DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF
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The Honorable Tom Udall
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Udall:

I am responding to your letter to Commissioner Everson dated September 3, 2004, on behalf of your constituent, Mrs. , a U.S. citizen, and her husband Mr. , a nonresident alien. Mrs. wrote about an informal opinion she received from an IRS tax specialist who indicated that amounts withheld by the European Commission, an institution of the European Union (EU), from her husband's pension income did not qualify for the foreign tax credit under section 901 of the Internal Revenue Code (the Code) because the amounts did not constitute taxes imposed by a foreign country. You asked us to review a Congressional Research Service (CRS) memo that examined the tax specialist's opinion.

The IRS tax specialist referenced an IRS private letter ruling, PLR 8707031, to support his view that a U.S. citizen or resident alien cannot claim a foreign tax credit for amounts withheld from salary received from an international organization because the international organization's assessment is not a tax imposed by a foreign country.

I am not sure why the IRS tax specialist cited the PLR. The CRS memo states the letter ruling involved a section 911 issue rather than a section 901 issue. However, I suspect the tax specialist may have cited it because the underlying facts involved a situation similar to this case in that a foreign country ceded its taxing jurisdiction to an international organization. In any case, private letter rulings are not formal IRS rulings. A private letter ruling is specific to the taxpayer who requested it, and other taxpayers may not use or cite it as precedent (Section 6610(k)(3) of the Code).

I hope the following general information on the foreign tax credit is helpful. This informational letter does not constitute a letter ruling. Taxpayers must follow certain procedural requirements in Rev. Proc. 2004-1, 2004-1 I.R.B. 1 to obtain a letter ruling.

Generally, if a U.S. citizen or resident earns foreign source income and pays foreign income tax, he or she can credit that tax in the United States, thereby reducing his or her U.S. federal income tax liability. Subject to some limitations, the law allows a credit

against United States income tax for the amount of any income, war profits, and excess profits taxes paid or accrued to any foreign country during the taxable year (Section 901(a) of the Code). For the law to consider a foreign levy a creditable income tax, it must arise from the authority of a foreign country to levy taxes (Section 901(a); Treas. Reg. §1.901-2(a)(2)(i)). The regulations define the term "foreign country" to include any foreign state and any political subdivision of any foreign state (Treas. Reg. §1.901-2(g)(2)).

The tax specialist cited in his letter Rev. Rul. 68-309, which held that the European Communities (the predecessor to the EU) was a "foreign government" for purposes of sections 892 and 893 of the Code. He said that the ruling remained in effect and that, in his view, it would be a short step from treating the EU as a foreign government for purposes of sections 892 and 893 of the Code to treating it as a foreign government for purposes of section 901 of the Code. However, the specialist incorrectly characterized the status and relevance of this revenue ruling.

Rev. Rul. 2003-99 made Rev. Rul. 68-309 obsolete because it no longer governs the determination of whether the former European Communities or the current EU constitutes a "foreign government" for purposes of sections 892 and 893 of the Code. Since 1988, Temp. Treas. Reg. §1.892-2T has governed this determination. In addition, the term "foreign government," a term of art defined in the regulations under section 892 of the Code, is not equivalent to the term "foreign country" as used in section 901. The taxing authority imposing the foreign levy must be either a single foreign country or a political subdivision of a foreign country (Section 901 of the Code).

The EU is not a single foreign country or state but rather an organization consisting of a number of sovereign countries, each of which independently has the authority to impose direct taxes. As explained on the EU's website:

> The European Union (EU) is a family of democratic European countries, committed to working together for peace and prosperity. It is not a State intended to replace existing states, but it is more than any other international organisation.[1]
>
> Within the EU, governments retain sole responsibility for direct taxes – the amounts they raise by taxing personal incomes and company profits. EU taxation policy focuses instead on the rates of indirect taxes like value-added tax and excise duties which can directly affect the single market.[2]

As the EU is not a single foreign state that possesses the authority to impose direct taxes on personal income and company profits, it is not a "foreign country" for purposes of section 901 of the Code and its regulations.

The fundamental purpose of the foreign tax credit provisions is to relieve double taxation of income earned abroad by U.S. taxpayers. *See American Chicle Co. v. United States*, 316 U.S. 450, 452 (1942). While I sympathize with your constituent's situation, the U.S. foreign tax credit rules require individuals to pay foreign taxes to a

[1] http://europa.eu.int/abc/index_en.htm
[2] http://europa.eu.int/pol/tax/overview_en.htm

"foreign country" to be eligible for the credit. Any change would require legislative action.

I hope this information is helpful. If you have any questions, please contact or me at .

Sincerely,

Barbara A. Felker
Chief, Branch 3
Office of the Associate Chief
Counsel (International)