DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF THE CHIEF COUNSEL

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Dear :

On July 6, 2010, this office sent you a letter with general information that a foreign income tax or a tax in lieu of an income tax that is dependent (by its terms or otherwise) on the availability of a U.S. foreign tax credit, as appears to be the case with the Salvadoran withholding tax, is a "soak-up tax" for which no U.S. foreign tax credit is allowed under section 901 and the regulations under that section. This letter responds to your representative's request dated September 03, 2010, for additional information with respect to that issue.

Article 16 of the Salvadoran law provides, in part, as follows:

> Income that originates from assets located in , as well as from activities conducted or from capital invested therein, and from services rendered or used within the national territory, even if these are received or paid outside the , are deemed as income obtained in .
>
> Income from services that are used in the country shall constitute income obtained in for the service provider, independently even if the activity that originates them is realized abroad.

It appears that this Article 16 is the legal basis for taxation of interest earned within by foreign corporations and that Article 14 operates to subject this income to withholding tax "unless the countries, states or territories in which they are domiciled do not provide in their internal laws with legal means to eliminate the respective double taxation or that have not enacted and ratified conventions with to avoid the double taxation of the income tax."

In the United States, the tax laws are set forth in the Internal Revenue Code. Section 11 of the U.S. Internal Revenue Code provides, in part, as follows:

> Sec. 11. Tax Imposed.
>
> (a) Corporations in General. A tax is hereby imposed for each taxable year on the taxable income of every corporation.

Section 63(a) of the U.S. Internal Revenue Code defines the term "taxable income" as follows:

> Sec. 63. Taxable Income Defined.
>
> (a) In general. Except as provided in subsection (b), for purposes of this subtitle, the term "taxable income" means gross income minus deductions allowed by this chapter….

The reference to "this subtitle" in section 63(a) is a reference to the U.S. Internal Revenue Code. The reference to "subsection (b)" in section 63(a) is not relevant because that subsection applies only to individuals.

Section 61 of the U.S. Internal Revenue Code defines the term "gross income," in part, as follows:

> Sec. 61. Gross Income Defined.
>
> (a) General Definition. Except as otherwise provided in this subtitle, gross income means all income from whatever source derived ….

Under these U.S Internal Revenue Code provisions, a U.S. domestic corporation is subject to tax on its world-wide taxable income. As the U.S. Supreme Court stated in *Commissioner v. Glenshaw Glass Co*., 348 U.S. 426, 429 (1955), "Congress applied no limitations as to the source of taxable receipts…." *See also*, *Commissioner v. Great-West Life Assurance Co. v. United States*, 678 F.2d 180, 183 (Cl. Ct. 1982). Section 7701(a)(4) of the U.S. Internal Revenue Code defines the term "domestic" when applied to a corporation to mean a corporation "created or organized in the United States or under the laws of the United States or of any State…."

Because a U.S. domestic corporation is subject to tax on its world-wide income, the U.S. Internal Revenue Code provides in section 901 that the corporation may claim a foreign tax credit for foreign income taxes paid or accrued in order to avoid double taxation. In order to assure that the credit operates only to eliminate double taxation, section 904 of the U.S. Internal Revenue Code provides that the foreign tax credit is limited to the U.S. pre-credit income tax attributable to the corporation's foreign source taxable income, such as the income earned within . As we stated in the July , 20 , letter, a foreign income tax or a tax in lieu of an income tax that is dependent

(by its terms or otherwise) on the availability of a U.S. foreign tax credit, as appears to be the case with the withholding tax, is a “soak-up tax” for which no U.S. foreign tax credit is allowed under section 901 of the U.S. Internal Revenue Code and the regulations under that section. Accordingly, a U.S. domestic corporation would be subject to double taxation on the interest earned within if the withholding tax was not excused under Article 14 of the law.

The United States does not have an income tax convention with which would alter this tax scheme for a U.S. domestic corporation.

This letter has called your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. *See* Rev. Proc. 2010-1, §2.04, 2010-1 IRB 7 (Jan. 4, 2010). In accordance with the provisions of a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative. If you have any additional questions, please contact our office at .

Sincerely,

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

cc: