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Federal Taxation--Credit Allowed for Foreign Social Security Payments

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NOTES

FEDERAL TAXATION—CREDIT ALLOWED FOR FOREIGN SOCIAL SECURITY PAYMENTS

In Revenue Ruling 69-338[1] the Internal Revenue Service held that certain compulsory contributions levied on the salary of a U.S. citizen employee under article 66 of the Venezuelan social security law were "an income tax which is creditable within the meaning of section 901 of the Code."[2]

Section 901[3] requires that in order for a foreign tax to be creditable against U.S. income tax, it must be an income tax, a war profit tax, or an excess profits tax. Section 903[4] expands the concept by making certain taxes imposed in lieu of income taxes also creditable against U.S. income tax.

The Government, aptly recognizing that it was not dealing with a war profits tax or an excess profits tax, first cited *Biddle v. Commissioner*[5] for the proposition that "[f]or a particular foreign tax to qualify as a creditable tax under Section 901 of the Code it must be shown that the tax imposed by the foreign law is a tax on income within the United States concept thereof."[6] The ruling then analogized the payments (contributions) made under the Venezuelan social security law to the tax on wages of employees imposed by section 3101, and openly recognizes that this tax is *not described as an income tax in section 3101.*[7] However, it attempts to bypass this essential requirement through the use of the following language in reference to the language imposed by section 3101:

> Although the tax is not described as an income tax in section 3101 of the Code, it has been referred to as an additional income tax in court decisions involving the constitutionality of Federal employment or self-employment taxes.[8]

At this point, the ruling concludes "[a]ccordingly, since the Venezuelan Social Security tax . . . *is imposed on the basis of income*, it is held that the contribution levied on the employee under such article *is an income*

1. 1969-1 CUM. BULL. 194.
2. *Id.*
3. INT. REV. CODE OF 1954, §901, 26 U.S.C.A. §901 (Rev. 1967).
4. INT. REV. CODE OF 1054, §903, 26 U.S.C.A. §903 (Rev. 1967).
5. 302 U.S. 573, 58 S.Ct. 379, 82 L.Ed. 431 (1938).
6. Rev. Rul. 69-338, 1969-1 CUM. BULL. 194.
7. *Id.*
8. *Id.*

tax which is creditable within the meaning of section 901 of the Code."[9]

There are two major reasons why the ruling cannot be upheld. The first is that the ruling plainly recognizes that the Venezuelan tax imposed is not an income tax, and therefore clearly, under the words of section 901, is not a creditable tax. No other result can be supported since it is not proposed by the ruling that the foreign tax is either a war profits tax or an excess profits tax. Since the ruling purports to make the tax creditable under the provisions of section 901, it is clearly not alleged to be a tax "in lieu of" income tax, and thus not creditable under section 903.

The second reason for rejecting this ruling is that the express purpose of the Congress, in providing for this tax credit, would not be served by permitting this tax to be creditable. As stated by the Treasury Department, the foreign tax credit is designed generally to relieve U.S. taxpayers of the double tax burden imposed when their foreign source income is taxed both by this country and the foreign country from which it is derived.[10] The credit has also been described as a tax relief device primarily intended to relieve U.S. business from the effect of double taxation resulting from the imposition of foreign income, war profits, or excess profits taxes on foreign operations.[11] The purpose is to make American business and industry, doing business in foreign countries, generally competitive with the same U.S. operations performed domestically.[12] To the extent possible, tax neutrality is the aim; there is no attempt to make U.S. business abroad competitive with foreign owned rivals.[13]

Clearly then, the thrust of the foreign tax credit is not at taxes of the sort encompassed by the ruling. However, even assuming arguendo that the purposes of Congress could be carried out by "interpreting" such a tax as being creditable, such an interpretation would be contrary to the precise wording of both the statute and the regulations.[14] As such, it would not support the ruling since it is repeatedly held that one may not go beyond the clear words of the statute to reach the legislative intent where the words of the statute are clear and unambiguous.[15]

Further, none of the cases cited in the ruling supports the reasoning stated therein or resolves the particular questions presented. While there are previous published rulings[16] which go directly to the question, differing only in the respect that the other rulings apply to the social security laws

9. *Id.* (emphasis added).

10. U.S. DEP'T OF TREASURY, FOREIGN TAX CREDITS FOR U.S. CITIZENS AND RESIDENT ALIENS, PUB. No. 514 (1975).

11. 5-3rd BNA, *Foreign Tax Credit* B-3 (1971).

12. *Id.*

13. *Id.*

14. Treas. Reg. §1.901-1(a)(1) (1973).

15. Dexter v. Commissioner, 47 B.T.A. 285 (1942).

16. *See* E.A. OWENS, THE FOREIGN TAX CREDIT 67 n.136 (1961).

of different countries, it is strange that none of these prior rulings, while on point, were cited.

In *Biddle*[17] the question resolved was not whether a certain tax was creditable, but rather, who paid the tax. The case involved U.S. citizens who had received dividends from United Kingdom corporations. The dividends had been previously "reduced" as a result of the payment of British taxes paid by the corporation.[18] *Biddle* held that the tax was not creditable by the U.S. shareholders of the U.K. corporation because they did not pay the foreign tax—rather the U.K. corporation did. As a result, no credit was allowable to the U.S. shareholder, even though a lesser amount of dividend was received as a result of a foreign income tax being paid. Admittedly, the foreign tax in *Biddle* was clearly an income tax. In any event, questions of this particular nature will no longer arise, since the adoption of a tax treaty with the United Kingdom in 1966,[19] and further changes in the statute regarding who is entitled to claim the credit.

In order for a foreign tax paid to be creditable, it must indeed be a tax by U.S. standards regardless of how it is designated in the foreign country. The ruling is correct in determining that the compulsory contributions required by the Venezuelan social security law are, indeed, a tax. However, merely being a tax is insufficient; to be creditable under section 901, the tax must also be an income tax, excess profits tax, or a war profits tax.[20] The error in the ruling is that the Venezuelan tax in question is *not* an income tax but rather an employment tax, just as our own section 3101 F.I.C.A. tax[21] is not an income tax.

What the ruling obviously fails to recognize is the very clear distinction between an income tax and an employment tax which is in part measured by a limited reference to income. The distinction as made by our own tax law is controlling; to ignore it is to not only fail to adhere to the clear and unambiguous words of the statute and the regulations but to attempt to override Congressional intent and confer a benefit where clearly none was intended.

Helverling v. Davis,[22] next cited in the ruling, was a suit by a shareholder of a Boston public utility company brought to enjoin the collection (withholding) and payment over to the Government of Social Security taxes on the theory that, *inter alia*, title VIII of the Social Security Act of 1935[23] was unconstitutionally imposed. In deciding the constitutionality of that sec-

17. 302 U.S. 573, 58 S.Ct. 379, 82 L.Ed. 431 (1938).

18. *Id.*

19. Treaty with United Kingdom on Double Taxation and Taxes on Income, March 17, 1966 [1966] 17 U.S.T. 1254, T.I.A.S. No. 6089.

20. INT. REV. CODE OF 1954, §901, 26 U.S.C.A. §901 (Rev. 1967).

21. INT. REV. CODE OF 1954, §3101, 26 U.S.C.A. §3101 (Rev. 1967).

22. 301 U.S. 619, 57 S.Ct. 904, 81 L.Ed. 1307 (1937).

23. Ch. 531, §801, 49 Stat. 620.

tion of the original Social Security Act, the U.S. Supreme Court alluded to the Social Security tax as an "income tax," for in the orginal version of that act to which the court referred, title VIII, section 801, described tax as an "income tax on employees."[24] However, over the intervening years, through changes in the Social Security Act and our income tax laws, such tax has been reclassified. At least since the adoption of the Internal Revenue Code of 1939,[25] the Social Security tax is no longer an "income tax on employees," nor an "additional income tax," but a different type of tax, *e.g.*, an employment tax, as separate and distinct a category as a gift tax, an inheritance tax, an estate tax, or an excise tax. These other types of taxes do not give rise to a section 901 credit, even if paid to a foreign country.

The court in *Davis* adopted the language of counsel for the Government in stating that the Social Security Act, title VIII, "lays a special income tax on employees."[26] Again, the Government's reliance is misplaced, since for this exact wording, "a special income tax," the Government's brief cities *U.S. v. Hudson*,[27] which was an action originated in the Court of Claims to determine the constitutionality of the retroactive application of the Silver Purchase Act of June 19, 1934,[28] where the taxpayer, Hudson, was subject to an additional 50% tax on profits gained by trading in silver futures. That case does not make any mention of the Social Security tax.

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24. 301 U.S. at 619, 57 S.Ct. at 904, 81 L.Ed. at 1307.

25.

Class of Tax	Prior to 1939 Code	1939 I.R.C.	1954 I.R.C.
Income Tax	Various Internal Revenue Acts	*Subtitle A* — (no heading) Ch. 1—Income Tax Subchapter E— Tax on Self-Employment income Sec. 480—Rate of tax *et. seq.* Ch. 2—Additional Income Tax (not Soc. Sec. Tax)	*Subtitle A*— Income Taxes Ch. 1—Normal taxes and Surtaxes Ch. 2—Tax on Self-employment Income Sec. 1401— *et. seq.*
Self-Employment Tax	Various Internal Revenue Acts		*Subtitle B*— Estate & Gift Taxes
Employment Tax	Soc. Sec. Act of 1935-Ch. 531, §801, 49 Stat. 620 (Taxes with respect to employment). Sec. 801-Income tax on employees.	*Subtitle B*— (no heading) Ch. 9—Employment Taxes Sec. 1400—Rate of Tax *et. seq.*	*Subtitle C*— Employment Taxes Ch. 21—Fed. Ins. Contrib. Act. Sec. 3101—Rate of Tax *et. seq.*

26. 301 U.S. at 619, 57 S.Ct. at 904, 81 L.Ed. at 1307.
27. 299 U.S. 498, 57 S.Ct. 309, 81 L.Ed. 370 (1935).
28. Ch. 674, §8, 48 Stat. 1178.

The ruling also cites *Cain v. U. S.*[29] for the proposition that the Social Security tax has been described as an "additional income tax." *Cain* was a case involving the constitutionality of the tax on self-employment income.[30] It is not questioned here that the present self-employment tax, or the tax under the 1939 Code provisions referred to in *Cain*,[31] are income taxes and properly creditable where imposed by a foreign country on a U.S. citizen.

In the scheme of both the 1939 and 1954 Codes, employment taxes occupy a completely separate subtitle. Congress could not have made its intent more clear. Income taxes are *not* employment taxes, and conversely employment taxes are not, by any interpretation, income taxes. Under section 901, if a tax is not an income tax, it is plainly and clearly not a creditable tax. Certainly the Government would not be expected to rule that our own section 3101 taxes are creditable against U.S. income taxes.[32] Congress did not intend to, and did not in the enactment of the section, permit foreign Social Security taxes to be creditable against U.S. income tax.

Although there are a number of previous rulings[33] holding that certain foreign Social Security taxes are creditable against U.S. income tax, they are either inapplicable now, because they were issued before the enactment of the 1939 and 1954 Codes, or clearly incorrect for the reasons stated herein.

Since it is well accepted that not all foreign taxes are creditable,[34] and that only income taxes, excess profits taxes, or war profits taxes, are creditable,[35] the initial holding in Revenue Ruling 69-338 is in error. The tax imposed by the Venezuelan social security law is not an income tax, but rather a noncreditable employment tax measured by a limited reference to income. The distinction is more than merely academic—it is both viable and important. As the holding of the ruling is somewhat limited, it is not suggested that the error would be costly in terms of tax revenues lost. However, in fairness to equal tax administration, it is submitted that the reasoning behind the ruling fails to support the holding, and that in fact, for the reasons stated, the holding should be reconsidered as being in error.

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29. 211 F.2d 375 (5th Cir. 1954).
30. INT. REV. CODE OF 1954, §1401 *et seq.*, 26 U.S.C.A. §1401 *et seq.* (Rev. 1967).
31. 211 F.2d at 376.
32. INT. REV. CODE OF 1954, §901(b), 26 U.S.C.A. §901(b) (Rev. 1967).
33. Owens, *supra* note 16.
34. BNA, *supra* note 11, at A-17; Owens, *supra* note 16, at 28.
35. INT. REV. CODE OF 1954, §901, 26 U.S.C.A. §901 (Rev. 1967).

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