4 (stating that Transmission Control Protocol/Internet Protocol is simply a means of specifying how data is broken up and told where to go).

178. See Treasury Discussion Paper, *supra* note 3, § 2.4. Routers determine which path to use when sending communications between one computer and another. See *id.*

179. Treasury Discussion Paper, *supra* note 3, § 2.4.

180. See Abrams & Doernberg, *supra* note 165, at 1573 (explaining that Internet service providers provide the infrastructure that makes it possible for customers to transmit and receive information on a physical network).

181. See Abrams & Doernberg, *supra* note 165, at 1573 (presenting different examples of Internet Service providers).

182. See Abrams & Doernberg, *supra* note 165, at 1573 (defining the World Wide Web and presenting different types of information available on the World Wide Web). "[A] server is a computer that stores and delivers information to other people's computers and the software that makes the process of delivering the information possible." David L. Forst, *The Continuing Vitality of Source Based Taxation In The Electronic Age*, 15 TAX NOTES INT'L, 1455 (Nov. 3, 1997), available in LEXIS, 97 TNI 212-17, § 72.

183. Forst, *supra* note 182, § 74.

184. See Treasury Discussion Paper, *supra* note 3, § 3.1.2 (stating that the location of a server is irrelevant).

185. Treasury Discussion Paper, *supra* note 3, § 3.1.1.

186. See Treasury Discussion Paper, *supra* note 3, § 3.1.1. (explaining that Web blends text, images, video and audio rather than just simple text on different Web sites).

of the Web through the use of an internet browser.¹⁸⁷

II. ENGAGED IN A TRADE OR BUSINESS WITHIN THE UNITED STATES

“[A]n initial question under the Code is whether a worldwide website, where the seller’s [web] page is situated on a computer server located in the U.S., will cause the seller to be engaged in a trade or business in the U.S.”¹⁸⁸ This question has not yet been answered. There have been however, numerous other court decisions and Revenue Rulings that have determined whether a non-resident’s activities constituted a trade or business within the United States. This Part provides a summary of these decisions. Specifically, Section A presents decisions where the court found a non-resident engaged in a trade or business within the United States. Conversely, Section B presents decisions where the court held that a taxpayer’s activities were insufficient to constitute a United States trade or business.

A. *Engaged in a Trade or Business Within the United States*

1. Real Estate Activities

A clear example of a United States trade or business is illustrated in the case *Snell v. Commissioner*.¹⁸⁹ In this case, a non-resident and his partner actively bought wasteland in St. Petersburg, Florida.¹⁹⁰ They subsequently improved, subdivided and sold the land to the city.¹⁹¹ The taxpayer maintained an office with a secretary where he plotted the subdivisions, determined the prices of different lots and participated in the sale of the land.¹⁹² The court unequivocally held that the taxpayer was engaged in a

“A company’s or individual’s collected Web documents are usually referred to as a Web site.” Treasury Discussion Paper, *supra* note 3, § 3.1.2 (internal quotations omitted).

187. See Treasury Discussion Paper, *supra* note 3, § 3.1.1. (stating that accessing the Web requires a browser program); see also Abrams & Doernberg, *supra* note 165, at 1573 (providing examples of different types of Web browsers including Netscape’s Navigator and Microsoft’s Internet Explorer).

188. Glicklich et al., *supra* note 5, at 327.

189. 97 F.2d 891 (5th Cir. 1938).

190. See *id.* at 893.

191. See *id.*

192. See *id.*

trade or business within the United States.¹⁹³

In *Pinchot v. Commissioner*,¹⁹⁴ a deceased British citizen and non-resident of the United States owned rental real estate in New York City.¹⁹⁵ The properties were managed through an agent who had the power to lease the properties, collect rents due and pay taxes owed on the property.¹⁹⁶ The court concluded that the taxpayer was engaged in a trade or business stating “in managing these eleven buildings in New York, it is certain that [these activities] must have been *considerable* in both respects as well as *continuous* and *regular*.”¹⁹⁷ This decision was later relied on when a court held that a taxpayer managing and operating numerous farms and ranches within the United States was considered engaged in a United States trade or business.¹⁹⁸

In yet another case, the court held that a non-resident was engaged in a trade or business where his agent “execut[ed] leases, collect[ed] the rents, [kept] the books . . . and execut[ed] the sale of the property.”¹⁹⁹ Citing *Pinchot*, the court stated that since the tax-

193. *See id.* at 893 (holding that since the taxpayer was not merely reselling the land, but rather improving and developing it, he was adding a business element to his activities).

194. 113 F.2d 718 (2d Cir. 1940).

195. *See id.* at 719 (stating that much of the property consisted of improved real estate within New York City).

196. *See id.* (explaining the powers that the agent in this case, *Pinchot*, was entrusted with); *see also* *Gilford v. Commissioner* 201 F.2d 735, 736 (2d Cir. 1953) (stating that the fact that a taxpayer acts through his agent will not prevent the taxpayer from being engaged in a business).

197. *Pinchot*, 113 F.2d at 719 (emphasis added); *see also* ISENBERGH, INT'L INCOME TAX., *supra* note 117, at 20:8 (stating that the three adjectives used by the court “considerable, continuous, and regular” should be a benchmark for determining whether a taxpayer is engaged in a trade or business).

198. *See* *Investor's Mortgage Security Co. v. Commissioner*, 4 T.C.M. 45 (1945) (holding that the amount of the income earned, although slight, will not affect the classification of a taxpayer as engaged in a trade or business). *See also* Rev. Rul. 58-166, 1958-1 C.B. 324 (asserting that the ownership of a fractional working interest in an oil lease constitutes a trade or business because of the high degree of skill needed for those having any interest in an oil lease).

199. *Lewenhaupt v. Commissioner*, 20 T.C. 151, 163 (1953), *aff'd*, 221 F.2d 227 (9th Cir. 1955) (holding that the agent's activities were beyond the mere ownership of real property or the receipt of income from these properties and thus place the owner in a trade or business). *See also* *De Amodio v. Commissioner*, 299 F.2d 623, 625 (3d Cir. 1962) (stating that a non-resident was engaged in a trade or business in the United States

taxpayer's activities were considerable, continuous, and regular, a trade or business existed.²⁰⁰ Finally, another court ruled that "the operation of even a *single* parcel of rental property may constitute the regular operation of a business."²⁰¹

2. Other Activities

One activity that certainly constitutes a trade or business within the United States is manufacturing.²⁰² Another example of an activity constituting a trade or business is illustrated in the case of *United States v. Balanovski*.²⁰³ The taxpayer in this case, Balanovski, remained in the United States for approximately ten months.²⁰⁴ During this time he purchased and sold trucks and other equipment within the United States.²⁰⁵ These activities were done on behalf of his Argentine partnership in response to purchase orders the partnership received from the Argentine government.²⁰⁶ Additionally, Balanovski physically inspected the goods before he purchased them²⁰⁷ while operating an office out of a hotel room located in New York City.²⁰⁸ Ruling that Balanovski was

when his agent was involved in the ownership and management of this income producing property).

200. See *Lewenhaupt*, 20 T.C. at 163 (citing the court's prior decision in *Pinchot v. Commissioner*, 113 F.2d 718 (2d Cir. 1940)); see also *Quantas Airway v. United States*, 97-1 U.S. Tax Cas. (stating that the case law is specific in that activities beyond the mere receipt of income from rented property which are considerable, continuous and regular establish a trade or business).

201. *Schwarcz v. Commissioner*, 24 T.C. 733, 739 (1955) (holding that the ownership of real estate devoted to rental purposes will constitute a trade or business even if a single piece of property) (emphasis added).

202. See *ISENBERGH, INT'L INCOME TAX.*, *supra* note 117, at 20:28 (declaring that not only is manufacturing a trade or business, but income properly attributable to it, is effectively connected income).

203. 236 F.2d 298 (2d Cir. 1956).

204. See *Balanovski*, 236 F.2d at 300 (summarizing Balanovski's reason for coming to the United States).

205. See *id.*

206. See *id.* (explaining that Balanovski would receive orders from the government, submit bids to American suppliers for these orders and then sell the goods to the Argentine government at a higher price).

207. See *id.* at 301 (characterizing Balanovski's activities within the United States as numerous and requiring the exercise of initiative).

208. See *id.* at 301 (stating that Balanovski also employed a secretary to work out of his hotel room). Additionally, Balanovski listed the address of his hotel on his business

conducting business within the United States, the court stated “he engaged in numerous transactions wherein he both purchased and sold goods in this country, earned his profits here, and participated in other activities, pertaining to the transaction of business.”²⁰⁹

In addition to manufacturing or selling goods within the United States, the performance of an athletic event within the United States has constituted a United States trade or business.²¹⁰ A similar result was found where the athletic event was a one time occurrence.²¹¹ Moreover, the Supreme Court found a full time gambler to be engaged in a trade or business within the United States.²¹² Finally, the illegality of an activity would not preclude it from being classified as a United States trade or business.²¹³

B. *Not Engaged in a Trade or Business Within the United States*

1. Sales and Advertising

An isolated sale to a United States customer by a non-resident corporation will not constitute a trade or business within the United States.²¹⁴ Moreover, a non-resident corporation's multiple sales to the United States will also be insufficient to constitute a United States trade or business.²¹⁵ One of the sales transactions in ques-

documents. *Id.*

209. *United States v. Balanovski*, 236 F.2d 298, 304 (2d Cir. 1956).

210. *See Johansson v. United States*, 336 F.2d 809 (5th Cir. 1964) (holding that participation by a boxer in a world championship bout constitutes a trade or business within the United States); *see also* Rev. Rul. 58-63, 1958-1 C.B. 624 (stating that the entry of a race horse in a single race will constitute a trade or business within the United States).

211. *See* Rev. Rul. 70-543, 1970-2 C.B. 172 (stating that even a single performance by either an entertainer or athlete will constitute a trade or business).

212. *See Commissioner v. Groetzinger*, 480 U.S. 23 (1987) (relying on the profit motive of the gambler to classify gambling as a United States trade or business).

213. *See Perez v. Commissioner*, 56 T.C.M. (CCH) 312 (1988) (holding that a money launderer's profit earned in the United States is income earned from the conduct of a trade or business within the United States).

214. *See European Naval Stores Co. v. Commissioner*, 11 T.C. 127,132 (1948) (holding that where a non-resident has no offices, showrooms, factories, officers, employees, or salesman in the United States, a single sale will be insufficient to constitute a trade or business).

215. *See Linen Thread Co. v. Commissioner*, 14 T.C. 725, 736 (1950) (stating that to find the taxpayer engaged in a trade or business would be to “exalt artifice above real-

tion consisted of the shipment of goods from the corporation's office in Scotland to the United States, where the goods were subsequently delivered to the customer by an agent of the United States office.²¹⁶ The court ridiculed the IRS's suggestion that this sale alone should constitute a trade or business within the United States when they referred to the agent's action as to those of a "delivery-man."²¹⁷

In a case most analogous to the issue at hand, a Mexican radio station advertising in the United States was determined by the court not to be engaged in a trade or business within the United States,²¹⁸ even though ninety-five percent of the radio station's revenue came from advertisers within the United States.²¹⁹ A majority of the radio station's responses came from United States listeners.²²⁰ Additionally, the negotiation of contracts with advertisers in the United States was done through an independent United States advertising agent.²²¹ However, most importantly, according to the court, the operations of the radio station were located in Mexico and "all of the services it rendered in connection with its business were performed in Mexico."²²²

2. Real Estate Activities

The case of *Neili v. Commissioner*²²³ involved a piece of property that was located in Philadelphia, and owned by an English

ity").

216. *See id.* at 735 (explaining that this is one of the transactions that the IRS believed should constitute a trade or business).

217. *Linen Thread*, 14 T.C. at 736.

218. *See Commissioner v. Piedras Negras Broad. Co.*, 127 F.2d 260 (5th Cir. 1942) (holding that these advertising revenues were foreign source income and thus not subject to United States tax); *see also* Tech. Adv. Mem. 81-47-001 (Jan. 3, 1979) (asserting that a foreign radio station which sold air time to United States citizens for the right to broadcast in the United States was not engaged in a United States trade or business).

219. *See Piedras Negras*, 127 F.2d at 260.

220. *See id.* The company maintained a hotel room in Mexico to collect its mail. *Id.*

221. *See id.*; *see also* I.R.C. § 864(c)(5)(A) (stating that only a dependent agent with the power to conclude contracts on the behalf of his principal will qualify his principal as being engaged in a trade or business within the United States).

222. *Piedras Negras*, 127 F.2d at 261.

223. 46 B.T.A. 197, 198 (1942) (stating that Ms. Neili inherited the property from her husband).

widow, Ms. Neili. The property was occupied by a tenant, who under the terms of a long term lease constructed a building on the property.²²⁴ Ms. Neili employed attorneys that collected the rents and also paid the interest payments due under the mortgage.²²⁵ In ruling that Ms. Neili was not engaged in a trade or business, the court stated “[t]he ownership of this property by petitioner is no more a business activity carried on within the United States than her ownership of stocks of bonds of American companies held for her by an American agent.”²²⁶

Similarly, *Herbert v. Commissioner*,²²⁷ was decided in the same fashion. Here, Ms. Herbert received the property in dispute from her father, as a gift.²²⁸ “[H]er only activities, in addition to the receipt of rentals, were the payment of taxes, mortgage principal and interest, and insurance premiums.”²²⁹ Moreover, Ms. Herbert executed a lease and made minor repairs to the property.²³⁰ The court, arguing that the facts of this case do not satisfy the benchmark established in *Pinchot*,²³¹ opined that the taxpayer activities with regard to the property were “sporadic, rather than continuous, were irregular rather than regular, and were minimal rather than considerable,”²³² thus failing to constitute a United States trade or business.²³³

224. See *Neili*, 46 B.T.A. at 198. The tenant was required under the terms of the lease to pay the taxes and insurance due under the lease. See *id.*

225. See *id.*

226. *Neili*, 46 B.T.A. at 198 (comparing this situation to the one in *Higgins v. Commissioner*, 312 U.S. 212 (1941)). “An occasional sale of land held as an investment is not such a business though profit results. The word, notwithstanding disguise in spelling and pronunciation, means busyness, it implies that one is kept more or less busy, that the activity is an occupation.” *Snell v. Commissioner*, 97 F.2d 891, 892 (5th Cir. 1938).

227. 30 T.C. 26 (1958) (holding that Ms. Herbert was not engaged in a trade or business within the United States).

228. See *id.* at 33 (explaining that Ms. Herbert received the property in the form of a gift rather than in a business transaction).

229. *Id.*

230. See *id.*

231. See *Pinchot v. Commissioner*, 113 F.2d 718, 719 (2d Cir. 1940) (holding that a non-resident’s activities which are “considerable, continuous, and regular” regarding real estate will be sufficient to classify a non-resident engaged in a trade or business within the United States).

232. *Herbert v. Commissioner*, 30 T.C. 26, 33 (1958) (enunciating the standard promulgated in *Pinchot*) (internal quotations omitted).

233. See *id.*; see also Rev. Rul 73-522, 1973-2 C.B. 226 (holding that the ownership

3. Record Keeping and Clerical Activities

Merely keeping records of one's investments in the United States will not constitute a trade or business.²³⁴ This is exemplified in a case that involved a French resident who maintained an office in New York City, but did not reside there.²³⁵ The only function of this office was to keep records, receive interest and dividend checks, and forward back to France weekly and annual status reports.²³⁶ Moreover, this office did not participate either directly or indirectly in the management of any company whose stock it owned.²³⁷ The court, ruling that the record keeping activities did not constitute a trade or business,²³⁸ emphasized that the size of an estate is irrelevant in determining whether a trade or business exists.²³⁹

Another case involved several Scottish investment trusts that established an office in New Jersey to handle all their clerical activities.²⁴⁰ In addition to managing this office, an accountant, a partner in a local accounting firm, served as assistant secretary to the trusts.²⁴¹ Yet, "[a]ll decisions as to the purchase and sale of securities and as to investment policies were made by the home offices."²⁴² The court ruled that the activities of the New Jersey of-

of rental property in the United States subject to a long term lease which requires the lessee to pay expenses related to this property will not be sufficient to characterize a taxpayer as doing business within the United States).

234. *See Higgins v. Commissioner*, 312 U.S. 212, 218 (1941) (holding that keeping records of an investment within the United States will not be sufficient to constitute a trade or business).

235. *See id.* at 214.

236. *See id.* All investment decisions were made in France and all purchases of securities were conducted through a United States financial institution. *See id.*

237. *See Higgins*, 312 U.S. at 214.

238. *See id.* at 218 (holding that the activities in question did not constitute a trade or business).

239. *See id.* (refusing to reverse the decision of the lower court on the ground that this was a sizable estate).

240. *See Scottish American Investment Co. v. Commissioner*, 12 T.C. 49,51 (1949) (explaining that this office handled the receipt of interest and dividends, and maintained complete records of all of the trusts holdings).

241. *See id.* at 50. There was also a direct telephone line that connected the New Jersey office and the office in Scotland. *See id.*

242. *See id.*

fice were insufficient to constitute a trade or business.²⁴³ As the court stated, "it can not be said that the local office . . . was doing what was principally required to be done by petitioners in order to realize [a] profit."²⁴⁴

4. Investment Activities within the United States

Investment activities, including the active management of one's own investments, will not constitute a trade or business within the United States.²⁴⁵ *Portanova* involved an Italian resident who was the beneficiary of trusts that owned fractional interests in several oil and gas leases.²⁴⁶ The trusts entered into an operating agreement with a management company whereby the management company had substantial control over the operations of the leases.²⁴⁷ The court held "the trusts' interest in the unit was only an investment. Income from the operation of the trusts therefore was not effectively connected with the conduct of a United States trade or business."²⁴⁸ It appears that *Portanova* establishes that the mere ownership of working interests in U.S. mineral properties will not constitute a trade or business within the United States.²⁴⁹

243. See *id.* at 56 (stating that the performance of incidental transactions by an office is insufficient to constitute a trade or business).

244. *Scottish American Investment Co.*, 12 T.C. at 59. (distinguishing this case from *Adda*, where the court held that the purchase of securities by a broker with the power to effect transactions did constitute a United States trade or business).

245. See *Portanova v. United States*, 690 F.2d 169, 173 (Ct. Cl. 1982) (referring to the holding in *Higgins*). In a subsequent case a similar statement was made:

The case before us rests on the claim that one who actively engages in serving his own corporation for the purpose of creating future income through those enterprises is in a trade or business. That argument is untenable . . . and we reject it. Absent substantial additional evidence, furnishing management and other services to corporations for a reward not different from that flowing to an investor in those corporations is not a trade or business.

Whipple v. United States, 373 U.S. 193, 203 (1963) (involving a case of a foreigner who owned several corporations which he leased land and loaned money to) (internal citations omitted).

246. See *Portanova*, 690 F.2d at 171.

247. See *id.*

248. See *id.* at 175 (relying on the fact that the operating agreements prevented the beneficiaries of the trust from actively participating in the oil and gas wells).

249. See *ISENBERGH, INT'L INCOME TAX.*, *supra* note 117, at 20:32 (including natural resources with rental real estate among the holdings that can successfully be structured as pure investments); see also *Hendrickson v. Commissioner*, 54 T.C.M. (CCH)

As previously stated, the trading of stock or other securities for one's own account or for another's, whether through a broker or other agent, will not be considered a trade or business within the United States.²⁵⁰ This interpretation of the statute was confirmed by the court in *Neuman de Vegvar v. Commissioner*.²⁵¹ In this case, a non-resident alien, Neuman de Vegvar, had assets in the United States worth \$2,300,000.²⁵² He subsequently transferred these assets to Chase National Bank²⁵³ and informed the bank that his personal attorneys had the authority to effect transactions in his account.²⁵⁴ All investment decisions were made by these attorneys and then communicated to the bank.²⁵⁵ Additionally, Neuman de Vegvar's activities within the United States consisted of being the sole stockholder of two Florida corporations that owned and managed citrus groves.²⁵⁶ The court concluded that all of his activities within the United States were insufficient to constitute a trade or business because they were those "related to the maintenance of a personal investment account rather than carrying on a trade or business."²⁵⁷

III. DOING BUSINESS WITHIN THE UNITED STATES THROUGH THE INTERNET

While it is clear that the sale of goods over the Internet would

1079 (1987) (holding that a minority interest in an oil well was insufficient to constitute a trade or business because a minority interest does not allow an owner to exert significant influence in the management of the well).

250. See I.R.C. § 864(b)(2)(A); *but see* I.R.C. § 864(b)(2)(A)(ii) (stating that this exception will not apply in the case of a dealer in stock or securities).

251. 28 T.C. 1055 (1957) (holding that the taxpayer was not engaged in a trade or business because of his security transactions within the United States).

252. See *id.* at 1056. These assets consisted of \$1,000,000 in United States currency and \$1,300,000 in United States Treasury Notes. See *id.*

253. See *id.* at 1057.

254. See *id.* at 1056. This was accomplished through executing a power of attorney with the bank naming De Vegvar's personal attorneys as his attorneys in fact. See *id.*

255. See *Neuman de Vegvar*, 28 T.C. at 1057.

256. See *id.* at 1060 (stating that Neuman de Vegvar had no interest in these corporations other than an investor).

257. *Neuman de Vegvar v. Commissioner*, 28 T.C. 1055, 1060 (1957); *see also* I.R.C. § 864(b)(2)(A) (stating the trading of stock or other securities for one's own account or for another's, whether through a broker or other agent, will not be considered a trade or business within the United States).

undoubtedly classify a seller as being engaged in a trade or business, it not equally as clear whether under current United States tax law the seller would be engaged in a United States trade or business.²⁵⁸ Part III presents different arguments regarding this issue. Section A presents arguments that address the issue of whether a foreign entity doing business in the United States solely through its web site on the Internet is considered under current United States tax law to be engaged in a trade or business within the United States. Section B presents arguments regarding the need for modification of existing United States tax laws to adapt to international transactions conducted electronically. Section C argues that under current United States tax law, a foreign corporation doing business within the United States solely through its web site on the Internet will not be considered engaged in a trade or business within the United States. Finally, Section C argues that current United States tax laws are suitable to handle international transactions conducted electronically.

A. *Is a Foreign Corporation Doing Business in the United States Solely Through its Web Site on The Internet Considered Under Current Tax Law To Be Engaged In a United States Trade Or Business?*

1. A Trade or Business Exists

The Treasury has suggested that a United States individual providing market and support services for a non-resident engaged in computerized research outside the United States may create “a [United States] trade or business for the foreign person even if the computer servers and other activities are located outside the United States.”²⁵⁹ Additionally, a United States service provider advertising or handling orders and credit checks for a non-resident on the Internet may create a United States trade or business for a non-resident because the activities of the service provider are active,

258. See Cigler & Stinnett, *supra* note 4, at 60; see also Treasury Discussion Paper, *supra* note 3, § 7.2.3.1 (stating that the Treasury is unsure whether these transactions would be classified as a United States trade or business).

259. Treasury Discussion Paper, *supra* note 3, § 7.2.3.1.

substantial and continuous or regular.²⁶⁰ The service provider in the aforementioned situation, whether a United States resident or not, would also undoubtedly be engaged in a United States trade or business.²⁶¹ The owner and operator of a web site that achieves Internet access through a United States server will also be treated as engaged in a trade or business within the United States because the operator of the web site would interact with United States customers to a greater extent than the owner of the server would.²⁶² Finally, a foreign corporation owning or leasing a server located in the United States, can itself be considered engaged in a United States trade or business if it presents its web site on this server.²⁶³

2. No Trade or Business Exists

In the case of *Piedras Negras* the court held that a Mexican radio station which sold air time to United States citizens for the right to broadcast in the United States was not engaged in a trade or business.²⁶⁴ “This finding suggests that a foreign person with no physical presence in the United States could engage in substantial business activity with U.S. customers over the Internet without crossing the U.S. trade or business taxing threshold.”²⁶⁵ Comparing *Piedras Negras* to the case of a Mexican newspaper that makes

260. James Cigler et. al., *The Final Frontier For International Tax Concepts*, 7 J. INT’L TAX’N 340,347 (1996) (resting on the holding of past cases that found a business to exist where a non-resident was carrying on activities in the United States for the production of income that were active, substantial and continuous or regular). This is true even where the United States service provider is an independent agent. *See id.*

261. *See* Kyrie Thorpe, Comment, *International Taxation of Electronic Commerce: Is the Internet Age Rendering the Concept of Permanent Establishment Obsolete*, 11 EMORY INT’L L. REV. 633, 680 (1997) (stating that a service provider that locates servers, routers, or other equipment for United States customers should be treated as engaged in a trade or business within the United States).

262. *See* John K. Sweet, Comment, *Formulating International Tax Laws In The Age Of Electronic Commerce: The Possible Ascendancy Of Residence-Based Taxation In An Era Of Eroding Traditional Income Tax Principles*, 146 U. PA. L. REV. 1949, 1978 (1998).

263. *See* Thorpe, *supra* note 261, at 680-81.

264. *See* Commissioner v. *Piedras Negras Broad. Co.*, 127 F.2d 260 (5th Cir. 1942); *see also* Tech. Adv. Mem. 81-47-001 (Jan. 3, 1979) (asserting that a foreign radio station which sold air time to United States residents for the right to broadcast in the United States was not engaged in a trade or business within the United States).

265. Sweet, *supra* note 262, at 1984 (referring to the holding in *Piedras Negras*).

itself available to United States customers solely through the Internet, one expert has argued that this Mexican newspaper should not be characterized as engaged in a United States trade or business.²⁶⁶

The Treasury believes that a trade or business within the United States will not exist when a foreigner with no physical presence in the United States merely solicits orders from United States customers and ships goods back to them.²⁶⁷ It thus appears that a foreign mail order firm will not be considered a United States trade or business because some of its orders come from the United States.²⁶⁸ The fact that a foreign corporation's web site is accessed by United States customers will not constitute the requisite substantial physical presence necessary to be classified as engaged in a United States trade or business.²⁶⁹

The Treasury concedes that a United States telecommunication service provider might qualify as an agent of a foreign corporation doing business within the United States.²⁷⁰ The Treasury further admits that the service provider could qualify as an independent agent and thus the imputation of a United States trade or business would be impossible.²⁷¹ Thus, an internet service provider could display a foreign corporation's web page on the Internet without

266. See Forst, *supra* note 182, § 48 (stating that in this situation a Mexican corporation would not have any United States source income even though a substantial number of the newspaper's customers and advertisers are located in the United States, similar to the conclusion reached in *Piedras Negras*).

267. See Treasury Discussion Paper, *supra* note 3, § 7.2.1.1.

268. See ISENBERGH, INT'L INCOME TAX., *supra* note 117, at 20:31 (explaining that it is unimaginable to find a United States trade or business when a foreign mail order firm ships goods to United States customers).

269. See Sweet, *supra* note 262, at 1982. This statement is made under an analysis undertaken to determine whether a permanent establishment exists. This is the standard used in international tax treaties. It is a similar threshold to the United States trade or business concept.

270. See Treasury Discussion Paper, *supra* note 3, § 7.2.5 (stating that it is not likely, but possible, that a service provider would qualify as a dependent agent).

271. See Treasury Discussion Paper, *supra* note 3, § 7.2.5 (explaining that the service provider would be an independent agent and would thus preclude the imputation of a United States trade or business to a foreign corporation). See also Carol A. Dunahoo, *Electronic Commerce Tax Study Group Comments to U.S. Treasury*, 17 TAX NOTES INT'L 682, § 37 (Sept. 12, 1997), available in LEXIS, 97 TNI 177-16 (arguing that Internet Service Providers do not act as agents of their customers and thus the imputation of a United States trade or business is impossible).

causing the foreign corporation to be considered engaged in a United States trade or business.²⁷²

B. *The Suitability of Current United States Tax Law*

Analogizing commercial transactions conducted over the Internet to the more traditional methods of transacting business presented in the Internal Revenue Code “is a task fraught with difficulties that we have scarcely begun to think about seriously.”²⁷³ An examination of this conflict is necessary and reveals two polar arguments. The first argument is that the United States needs to modify existing tax law to properly address international transactions conducted over the Internet. The second argument, on the contrary, is that the suitability of current United States international tax law to address international business transactions conducted electronically.

1. Arguments for Changing the Law

The explosion of commercial transactions conducted over the Internet is raising new problems in federal taxation.²⁷⁴ “[E]lectronic commerce doesn’t seem to occur in any physical location but instead takes place in the nebulous world of cyberspace.”²⁷⁵ The United States taxing regime, however, focuses on the source of the income and the residence of the seller.²⁷⁶ Since electronic commerce is “conducted without regard to national boundaries,”²⁷⁷ electronic commerce may “dissolve the link”²⁷⁸ between the location of where the payment was received and the site where the income was produced. Thus, even if the appropriate type of income has been determined, current United States sour-

272. See Thorpe, *supra* note 261, at 680 (stating that the use of an internet service provider by a foreign corporation to display its web page on the Internet should not qualify the foreign corporation as doing business within the United States).

273. Amy Hamilton, *Hellerstein Comments on Treasury’s Electronic Commerce Paper*, 97 TNT 53-4 (Mar. 19, 1997), available in LEXIS 97 TNT 53-4 (arguing that current United States tax law is insufficient to handle electronic commerce).

274. See Glicklich et. al., *supra* note 6.

275. Treasury Discussion Paper, *supra* note 3, § 7.2.3.1.

276. See Cigler & Stinnet, *supra* note 4, at 59.

277. See Treasury Discussion Paper, *supra* note 3, § 7.2.3.1.

278. See *id.*

ing rules are inadequate to determine the source of income when derived from electronic commerce.²⁷⁹

A limited definition of a United States trade or business is presented in section 864(b) of the Internal Revenue Code.²⁸⁰ Unfortunately, this definition “does not adequately address the types of business currently being negotiated in Cyberspace. All cases not governed by section 864(b) are left to the courts and the IRS for interpretation.”²⁸¹ The IRS, to combat an enormous loss of revenue, must modify current international tax law to include business transactions conducted over the Internet within the definition of a United States trade or business.²⁸² However, any modification must be done without offending traditional principles of neutrality.²⁸³

2. Arguments for not Changing the Law

The United States taxing regime is predominantly based on a doctrine known as Capital Export Neutrality.²⁸⁴ This doctrine requires that “the tax system treat economically similar income equally, regardless of whether earned through electronic means or

279. See Cigler et. al., *supra* note 260, at 345 (arguing that income from many new technological products are unable to be sourced according to the current United States income sourcing rules); see also Sweet, *supra* note 262, at 1968 (commenting that traditional income sourcing rules are threatened by electronic commerce).

280. See I.R.C. § 864(b) (stating that the performance of personal services within the United States constitutes a trade or business, but other security trading activities do not).

281. See Cigler et al., *supra* note 260, at 347 & n.12 (arguing that current definition of a United States trade or business is insufficient to deal with transactions conducted over the Internet). See Treasury Discussion Paper, *supra* note 3, at *Introduction* (stating that the development of electronic commerce will require existing principles be reinterpreted and in some extreme cases new rules formulated).

282. See Kesoglou, *supra* note 175, §§ 39-40 (arguing that unless the United States modifies the definition of a US trade or business presented in I.R.C. § 864(b) a substantial amount of revenue will be lost).

283. See Kesoglou, *supra* note 175, § 42 (concluding that any change to the tax law must not offend the United State’s policy of neutrality); see also Treasury Discussion Paper, *supra* note 3, § 6.2 (stating that the best way through which neutrality can be achieved is through an approach which adapts and adopts existing principles).

284. See GARY CLYDE HUFBAUER & JOANNA M. VAN RUOIJ, U.S. TAXATION OF INTERNATIONAL INCOME: BLUEPRINT FOR REFORM 59 (1992) (stating that the goal of Capital Export Neutrality is to prevent tax considerations from distorting the locational decisions of multinational firms).

through more conventional channels of commerce.”²⁸⁵ “New source rules or the modified application of existing rules would source income differently with respect to E-commerce (as opposed to physical) transactions, violating the neutrality principle.”²⁸⁶ Thus, United States taxing authorities should avoid trying to expand the definition of a United States trade or business to include foreign entities conducting business in the United States solely through their web site on the Internet because doing so would violate the United States policy of neutrality.²⁸⁷

The Internet really is just an extension of the traditional means of conducting business.²⁸⁸ According to the Treasury, it is immaterial for tax considerations whether parties conduct transactions over the Internet or through other private means.²⁸⁹ Technology now permits any good that can be bought or sold in a store, to be bought or sold over the Internet,²⁹⁰ decreasing the amount of human physical contact required.²⁹¹ However, the Internet has still not “transformed the fundamentals of how income is earned; and it is these enduring fundamentals that form the basis of the international tax system.”²⁹² Thus changing the tax law “clearly would act as a strong disincentive to [the continued growth of] electronic commerce.”²⁹³

285. Treasury Discussion Paper, *supra* note 3, § 6.2.

286. Sweet, *supra* note 262, at 1972.

287. See Sweet, *supra* note 262, at 1984.

288. See Bruce Cohen, *Treasury to Adapt Existing Tax Rules for Internet*, *Official Says*, 96 STN 222-37 (Nov. 16, 1996), available in LEXIS 96 STN 222-37; see also Dunahoo, *supra* note 171, § 37 (arguing that electronic commerce is simply an evolution in the means of doing business).

289. See Treasury Discussion Paper, *supra* note 3, § 2.3 (explaining that communications done over the Internet are not significantly different than communications done through a private network).

290. See Forst, *supra* note 182, § 8 (presenting examples of this including groceries, airline tickets, software, and photographs).

291. See Barbara Rosenfeld, *MPAA Comments on Tax Issues of Global Electronic Commerce*, 15 TAX NOTES INT’L 923, § 20 (Sept. 12, 1997), available in LEXIS 97 TNI 177-19 (arguing that the Internet allows for a company to do business in a country without creating a physical presence in that country).

292. Forst, *supra* note 182, § 3.

293. See Dunahoo, *supra* note 271, § 15 (referring to the imposition of withholding taxes on income from electronic commerce, where as no withholding tax would be imposed if the income were earned from non-electronic means); see also Cigler et al., *supra* note 260, at 348. Due to the unimportance of the location of a computer or server and the

The items used by internet service providers to transmit communications (wires, cables, optics, routers and switches) are not significantly different than those items used to transmit communications between phones and faxes.²⁹⁴ Thus, to ensure a level playing field, internet service providers should not be subject to different trade or business thresholds than those applied to other telecommunication companies.²⁹⁵ Moreover, “[t]he treatment of . . . income should not change simply because the mode of performance of delivery may have evolved [in a different fashion].”²⁹⁶ In sum, since changes were not made to the tax law when the telephone and radio were invented, current tax law should not be changed because the Internet was invented.²⁹⁷

C. Doing Business in the United States Solely Through the Internet is Not Considered Under Current United States Tax Law to be Engaged in a United States Trade Or Business

A foreign corporation doing business within the United States solely through its web site on the Internet will not be considered engaged in a trade or business within the United States. As well, current United States tax law should not be modified to adapt to international business transactions conducted over the Internet

1. A United States Trade or Business Should Not be Found

The court in *Piedras Negras* decided that a Mexican radio station which sold air time to United States citizens for the right to broadcast in the United States was not engaged in a trade or busi-

inability to determine their location, a payor would not be able to determine if a withholding obligation has arisen. *See id.*

294. *See* Forst, *supra* note 182, § 70 (comparing communication over the internet to communications over the telephone or fax).

295. *See* Dunahoo, *supra* note 271, § 39 (arguing that companies should not be treated differently under the United States tax law because of the different businesses they are in).

296. *See* Sweet, *supra* note 262, at 1968.

297. *See* Rosenfeld, *supra* note 291, § 22 (arguing that the time for discussing this issue came and went with the invention and widespread use of the radio and telephone).

ness.²⁹⁸ This confirms the view of the Treasury that a trade or business within the United States will not exist when a foreigner with no physical presence in the United States merely solicits orders from United States customers and ships goods back to them.²⁹⁹ The decision by the court and the opinion promulgated by the Treasury further bolster the claim that a foreign corporation selling goods to American customers through its Internet web site will not be considered engaged in a United States trade or business.

The Internal Revenue Code, although providing a limited definition of a United States trade or business, does state that the performance of personal services within the United States will constitute a United States trade or business.³⁰⁰ However, as has been previously stated, the fact that a foreign corporation's web site is accessed by United States customers will not itself establish the requisite physical presence to constitute the performance of personal services within the United States.³⁰¹ Furthermore, an exception stated under the code allows for a foreign corporation's non-resident employee to perform personal services within the United States without crossing the United States trade or business threshold.³⁰²

Previous case law establishes that a United States trade or business will exist when a taxpayer is engaged in continuous, considerable and regular business activity within the United States.³⁰³

298. *See* Commissioner v. Piedras Negras Broad. Co., 127 F.2d 260 (5th Cir. 1942); *see also* Tech. Adv. Mem. 81-47-001 (Jan. 3, 1979) (asserting that a foreign radio station which sold air time to United States citizens for the right to broadcast in the United States was not engaged in a trade or business).

299. *See* Treasury Discussion Paper, *supra* note 3, § 7.2.1.1.

300. *See* I.R.C. § 864(b) (stating that the term trade or business within the United States includes the performance of personal services in addition to excepting certain personal services from this definition).

301. *See* Sweet, *supra* note 262, at 1982. This statement is made under an analysis undertaken to determine whether a permanent establishment exists. This is the standard used in international tax treaties. It is a similar threshold to the United States trade or business concept.

302. *See* I.R.C. § 864(b)(1) (limiting this exception to non-resident alien individuals temporarily present in the United States less than 90 days, whose compensation does not exceed \$3,000 and who is performing these personal services for either a non-resident who is determined not to be engaged in a trade or business within the United States or for a United States resident with an office or other place of business in a foreign country).

303. *See* Spermacet Whaling & Shipping Co. v. Commissioner, 30 T.C. 618, 634

However, the holding in *Piedras Negras* suggests that a non-resident without any physical presence in the United States could conduct considerable business activity with United States customers and not cross the United States trade or business threshold.³⁰⁴ Moreover, the activities associated with the sale and shipment of the goods to United States customers by foreign corporations also do not constitute a United States trade or business.³⁰⁵ Thus, since a foreign mail order firm will not be considered a United States trade or business because some orders come to it from the United States,³⁰⁶ a foreign corporation that ships goods to United States customers who purchased these goods from the foreign corporation's web page, should also not be considered a United States trade or business.

A server located in the United States should not in and of itself constitute a United States trade or business. This is true because a server can be located anywhere in the world without having any effect on the server's accessibility.³⁰⁷ Thus, if the United States were to look at the location of a server when determining whether

(1958) (specifying what type of activity constitutes a trade or business within the United States); *see also* *Pinchot v. Commissioner*, 113 F.2d 718, 719 (2d Cir. 1940) (stating that the activities of the taxpayer in this case were considerable, continuous and regular and thus a trade or business within the United States was found to exist); ISENBERGH, INT'L INCOME TAX., *supra* note 117, at 20:8 (stating that the three adjectives used by the court "considerable, continuous, and regular" should be a benchmark for determining whether a taxpayer is engaged in a trade or business).

304. *See* *Sweet*, *supra* note 262, at 1984 (referring to the holding in *Piedras Negras*); *see also* *Commissioner v. Piedras Negras Broad. Co.*, 127 F.2d 260 (5th Cir. 1942) (holding that the United States couldn't tax the profits of a Mexican radio station selling air time to American customers); Tech. Adv. Mem. 81-47-001 (Jan. 3, 1979) (asserting that a foreign radio station which sold air time to United States citizens for the right to broadcast in the United States was not engaged in a trade or business).

305. *See* *European Naval Stores Co. v. Commissioner*, 11 T.C. 127, 132 (1948) (holding that where a non-resident has no offices, showrooms, factories, officers, employees, or salesman in the United States, a single sale will be insufficient to constitute a trade or business); *see also* *Linen Thread Co. v. Commissioner*, 14 T.C. 725, 736 (1950) (holding that a number of sales made by a non-resident corporation to the United States were also insufficient to constitute a United States trade or business).

306. *See* ISENBERGH, INT'L INCOME TAX., *supra* note 117, at 20:31 (explaining that it is unimaginable to find a United States trade or business when a foreign mail order firm ships goods to United States customers).

307. *See* Treasury Discussion Paper, *supra* note 3, § 3.1.2 (stating that the location of a server is irrelevant).

a United States trade or business exists, the server would simply be moved.

Secondly, an internet service provider will not qualify as an agent of a corporation that simply utilizes an internet service provider to display its web page.³⁰⁸ Even if an agency relationship were somehow deemed to exist, the Treasury states that the service provider would qualify as an independent agent and thus the imputation of a United States trade or business would be impossible under section 864 (c)(5)(A) of the Internal Revenue Code.³⁰⁹ In sum, a United States internet service provider can display a foreign corporation's web page on the Internet without causing the foreign corporation to be engaged in a United States trade or business.³¹⁰

2. Current United States Tax Law is Suitable to Handle International Business Transactions Conducted Electronically

Changing the tax law to encompass Internet transactions within the definition of a United States trade or business, while allowing other similar transactions to escape taxation would violate the United State's policy of neutrality.³¹¹ Furthermore, modifying the current income sourcing rules to effect the treatment of income derived from the Internet differently than income derived from other

308. See Dunahoo, *supra* note 271, § 37 (arguing that Internet Service providers do not act as agents of their customers and thus the imputation of a United States trade or business is impossible).

309. See I.R.C. § 864(c)(5)(A) (stating that only dependent agents with the power to conclude contracts on behalf of their principal will be sufficient to render the principal as engaged in a trade or business within the United States); see also Treasury Discussion Paper, *supra* note 3, § 7.2.5 (explaining that the service provider would be an independent agent and would thus preclude the imputation of a United States trade or business to the foreign corporation).

310. See Thorpe, *supra* note 261, at 680 (stating that the use of an internet service provider by a foreign corporation to display its web page should not be sufficient to qualify the foreign corporation as doing business within the United States).

311. See HUFBAUER & VAN RUOIJ, *supra* note 284, at 59 (stating that the goal of Capital Export Neutrality is to prevent tax considerations from distorting the locational decisions of multinational firms); see also Treasury Discussion Paper, *supra* note 3, § 6.2 (requiring that the tax system treat economically similar income equally, regardless of whether earned through electronic means or through more conventional channels of commerce).

traditional methods would also violate this policy.³¹² Since it appears that the Internet has not “transformed the fundamentals of how income is earned; and it is these enduring fundamentals that form the basis of the international tax system,”³¹³ modification of these laws would seem inappropriate.

Changes to the tax law were not made when the telephone and radio were invented.³¹⁴ Moreover, the items used by internet service providers to transmit communications (wires, cables, optics, routers and switches) are not significantly different than those items used to transmit communications over telephones and faxes.³¹⁵ It appears that the Internet is merely an expansion of an already existing method of doing business.³¹⁶ Therefore, changing current United States tax law to reflect the explosion of Internet transactions would seem hypocritical.

CONCLUSION

Foreign corporations conducting business in the United States solely through their Internet web site should not be considered under current United States tax law to be engaged in a trade or business within the United States. The Internal Revenue Code contains a limited definition of what constitutes a United States trade or business. However, a substantial number of cases have been decided that address this issue. One underlying theme that has flourished, absent a substantial physical presence within the United States, a United States trade or business will not be found to exist.

The Internet provides foreign corporations with cheap and easy access to a potentially lucrative market. Foreign corporations no longer have to commit substantial financial and human capital to enter the United States market place. A web site can be created

312. See Sweet, *supra* note 262, at 1972.

313. Forst, *supra* note 182, § 3.

314. See Rosenfeld, *supra* note 291, § 22 (arguing that since changes were not made to the tax law when the radio and television were invented, changes should not be made because the Internet was invented).

315. See Forst, *supra* note 182, § 70 (comparing communication over the internet to communications over the telephone or fax).

316. See Cohen, *supra* note 288; see also Dunahoo, *supra* note 171, § 37 (arguing that electronic commerce is simply an evolution in the means of doing business).

and placed onto the Internet very easily. In addition to maintaining this web site, an internet service provider can provide clerical and other order processing support services necessary for the completion of a sales transaction . Finally and most importantly, if structured correctly, this can all be achieved without incurring any United States tax liability.

Most tax laws that apply to commercial transactions were written before the Internet had developed into an avenue of commerce. Similarly, prior to the invention of the telephone, another major avenue of commerce, most tax laws that applied to commercial transactions were also already written. These laws were not substantially altered to reflect the increased commercial opportunities made available when the telephone was invented. Therefore, the myriad opportunities that have evolved from the explosion of the Internet should also not be restrained by a subsequent change in the tax law.