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June 26, 2006

Mr. Eric Solomon
Acting Deputy Assistant Secretary (Tax Policy)
Department of the Treasury
Room 3112 MT
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Mark W. Everson
Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Qualified Foreign Corporations and Treaties

Dear Acting Deputy Assistant Secretary Solomon and Commissioner Everson:

I am pleased to enclose New York State Bar Association Tax Section Report No. 1113, addressing limitation on benefits provisions in treaties and Section 1(h)(11).

Under Section 1(h)(11), a foreign corporation (other than a passive foreign investment company) is a "qualified foreign corporation" if it is eligible for benefits of a comprehensive income tax treaty with the United States. Congress's decision to base qualified foreign corporation status on treaty eligibility presumably stemmed from a perception that dividends from a foreign corporation should be eligible for Section 1(h)(11) only if the foreign corporation's income is subject to tax in the corporation's resident jurisdiction. Similarly, limitation on benefits provisions in treaties are intended to provide treaty benefits to treaty country taxpayers. We believe that our recommendations are consistent with this common purpose of Section 1(h)(11) and limitation on benefits provisions. The Report discusses two topics that arise from the intersection of Section 1(h)(11) and limitation on benefits provisions.

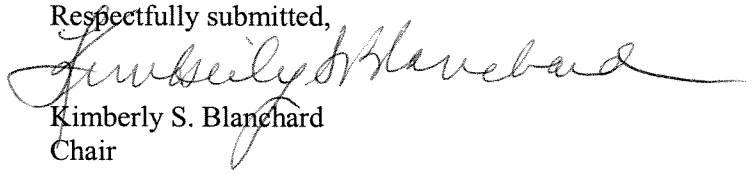
First, the Report considers how the "base erosion" test found in many treaties should be applied when a foreign corporation owns subsidiaries. This issue is not unique to Section 1(h)(11). It arises in applying treaties generally and our recommendation in this area applies both for purposes of Section 1(h)(11) and for treaty analysis generally.

Because the purpose of a base erosion test is to determine whether the U.S. source income of a foreign corporation is subject to tax in the treaty jurisdiction, we recommend that the Department of the Treasury confirm that U.S. tax classification of a subsidiary of a foreign corporation is not relevant to the question whether payments made by, and gross income of, the subsidiary should be taken into account for purposes of applying the base erosion test to the foreign parent corporation. We further recommend that if a subsidiary's losses are permitted to be used currently against the parent's income for local tax purposes, then the subsidiary's gross income and deductible payments generally should be taken into account in measuring the parent's qualification under the base erosion test. Where a parent and subsidiary report on a combined basis in the treaty jurisdiction, the truest measure of base erosion is a combined measure. We believe that Treasury has authority to adopt such guidance under existing treaties.

Second, the Report considers how the "active trade or business" test found in many treaties should apply in the context of Section 1(h)(11). The active trade or business test provides treaty benefits for specific items of income, while other limitation on benefits provisions typically provide treaty benefits for all items of income. We recommend that the active trade or business test be interpreted to permit a foreign corporation to qualify as a qualified foreign corporation if the foreign corporation and its subsidiaries have substantial business activities in the treaty jurisdiction and substantially all the U.S. source income (if any) of the foreign corporation and its subsidiaries qualifies for treaty benefits under the active trade or business test. We make this recommendation for purposes of Section 1(h)(11) only.

We appreciate your consideration of our recommendations and comments. We would be pleased to discuss these matters with you further or provide any other assistance that you would find helpful.

Respectfully submitted,



Kimberly S. Blanchard
Chair

Enclosure

Cc: Harry (Hal) J. Hicks, III, International Tax Counsel,
Treasury Department
Stephen A. Musher, Associate Chief Counsel International,
Internal Revenue Service