

Withholding Tax on Payments to Foreign Persons

HARVEY P. DALE *

“No man can serve two masters” †

The United States taxes the income of foreign persons in two different ways. If the foreign person is doing business in this country, the United States taxes his business-related income, net of deductions, at progressive rates.¹ Income of foreign persons not connected with a U.S. business is taxed, without any deductions, at flat rates, but only if it is from sources within the United States and is of a special character.²

Long-standing international legal principles make it very difficult for any country to collect taxes from foreign persons outside of its borders.³ Thus, to protect its revenue, the United States requires the withholding of income taxes from certain payments made to foreign persons.⁴ Almost all of the items subject to flat-rate, gross-amount income tax are also subject to this regime of withholding. Only a small class of business-related income is subject to this sort of withholding.⁵ This article will first briefly explore the patterns of such withholding, and will then focus on the problems of withholding agents.

Introduction

There is a significant distinction between having jurisdiction to impose a tax and having the ability to collect it. There is no practical limitation on the ability of the United States to impose taxes on foreign

* HARVEY P. DALE is Professor of Law, New York University School of Law. Authorities cited herein are believed to be current through January 15, 1981. The author is grateful to his colleague, Professor LAWRENCE LOKKEN, for his thoughtful comments on an earlier draft of this article.

† *Matthew* 6:24 (King James).

¹ I.R.C. §§ 871(b), 882(a).

² I.R.C. §§ 871(a)(1), 881(a).

³ See the text accompanying Ns. 8–10 *infra*.

⁴ I.R.C. §§ 1441–1464. These sections constitute chapter 3 of subtitle A of the Internal Revenue Code.

⁵ Compensation for personal services is subject to chapter 3 withholding under certain circumstances. I.R.C. § 1441(c)(1). See the text accompanying Ns. 77–88 *infra*.