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Tax Planning for Latin American Investors in U.S. Income-Producing Realty

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INTRODUCTION

The typical Latin American has traditionally been oriented towards real estate investments, both in his country and abroad. He has particularly been attracted to such investments when utilizing his "security" or "nest egg" funds located outside his native country. He feels better when he can see tangible real estate property on his periodic visits.

This traditional interest has been fortified as a result of sad experiences which many *latinos* have had with the rise and fall of the offshore mutual funds. Therefore, it is to be anticipated that the available Latin American capital for investment abroad will be targeted more and more towards real estate investments. Indeed, a large proportion of South Florida's booming office, condominium, and apartment building activity is financed with Latin American funds.

The *latino* investor, generally a person of means and a non-resident of the United States, customarily seeks a secure investment in the relatively stable real estate market in the United States, with the thought of generating a positive cash flow and expecting an increase in market values to more than keep pace with inflation. Frequently, such an investor is satisfied if the cash flow is sufficient to pay the operating expenses of the property, amortize mortgage principal, and show a return of somewhat more than the interest he may earn on tax exempt savings accounts in the United States.[1]

Inasmuch as the income derived from such real estate investment is generated in the United States, the incidents and extent of U.S. income taxation will play a large part in the determination of the final cash flow available to the investor. This article is designed to explore the various

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methods for ownership of U.S. real estate available to the Latin American investor and the tax consequences created by each.

U.S. TAXATION OF NON-RESIDENT ALIENS AND FOREIGN CORPORATIONS

The U.S. Foreign Investors Tax Act, which became law on November 13, 1966,[2] lessened the U.S. tax burden of non-resident alien individuals and foreign corporations earning income in the United States. The obvious purpose of the Act was to create a favorable tax climate which would induce such individuals and corporations to increase their investments in the United States, thereby improving the balance of payments position.[3]

The provisions of the Act, basically, classify non-resident aliens (hereinafter this term will be used interchangeably in referring to both individuals and corporations) as: (a) not engaged in a U.S. trade or business; and (b) engaged in a U.S. trade or business.[4]

A non-resident alien not engaged in a U.S. trade or business is taxed only on the fixed and determinable annual or periodical income from a U.S. source.[5] The tax is imposed at the rate of 30% (or lower treaty rate) on the gross amount received[6] and, under certain conditions, it is collected at its source by withholding.[7]

A non-resident alien engaged in a U.S. trade or business, but having no office or place of business located therein, is subject to tax on U.S. source income only, but under two different methods. The first method imposes a tax of 30% (or lower treaty rate) on U.S. source income not effectively connected with a U.S. business,[8] while the second method imposes a tax on a net income basis at regular rates on U.S. source income effectively connected with a U.S. business, on a parity with U.S. taxpayers. The latter method has application for the alien's entire taxable year, although he may engage in a U.S. business at any time during such year.[9]

A non-resident alien engaged in a U.S. trade or business and having an office or other fixed place of business in the U.S. is also taxed under two separate methods, but his types of income must first be segregated into: (a) U.S. source income not effectively connected with the conduct of a U.S. business; (b) U.S. source income effectively connected with the conduct of a U.S. business and (c) foreign source income attributable to the U.S. place of business. The income under (a) is taxed at a rate of 30% of the gross amount,[10] while the income under (b) and (c) is taxed at graduated rates on the net amount.[11]

U.S. TAXATION OF INCOME FROM OWNERSHIP AND MANAGEMENT OF REAL ESTATE

The taxation of income from real property is hereby treated as a special subject, inasmuch as it will bear directly on the discussion of tax planning opportunities for non-resident aliens deriving income from the ownership and management of U.S. real estate. The foregoing principles of U.S. taxation are, however, basic, in that they formulate the means for taxing certain categories of income, including income from real estate.

The basic consideration in determining the basis of U.S. taxation on real estate income (which is herein considered as being rental income) is whether such income will be classified as income earned by the non-resident alien while (a) engaged in a U.S. trade or business directly, or through an agent, or (b) not engaged in a U.S. trade or business either directly or through an agent. In the case of the former, the U.S. tax will be imposed on the net amount of income at regular corporate or individual tax rates, while the latter situation will call for the imposition of a 30% withholding tax on the gross receipts.

Prior to the enactment of the Foreign Investors Tax Act, the various activities of the non-resident alien, or his agent, determined the existence of a U.S. trade of business. In *Lewenhaupt v. Commissioner*,[12] the court held that the taxpayer's activities with respect to certain parcels of improved real estate constituted engaging in a U.S. trade or business. The facts showed that the taxpayer employed a local agent to manage the properties, and empowered such agent to buy, sell, lease and mortgage real estate for and in the name of said taxpayer. During the taxable year, the agent's activities included, among others, the following: executing leases and renting the properties, keeping the books of account, collecting rents, supervising repairs to the properties, insuring the properties, paying taxes and mortgage interest, executing an option to purchase a new parcel of property and executing the sale of one of the properties, as well as notifying the taxpayer of prospective and advantageous sales or purchases of realty. Conversely, a strong argument could be made that the taxpayer is not engaged in a U.S. trade or business if the alien owner executes the leases, and attends to the payment of taxes, mortgage, interest and insurance,[13] while his agent is entrusted only with basic necessary duties, and does not work exclusively for the owner. In most cases, however, it is desirable for the alien to be considered engaged in a U.S. business, as his U.S. tax may be lower if computed on net rather than gross income. If, however, the alien is contemplating the sale of the property at an appreciated value, the fact that he is deemed engaged in a business may negate the tax-free sale otherwise available as a result of the non-taxability of capital gains to non-resident aliens.[14]

One of the steps taken by the Foreign Investors Tax Act was to remedy the uncertainties of the "U.S. trade or business" test by introducing a special tax election for non-resident aliens which allows them to treat income from realty as being effectively connected with a U.S. trade or business, regardless of their U.S. business status. The transaction involved, however, must be entered into for profit, and the income should not otherwise be taxable as "effectively connected" income. This election, once made, applies to all real property owned by the non-resident alien in the U.S., to gains from the sale or exchange of such property, and to rents or royalties from mines, wells, or other natural resources, and cannot be revoked without the prior consent of the Commissioner of Internal Revenue. If revocation is approved, a new election cannot be made for five years.[15]

Tax treaties with various countries provide for a similar election, but such election can be made on a year-by-year basis, thereby permitting revocation in the year of a desired sale of the property, in order to obtain a potential tax-free capital gain. Inasmuch as no Latin American country has a tax treaty with the U.S., such an election will be available only if the Latin investor acquires the U.S. property through a corporation formed in one of the treaty countries, which provides for this particular election.[16]

METHODS OF OWNERSHIP

After having reviewed the basic rules of U.S. taxation of non-resident aliens, and the particular impact of such rules on earnings derived from the ownership of U.S. income producing realty, these rules will now be applied to the various methods of ownership available to non-resident investors.

INDIVIDUAL AND PARTNERSHIP OWNERSHIP

Sole Proprietorship

The non-resident alien investor can purchase the property in his own name and appoint a U.S. real estate agent to manage such property. The power granted to such agent will consequently be a material factor in determining whether such owner is deemed as being engaged in a U.S. trade or business.[17] A presumption of being engaged in a U.S. trade or business may be created, for example, if such agent is given broad powers of negotiation and of signing of leases on behalf of his principal and performs such other acts normally performed by an owner. However, if the agent's powers are limited to the collection of rents and the payment of taxes, insurance and the mortgage, there is a likelihood that the owner will not be deemed as being engaged in a U.S. business through his agent.[18]

As previously discussed, the fact that the non-resident will be deemed engaged in a U.S. business will cause him to be taxed at graduated rates on the net income which may (but in very unlikely situations) exceed a tax liability computed at 30% of gross income. The net income, once taxed, will flow to the owner without the imposition of a U.S. tax withholding at the source. This dual method of taxation is in reality a two-edged sword, as low current taxation on net income may result in a future capital gains tax on the sale of the property. Should the owner qualify as not being engaged in a U.S. business, the gross rentals will be taxed at the flat 30% rate unless an election to be taxed as a U.S. taxpayer under IRC Sec. 871(d) is made. If the election is not made, future capital gains resulting from the sale of the property may escape U.S. taxation.

Foreign Partnership

The Latin investors may also choose to join other non-resident aliens in the purchase of the U.S. realty, and operate the property as a partnership or joint venture. Both forms of operation are considered as partnerships for U.S. tax purposes, even though organized abroad,[19] and the partners, not the partnership, are taxed.[20]

The foreign partners, whether corporate or individual, are taxed on their respective shares of partnership income which is derived from U.S. sources. The incidence of taxation is, however, different where: (a) the partnership income is effectively connected with a U.S. business, and (b) the partnership income is not effectively connected with a U.S. business. The partners are considered engaged or not engaged in a U.S. business if the partnership is or is not so engaged.[21]

With respect to the operation of U.S. real estate, the partnership's direct or indirect involvement in the management of the property will determine whether the "effectively connected" rules will apply. Basically, the guidelines for such determination follow the ones discussed in the *Lewenhaupt* case,[22] and the resulting tax treatment of the individual partners is similar to the one discussed above.

The election to have real property income taxes as "effectively connected" income also applies in the partnership situation, but the method of executing the election is not spelled out by the U.S. Internal Revenue Code and the regulations thereunder. It appears, however, that the election is not to be made at the partnership level, but at the partner's level. Once the partner elects the special tax treatment, the election will cover all of the U.S. realty owned by such partner.

The sale of the property by the partnership, if of a long-term capital gain nature, will be considered as a sale made by each individual partner. Absent the election by a partner to be taxed on income as if it were "effectively connected," the gain would escape U.S. taxation if the partner is: (a) a foreign corporation, or, (b) a non-resident alien individual, provided he has not been present in the U.S. for 183 days or more during the year of sale.[23] With respect to the latter, it may well be possible that the partnership's presence in the U.S. may be imputed to the non-resident partner. Such a possibility, however, appears presently remote.

With respect to the distribution of partnership profits to each partner, it is not clear whether a payment to a partner who is an individual will be subject to U.S. tax withholding at the source.[24] With respect to a partner which is a foreign corporation, the withholding rules are not clear, nor are the withholding rules concerning the sale or retirement of a partnership interest.

It is also important to examine carefully the partnership attributes of this foreign entity, as the U.S. tax laws govern in determining whether an entity subject to U.S. tax is, in effect, a partnership. Oftentimes, foreign partnerships are deemed to be corporations, when their attributes are similar, to a great extent, to the attributes of a U.S. corporation.[25]

Domestic Partnership

When the Latin investor acquires U.S. realty in partnership with U.S. taxpayers, such partnership will be deemed a U.S. partnership, and distribution from such partnership to its non-resident alien partners will be subject to U.S. tax withholding at the source.[26] If the recipients elect to treat the real estate income to be taxed as "effectively connected," and file the required documents with the U.S. tax authorities, the 30% withholding will not apply, but the recipients will be taxable at regular U.S. rates.[27] Basically, the non-resident partners overall U.S. taxation follows the pattern discussed above under *Foreign Partnerships.*

Estate and Gift Tax Considerations

An additional factor to be considered when individual or partnership ownership of real property is contemplated by a non-resident alien is the U.S. Estate Tax, as the U.S. Internal Revenue Code requires the inclusion in the gross estate of every decedent non-resident alien all real estate owned within the U.S.[28] Further consideration should be given to possible State inheritance taxes and related probate and administrative costs. The U.S. Gift Tax is also imposed on non-resident aliens upon transfers in gift of U.S. real estate.[29]

OWNERSHIP THROUGH CORPORATE ENTITY

Ownership Through Corporations

If the property is acquired by a U.S. corporation, the entity will be subject to tax at regular U.S. corporate rates, and dividends and interest paid to its non-resident alien shareholder(s) will be subject to U.S. withholdings at the source.[30] The withholding will be at a 30% rate, as no Latin American country has a tax treaty with the U.S. which provides for a lower rate.

The payment of taxable dividends, of course, is predicated on the existence of tax earnings and profits, which may differ from the amount of cash available for distribution. In past years, it was entirely possible that accelerated depreciation deductions (non cash charges) could exceed the mortgage principal amortization, when added to interest and operating expenses, thereby creating a loss for income tax purposes. In such a situation, distributions of excess cash balances would not constitute a dividend.[31] The Tax Reform Act of 1969, however, eliminated the use of accelerated depreciation in the computation of a company's earnings and profits for dividend determination purposes, thus eliminating, or rigidly curtailing the availability of non-taxable dividends.[32]

In order to minimize the aforementioned tax earnings and profits, the shareholder could capitalize the company with a minimum of paid-in capital and advance the remaining amount of the required down payment for the real estate acquisition as interest bearing debt. The resulting interest payments could then be utilized to offset the U.S. corporate income, and minimize or erase any earnings and profits. As a consequence, a large portion of the above mentioned positive cash flow could be remitted abroad as a repayment of debt rather than as a taxable dividend, while the remaining portion could also be remitted almost entirely free of U.S. tax due to the minimal or non-existent earnings and profits.

An inherent danger in the foregoing arrangement is that U.S. corporations are subject to a "thin capitalization" rule, whereby the absence of an adequate debt to equity ratio may cause the debt to be treated as capital, and repayment thereof could be deemed as a taxable dividend to the extent of existing earnings and profits.[33] Should the capitalization not be challenged, the payment of interest on the stockholder's debt would be subject to withholding at a full 30% rate.

The earnings and profits of the corporation, of course, do not have to be currently distributed, but they may be accumulated by the corporation itself. A caveat in this instance is warranted, as an unexpected U.S. penalty tax may be imposed by virtue of the accumulated earnings tax provision of the Internal Revenue Code.[34] The tax is triggered when the accumulated earnings are in excess of the necessary needs of the business and are accumulated for tax avoidance purposes. The test ordinarily involves a question of fact but, from a practical viewpoint, an accumulation in excess of twice the needed operating capital for the rental operation may be subject to scrutiny by the U.S. taxing authorities.

At the time a sale of the property is desired, such sale can be accomplished by one of the following ways:

(1) *Sale of the property by the corporation with a distribution of the proceeds to the shareholders in exchange for their stock.*

A sale of the property by the corporation would normally give rise to a taxable capital gain, while the distribution of the proceeds to the shareholders would be deemed a dividend to the extent of earnings and profits. In order to avoid the double tax which the foregoing could generate, the corporation could be liquidated under IRC Section 337, which would exempt the sale of assets by the corporation from U.S. tax, with the exception of the portion of Section 1250 depreciaton recapture computed as of the date of sale. The exchange by the stockholders of the cash realized for their total amount of stock, which will follow the tax-free sale of the assets by the corporation will constitute, in effect, a complete liquidation. This transaction is the equivalent of a payment in exchange for stock, normally subject to the U.S. capital gains tax rules.[35] An exception, however, appears to exist where the recipients are non-resident alien shareholders. As the payment in exchange for stock is not defined as fixed or determinable annual or periodical income, it is not subject to U.S. tax, provided the recipients are not engaged in a U.S. business and are not present in the U.S. for 183 days or more in the year of the exchange.[36]

Care must be exercised in that the sale of the real estate coupled with the liquidation of the corporation may fall within the "collapsible corporation" provisions of IRC Section 341, which would render the resulting gain taxable at ordinary rates.[37] If, however, the stockholders are not engaged in the business of selling real estate in the U.S. in the normal course of their trade or business, a special escape provision may render Section 341 inapplicable.[38]

(2) *Sale of Corporate Stock.*

A sale of the stock of the corporation would give the same results as above, additionally eliminating the tax which may be imposed on the amount of depreciation recapture. The "collapsible corporation" problem would also be present, but it may be eliminated by special escape provisions as well.[39]

U.S. securities are a type of asset includable in a non-resident alien's U.S. taxable estate.[40] Gifts of U.S. securities, however, will not be subject to U.S. tax.[41]

In summary, the ownership of income-producing real estate by Latin American investors through a U.S. corporation would be subject to the following incidents of taxation:

(a) U.S. tax at normal corporate rates on the net income of the corporation.

(b) U.S. withholding tax at 30% on interest and dividends paid by the corporation to its shareholders.

(c) U.S. tax may be minimal on the sale of property if a Section 337 liquidation is elected.

(d) U.S. tax may be avoided completely by selling stock of corporation.

(e) U.S. estate taxes will be imposed as a result of owning stock in a U.S. corporation.

(f) State inheritance taxes may be imposed.

(g) Gifts of the stock in a U.S. corporation will not be subject to U.S. tax.

Ownership Through A Foreign Corporation

If the realty is acquired through a foreign corporation, this entity will be subject to U.S. tax at 30% on its gross receipts if not engaged in a U.S. trade or business, and at regular U.S. corporate rates on its net income if it is engaged in a U.S. trade or business, or elects to be so treated. The dividends paid directly or indirectly to its non-resident alien shareholders may be subject to a U.S. withholding tax of 30%[42] as may any interest paid to such non-resident alien stockholders.[43] Where withholding is required, the foregoing will apply in the absence of a tax treaty providing for a lesser withholding rate.

The creation of a positive cash flow with a concurrent tax loss could, as in the instance of the U.S. corporation, be accomplished by the use of a proper capital structure and appropriate depreciation deduction methods. The former would entail a maximum permissible debt to capital ratio, such debt being subject to interest rates applicable in the country of incorporation or of residence of the shareholders which, in most instances, are higher than the U.S. rates. The additional interest deduction will, of course, substantially lower or nullify the tax earnings and profits so that excess cash may be remitted without being a taxable dividend. The interest paid to the shareholders, however, would be subject to the 30% U.S. withholding at the source.

The accumulation of earnings by the foreign corporation may also cause the imposition of the accumulated earnings tax, therefore care should be exercised in planning income and dividend distributions.[44]

A desired sale of the property may be accomplished free of U.S. tax by electing a Section 337 liquidation, or by selling the stock of the foreign corporation itself. The liquidation under Section 337 may trigger a tax on the recapture of depreciation, but whether the recapture rules apply to a foreign corporation under these circumstances has not yet been clearly established. The "collapsible corporation" provisions will also apply to the foreign corporation, but the fact that the shareholders will, more than likely, not be engaged in the business of selling real estate, should provide the desired exemption.[45]

With respect to U.S. Estate and Gift taxation, no such taxes will be imposed on the non-resident stockholder upon his death by virtue of his stock ownership,[46] or by the making of gifts of such stock.[47]

In summary, the ownership of U.S. income producing real estate by a Latin American investor through a foreign corporation would be subject to the following incidents of U.S. taxation:

(a) U.S. tax at 30% on gross receipts of the corporation unless election to be taxed on net profit is made.

(b) U.S. tax at normal corporate rates on the net income of the corporation if proper election is made.

(c) U.S. withholding tax at 30% on interest and dividends paid by the corporation to its non-resident shareholders.

(d) U.S. tax may be nominal on the sale of the property by electing a Section 337 liquidation.

(e) U.S. tax may be avoided completely by selling the stock of the corporation.

(f) U.S. Estate and Gift taxes will not be imposed as a result of owning or making gifts of stocks in foreign corporations.

The Netherlands Antilles Corporation

In outlining the tax consequence of the ownership of U.S. income producing real estate by a non-resident alien through a foreign corporation, we applied our discussion, in the main, to corporations incorporated in Latin American countries where no tax treaty with the U.S. is in existence. This situation, as we have seen, does not provide for either an exemption from U.S. taxation, or a reduced rate of withholding on dividends and interest paid to the non-resident alien shareholder. There is one country off the shores of Latin America, however, which does have a very favorable treaty with the U.S. This country is comprised of that group of islands called the Netherlands Antilles.

Article 12 of the Netherlands Antilles Profit Tax Ordinance applies in particular to real estate corporations, as do certain sections of the Protocol extended to the Netherlands Antilles by the U.S.-Netherlands Tax Treaty.[48]

Formation of a Netherlands Antilles corporation (Naamlose Vennootschap, "N.V.") by non-resident aliens to own and operate U.S. real estate affords certain distinct advantages not found in the methods previously examined. Basically, ownership through an N.V., if properly structured, could give rise to the following overall tax consequences:

(a) U.S. rental income from real property can be taxed on a net basis if so elected. Election, as provided by the treaty, is made on a year-by-year basis.[49]

(b) Dividends received by non-resident alien shareholders from an N.V. are not subject to U.S. withholding, even if 50% or more of the N.V.'s income is derived from U.S. sources.[50]

(c) Interest payments made to the non-resident shareholders by the N.V. are not subject to U.S. withholding.[51]

(d) Capital gains which may arise from the sale of real estate may not be subject to either U.S. or Netherlands Antilles tax.[52]

(e) The types of income listed in (a), if election is made, (b) and (c) above are not subject to Netherlands Antilles tax.

(f) No estate tax exists in the Netherlands Antilles.

In summary, it can be observed that the proper use of an N.V. as a vehicle by a non-resident alien investor to own and operate U.S. income producing real estate could result in only one tax; i.e., a U.S. tax on the net income of the corporation. Such tax, however, could be sheltered by proper tax planning.

CONCLUSION

In the space allotted, the writers have attempted to analyze the tax intricacies faced by non-resident aliens investing in income-producing U.S. real estate. The Foreign Investor Tax Act has, at the same time, simplified the rules and made their application a partial guessing game.

Inasmuch as every dollar invested by non-residents contributes toward the improvement of the critical U.S. balance of payments, such investments should continue to be encouraged by favorable tax legislation and should be protected by proper planning.

NOTES

[1]Interest on bank deposits paid or credited before January 1, 1975, to foreign persons is exempt from U.S. tax, provided such interest is not effectively connected with the conduct of a trade or business in the U.S. See IRC Sec. 861(a) (1) (A), 861(c) and Reg. Sec. 1.864-4(c) (ii).

[2]80 Stat. 1539 (1966), in United States Code Congressional and Administrative News 5778 (1966).

[3]See: Legislative History of H.R. 13103, 89th Congress, 2d Sess., Foreign Investors Tax Act of 1966 (U.S. G.P.O. 1967).

[4]Neither the Internal Revenue Code (IRC) nor the Regulations promulgated

thereunder positively define the term "trade or business." Factual circumstances have been the material *indicia* used by the courts in interpreting its meaning. See also Saunders, *"Trade or Business, Its Meaning Under the Internal Revenue Code."* 1960 So. Calif. Tax Institute 693.

[5]IRC Sec. 871(a) and Sec. 881(a). This type of income usually will include interest and dividends paid by a U.S. obligor or a foreign corporation, certain capital gains and other such items, unless exempt by tax treaty.

[6]IRC Sec. 871(a) and Sec. 881(a).

[7]IRC Sec. 1441 and Sec. 1442. For a treatise on withholding of U.S. tax at the source, see Kust, Reale, 80-2nd T.M., *Foreign Operations—Source of Income.*

[8]IRC Sec. 871(a) and Sec. 881(a).

[9]IRC Sec. 871(b) and Sec. 882(a).

[10]See (6) *supra.*

[11]See (9) *supra.* The "effectively connected" meaning is outlined in IRC Sec. 864(c). Basically, income may be deemed "effectively connected" with a U.S. business if the assets from which such income is derived are used or held for use in the conduct of a U.S. trade or, business, or if the activities of the U.S. trade or business play a material role in the realization of such income. See also: Senate Report, in *Cong. & Adm. News* 6191-2, 6208.

[12]20 T.C. 151 (1963), aff'd. per curiam, 221 F.2d 227 (9th Cir. 1955).

[13]*Elizabeth Herbert v. Commissioner,* 30 T.C. 26 (1958), ACQ 1958-2 C.B. 6.

[14]IRC Sec. 1201(a) and 1201(b) will apply where the non-resident is engaged in a U.S. trade or business and the gain is "effectively connected" with such trade or business. See IRC Sec. 871(b) (1) and Sec. 882(a) (1).

[15]IRC Sec. 871(d)and Sec. 882(d).

[16]Australia, Art. XI; Austria, Art. IX; Belgium, Art. IX(1); Canada, Arts. XI, XIII A; Denmark, Art. IX; Finland, Art. IX; France, Art. 5; Germany, Art. IX; Greece, Art. VIII; Ireland, Art. IX; Italy, Art. IX; Japan, Art. VIII; Luxembourg, Art. VI; Netherlands, Art. VII; Norway, Art. VIII; Switzerland, Art. IX; Republic of South Africa, Protocol III; United Kingdom, Art. IX.

[17]See (12) and (13) *supra.*

[18]See (13) *supra.* However, there are other facts to be considered in determining whether a business exists. For example, the fact that the property was purchased was held as being an indication of a business purpose. *Inez de Amadio,* 34 T.C. 894 (1960), aff'd. 299 F.2d 623 (3rd Cir. 1962).

[19]IRC Sec. 7701(a) (5), Reg. Sec. 301.7701-3.

[20]IRC Sec. 701.

[21]IRC Sec. 875(1), Reg. Sec. 1.875-1.

[22]Same as Note 12.

[23]IRC Sec. 871(a) (2).

[24]The payment is generally treated as a return of capital by the Code. (IRC Secs. 731-736). Therefore it appears not subject to withholding. See G.C.M. 2467, VII-2, Cum. Bull. 188,192 (1928).

[25]IRC Sec. 7701(a) (2), Reg. Sec. 301-7701-2.

[26]IRC Sec. 1441(b).

[27]IRC Sec. 1441(c) (1).

[28]IRC Sec. 2103.

[29]IRC Sec. 2511.

[30]Reg. Sec. 1.1441-3(a) and (b) (2) (ii).

[31]IRC Sec. 316.

[32]IRC Sec. 312(m) (1).

[33]See H. F. Shannon, 29 T.C. 702 (1958).

[34]IRC Sec. 531.

[35]IRC Sec. 331.

[36]Reg. Sec. 1.1441-3(b).

[37]IRC Sec. 341(a) (2).

[38]IRC Sec. 341(e).

[39]IRC Sec. 341(e). Additionally, if the property will have been held in excess of 3 years, collapsibility will be avoided. IRC Sec. 341(d) (3).

[40]IRC Sec. 2104(a).

[41]IRC Sec. 2501(a) (2).

[42]The 30% withholding will apply if 50% or more of the corporation's gross income for the preceding three-year period was "effectively connected" income. IRC

Sec. 861(a) (B); Reg. Sec. 1.1441-3(a).

[43]See (42) *supra* as to legend only. IRC Sec. 861(a) (1) (c); Reg. Sec. 1.1441-3(a). In connection with the foregoing, in most cases an election to be taxed on net income will have been made, so that the obligation for withholding will exist.

[44]IRC Sec. 531.

[45]IRC Sec. 341(e).

[46]IRC Sec. 2104(b).

[47]IRC Sec. 2501(a) (2).

[48]Income Tax Convention between U.S. and the Netherlands, as extended to the Netherlands Antilles and modified by Protocol of October 23, 1963. (The Supplementary Convention of December 20, 1965 between the U.S. and the Netherlands is not applicable to the Netherlands Antilles.)

[49]Netherlands, Art. X (as modified) as extended to Netherlands, Antilles.

[50]Netherlands, Art. XII as extended to the Netherlands Antilles.

[51]Same as (50) *supra*.

[52]Netherlands, Art. V, as extended to the Netherlands Antilles.